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Mr. Ted Fellman
Executive Director
Tennessee Housing Development Authority
404 James Robertson Parkway, Suite 1200
Nashville, TN 37243-0900

Dear Mr. Fellman,

I am writing on behalf the NH&RA's Tennessee Developers Council (TDC) to provide comments to the Tennessee Housing Development Authority (THDA) as the agency considers revisions for its 2012 Qualified Allocation Plan (QAP). We appreciate the opportunity to provide helpful feedback on the allocation process and welcome the opportunity to have a continuing dialogue between THDA and the affordable housing development community.

Allocation Calendar

Affordable housing developers incur a number of costs during the application process including carrying land, holding options on properties and overhead. These costs generally cannot be reimbursed but are incurred in the hope that the developer will secure an allocation. THDA can help mitigate some of these costs and the risks involved through simple administrative changes to the allocation process and calendar.

Recommendation: Publish on the THDA website preliminary competitive scores prior to the cure hearing. This will give owners a sense of where they stand in the competitive mix and whether or not it is worthwhile to pursue application appeals or continue to control a property. As a secondary benefit, it will also likely result in fewer appeals, providing less of a burden on THDA staff time.

Recommendation: Publish in the QAP an allocation calendar that includes hard benchmarks dates including preliminary announcements and final announcements. Having dates certain during the allocation process provides developers with more certainty in negotiating contracts with sellers and permits for greater advance planning for businesses.

Expiring HERA Provisions

An important provision in the Housing and Economic Reform Act of 2008 that sets the LIHTC at a fixed 9% level (vs. the floating rate published monthly) is set to expire in the very near future. Projects that are not placed in service by December, 2013 will not be able to take advantage of the increased amount of tax credits. The financial environment remains challenging as development costs continue to rise, while tax credit equity pricing remains low and sources of gap financing are limited. While we hope Congress will remedy this situation prior to the expiration, TDC feels it would be prudent for THDA to take steps to insure that as many properties as possible are able to take advantage of the fixed 9% credit while it remains available.

Recommendation: The simplest way for THDA to secure favorable equity for these properties would be to accelerate the allocation process in 2012 and 2013. We recommend that THDA consider forward allocating LIHTCs beginning as soon as possible. Forward allocating of LIHTCs is a common practice utilized by some states (e.g. Louisiana) and also provides the additional advantage of providing more certainty to the development community on their pipeline and allows for more advanced business planning. To address the immediate concerns of the expiring HERA provision, THDA should also consider if it is feasible to amend the 2011 QAP to allow for forward allocating (all or) a portion of the 2012 allocation to 2011 applicants. Whether or not THDA chooses to forward allocate credits, TDC still recommends accelerating the application calendar to the earliest feasible date(s) to allow developers the greatest amount of time to place their 2012 and 2013 projects in service prior to the expiration of the HERA benefits.

Special Housing Needs Set-Aside

THDA made an effort to broaden its definition of what constitutes “Elderly” rental housing in recognition that other state and federal programs (e.g. HUD and USDA) view elderly targeted housing from a broader perspective. Currently, these other state and federal program definitions that are given safe harbor under the QAP refer explicitly to this being in the form of “financing.” It would be more accurate and avoid any unintended narrowness of interpretation to broaden this language to include “state or federal financing and/or operating subsidy.”

Land Appraisals and Basis Issues

THDA requires developers to obtain a land appraisal as part of the application process. At present THDA does not include the cost of the appraisal in eligible basis. We understand the appraisal is required of developers to protect against unreasonable inurnment in related party transactions. For the purposes of underwriting, additional appraisals will be required by the lender and syndicator. In a financial environment where resources are limited and gap financing is increasingly difficult to secure, even relatively small costs to the project can be difficult to finance. If an appraisal is a necessary project expense akin to other consulting costs that are included in eligible basis (e.g. architectural fees, market study), then the costs of a land appraisal should likewise be included in eligible basis.

Recommendation: TDC maintains that the requirement for land appraisals in many cases is unnecessary and recommends dropping this requirement except in the case of related-party transactions. When a land appraisal is required, TDC recommends that the cost be included in eligible basis.

Rehab Requirements

THDA currently requires the following minimum requirements for LIHTC applicants seeking to rehabilitate existing properties:

1. If the development does not involve tax-exempt financing (i.e. 9% LIHTCs), rehabilitation hard costs must be at least forty percent (40%) of total development costs.
2. If the development involves tax-exempt financing (i.e. 4% LIHTCs), rehabilitation hard costs must be the greater of (A) thirty percent (30%) of building acquisition costs or (B) an amount sufficient to satisfy the requirements of Section 42(e)(3)(A)(ii).

THDA implemented these requirements to ensure that applicants undertake a sufficient scope of work so that major building systems will endure through the entire credit period. While TDC concurs with THDA's goals, we suggest that calculations based on development and acquisition costs fall short. By virtue of using percentages, properties with higher land costs will require a higher degree of rehabilitation regardless of need. Moreover, a requirement that is based on total development costs is based on a figure that is not known for certain until the final cost certification for the project is prepared. **Recommendation:** TDC recommends that THDA adopt a flat minimum per unit standard (perhaps $25,000 per unit) for applicants seeking 9% LIHTCs. TDC also recommends THDA amend its QAP for applicants seeking 4% LIHTCs with tax-exempt financing. TDC recommends that the minimum federal rehabilitation standard set forth by the IRS in Section 42(e)(3)(A)(ii) sufficiently ensures that an adequate rehabilitation scope of work will be undertaken where tax-exempt bonds and 4% LIHTCs are involved.[1]

QCTs

The 2011 QAP contains two provisions pertaining to Qualified Census Tracts (QCTs). The first provision sets a limitation on the amount of allocation that can be located in a QCT. The second provision appears in the competitive scoring section. Projects located in QCTs are only eligible for one point in the scoring section, whereas projects located outside of QCTs are eligible for up to five points. This places projects in QCTs at a significant and perhaps insurmountable scoring disadvantage.

TDC recognizes that THDA seeks a policy environment that ensures a fair yet diverse distribution of its allocation across the state while protecting against measures that would increase the poverty concentrations in already low-income areas. Recognizing that it is also the agency goal to establish a fair playing field where the most worthy projects in the communities with the greatest need receive allocation, we feel that the scoring provision is counterproductive.

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[1] Section 42(e)(3)(A)(ii): the amount of such expenditures during any 24-month period meets the requirements of whichever of the following subclauses requires the greater amount of such expenditures:

(I) The requirement of this subclause is met if such amount is not less than 20 percent of the adjusted basis of the building (determined as of the 1st day of such period and without regard to paragraphs (2) and (3) of section 1016(a)).

(II) The requirement of this subclause is met if the qualified basis attributable to such amount, when divided by the number of low-income units in the building, is $6,000 or more.

Recommendation: TDC recommends eliminating the scoring handicap pertaining to location in a QCT. A cap on the amount of allocation located in a QCT can adequately ensure that a significant proportion of the state's allocation will be located outside of QCTs. TDC suggests that in the absence of the scoring preference vis-à-vis location in a QCT, there is unlikely to be an over-concentration of applicants in these locations.

Market Studies & Occupancy Rates

TDC commends THDA for taking additional steps to ensure it allocates LIHTCs to applicants demonstrating strong market need. We believe the agency took an important step last year to accelerate the timing of the market study to the beginning of the application process. We concur that the previous system that utilized country ranking as the primary driver of markets had significant flaws. TDC also believes that THDA has an opportunity to make further improvements in this area.

Currently, THDA has a competitive scoring category based on occupancy rates in the proposed market area as determined in the Market Study. In its implementation, this category demonstrated a number of practical challenges. It relies overwhelmingly on a single point in time survey of other competitive properties, which may not tell an accurate story of the overall market. For example, if a market analysts surveys an individual property on the first of the month (when leases typically turnover, but before a unit is reoccupied) it may indicate a higher vacancy than is typical of the market. Moreover, occupancy of LIHTC comps alone is not necessarily determinative of the overall strength of a market. For example, in some markets there are no LIHTC comps at all or the only LIHTC properties are not appropriate comps (a family project when the proposed project as a senior project). Projects in market areas that do not have an appropriate comp should not be penalized for their lack of competition. The age and condition of the selected comps may be a determinative factor in their occupancy and how competitive a new project may be. Furthermore, mitigating factors to rent like project-based rental assistance may not be given full weight using this methodology. Even the definition of a market area is subjective and thus which comps should be considered is variable. Furthermore, THDA places a great competitive priority on this calculation, which we speculate will be the determining factor on whether or not many applicants will receive an allocation.

Recommendation: TDC suggests eliminating the occupancy calculation category entirely from the competitive scoring section of the QAP. As an alternative, we suggest that the determination of the market analyst as to the suitability of the proposed project in the market be considered as a threshold criteria. This will ensure that only proposals with sufficient demand be considered for allocation and place more weight in the competitive round on other factors like project amenities and features, developer experience, and readiness to proceed. It should be noted that the vast majority of state Housing Finance Agencies utilize the components of a market study pertaining to demand and feasibility as a threshold criteria. Failing this, TDC recommends amending the QAP to place less total emphasis on occupancy as a scoring criteria and implementing a percentage occupancy range for competitive scoring (e.g. 94% to 96% = 1 point 97% to 100% = 2 points).

Contracting Market Studies

THDA presently requires developers to contract directly with THDA-approved market analysts. The market study is an important consultative tool for developers, which is used both for allocation decisions but also to help in determining sites and property characteristics. Taking this tool away from developers early in the process would likely result in higher predevelopment costs and additional applications for credits that would have been deemed unfeasible earlier in the pre-development process.

Recommendation: TDC recommends that the developer continue to contract directly with the market analyst.

Regional Diversity

Recognizing that THDA seeks regional diversity in its allocation of LIHTCs, we concur with THDA that the previous county ranking system was inefficient and unwieldy.

Recommendation: Should THDA wish to take additional steps to ensure regional diversity, TDC recommends implementing a 50% set-aside evenly divided across Tennessee's three grand divisions (i.e. a 16.67% set-aside for East, Middle, and West Tennessee) with the remaining allocation to be considered 'at large'.

Experience Requirements

The present QAP has very minimal experience requirements for developers seeking allocation. The only substantive requirement in the QAP pertaining to experience related to ineligibility if the developer "has an uncured event of noncompliance under (i) Section 42; (ii) the restrictive covenants recorded in connection with such development or (iii) an IRS form 8823." Ineligibility due to such noncompliance shall be in effect "for the calendar year in which the noncompliance was identified and for the following calendar year." The QAP further provides that "THDA will determine, in its sole discretion, whether an event of noncompliance exists which has not been cured."

TDC suggests that this criterion does not tell the full story of an applicant or their likeliness to succeed. In fact, such criteria will only serve to disqualify developers with prior experience in Tennessee. Furthermore, we contend that not all 8823 violations should be treated equally. While gross non-compliance should be penalized in the allocation process, minor issues in the process of being cured should be given leeway. For instance, an 8823 may be triggered as a result of vacant units resulting from a fire or natural disaster. Likewise, if a resident becomes a full time student while occupying a tax credit unit, that unit becomes non-compliant for the period. Furthermore, local laws may make it difficult or impossible to evict the resident, potentially resulting in long-term non-compliance of the unit. In both cases the owners may be unfairly penalized for minor circumstances beyond their control.

Recommendation: TDC suggests the QAP be amended to allow owners to be eligible to apply with an outstanding 8823 if sufficient steps are being taken to cure the issue as approved by THDA staff. Developers should also be given the opportunity to appeal THDA staff decisions to the THDA Policy and Programs Committee prior to the application deadline. Additionally, we suggest THDA adopt policies that reward success and positive experience. By ensuring that only competent and experienced development teams will receive allocations, THDA increases the likelihood of successful developments. TDC recommends a two tiered approach to experience:

1. Threshold: Require all applicants and ongoing ownership to demonstrate significant experience in the development, ownership and/or operation of multifamily real estate.
2. Competitive Scoring: Add a competitive scoring category based on the developer's experience in the development, ownership and/or operation of LIHTC or HUD-Assisted Affordable Housing.

Site Characteristics: Public Safety

Encouraging public safety is an important policy goal. Presently, THDA awards competitive points based on proximity to: Police or Sheriff Stations, Fire Stations and Emergency/Urgent Care Facilities. Proximity to these facilities may not be the most relevant metric in determining public safety. For example, in areas where crime is not an issue, proximity to a police station may not be a relevant contributor to public safety. Furthermore, no credit is given based on on-site security measures, and jurisdictional boundaries may render proximity to services moot – a project may be located close to a police station; however, if the station is located in another jurisdiction it might not actually serve that community.

Recommendation: TDC recommends consolidating several of these items into a single "Public Safety" category, where proximity to any of the following service providers will qualify the applicant for public safety point(s): police or sheriff station, fire station, EMS and/or emergency care facility. Additionally, TDC recommends that THDA consider significant security features (e.g. full time on-site security service) to meet this scoring criterion.

Site Characteristics: Scoring

The current QAP offers up to 10 points out of an available 12 based on site characteristics and amenities.

Recommendation: Our previous comments recommend consolidating several categories. We recommend a corresponding reduction in the maximum points available from 10 to 8 points to match this consolidation.

Site Characteristics: Prospective Amenities

The present QAP only gives credit for existing amenities. In many cases, LIHTC developments are part of a greater redevelopment plan for a particular neighborhood and jurisdiction.

Recommendation: The QAP should give credit for prospective local amenities that have a high likelihood of placement in service in the immediate future. We recommend that credit be given to prospective amenities that are permitted and/or already under construction. Lastly, the QAP should clarify that the cited amenities are those that exist (or are under construction) in the community as opposed to being part of the planned development itself.

Developer & Contracting Profit

The present QAP sets the maximum developer fee at 15% of eligible basis and the maximum Contractor profit at 14% of eligible costs. However, when the developer and contractor are related (many companies create operational efficiencies by vertically integrating design, development, management and/or building functions) the maximum combined fee that can be taken is 25% (4% less than if the functions of development and general contracting were separate).

This policy unfairly penalizes vertically integrated development firms by limiting their fees and profits. We presume this discrepancy in fees was adopted by THDA as a means to protect against inappropriate inurnment; however, we contend that other policies in place already assure this goal. THDA's has already adopted a rigorous cost-certification procedure for related firms that ensures that related developer-contractors are held accountable.

Recommendation: Remove the sections related to fee limitations for related developer-contractors from the QAP. Additional limits put unfair and unnecessary constraints against a company's profitability.

Tiebreakers

In the event of a tie, the current QAP uses a tiebreaker that gives priority to the application that uses "the least tax credits per square foot of heated, low-income, residential floor space." TDC believes that using the efficiency of credits as a tiebreaker is a laudable goal and makes certain sense from a public policy and scarce resources perspective; but it does have two notable flaws:

1. There are several methodologies used by the industry to calculate square-footage. The QAP does not identify which methodology applicants must use, resulting in inconsistent calculations. Furthermore, it is unclear whether or how THDA validates the accuracy of the square-footage listed in the application.
2. As with most tiebreakers we have observed in other states, this methodology favors certain classes of properties over others. Many affected by this bias would prefer an alternative that does not favor one type of property over another (e.g. equal treatment of new construction vs. rehab, family vs. senior, etc…)

Recommendation: TDC recommends that THDA explicitly adopt the Building Owners and Managers Association International (BOMA) Multi-Unit Residential Buildings: Standard Methods of Measurement[2] or similar standard for the purposes of measuring the square-footage of residential space. Additionally, we recommend THDA require an architect or similar professional certify the requested square-footage in the application.

TDC does not have a specific recommendation on how to address the fairness issue at this time. We have assessed many alternative tiebreaker methodologies used by other states and have found significant issues with all of them. We would be happy to discuss with THDA staff some of the pros and cons of various alternatives at your convenience.

[2] http://www.boma.org/MeasurementStandards/Pages/MURS.aspx

Conclusion

We deeply 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.

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

cc: Laura Sinclair
Ed Yandell