



National Housing
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Association

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September 9, 2013

Mike Blade
Tennessee Housing Development Agency
404 James Robertson Parkway, Suite 1200
Nashville TN 37243-0900

Dear Mr. Blade:

I am writing on behalf of the National Housing & Rehabilitation Association's (NH&RA's) Tennessee Developers Council (TDC) to respond to the Tennessee Housing Development Agency's (THDA) request for comments regarding the 4% noncompetitive Low-Income Housing Tax Credits (LIHTC) Bond Program Description (BPD).

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.

Recommendation: TDC recommends that THDA create a dedicated source of funds to be used as gap financing for affordable housing 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. 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 allows 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 recommended in this letter will significantly increase the volume of TEB transactions annually.

Enhancing the Developer Fee Calculation to Raise More Tax Credit Equity

In addition to creating an additional gap financing source, TDC recommends THDA consider modifying 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 equity 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).”

Recommendation: TDC suggests raising the maximum current developer fee calculation to 25% of total development costs (less reserves), applicable only 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. TDC believes this proposal will enhance the amount of LIHTC a project owner will be able to raise by approximately \$.10 per \$1.00, at no additional cost to THDA. This will enable 2-3 additional tax-exempt bond financed 4% LIHTC deals per year resulting in an additional 300-450 units of affordable housing for the State.

TDC recommends amending 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 cash 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 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).~~

Conforming changes in the QAP may be necessary to implement this proposed change.

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 may be limited. Under the current limitations of the BPD, in most markets a 60+ unit Year 15 LIHTC property with even modest per unit acquisition costs will easily exceed the bond caps to be eligible for either the moderate and limited tiers. We believe this is a significant impediment to maximizing the efficacy of the bond program and is currently prevent existing affordable properties in Tennessee from being preserved. TDC believes that an independent 3rd party physical 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.

Furthermore, we observe that THDA's potential concerns with respect ensuring that the scope of rehab is sufficient to last through the fifteen year compliance period will be further protected by the syndicator and lender. We observe that syndicators and investors are highly cognizant of the risks of doing too little rehab and will not invest in transactions that will need major capital investments before the end of the compliance period. Equity providers and many lenders conduct their own independent physical needs assessments and review all plans, documents and reports with their own in house construction managers and engineers before committing to making investments and loans. It is also not uncommon for investors to require increased scopes of works and/or increased reserve requirements to address any concerns they might have with the rehab scope of work.

Additionally, TDC also believes that New Construction TEB transactions should be offered the same amount of potential bond volume cap available to preservation and rehab transactions.

Preferred 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 (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.~~

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

Secondary Recommendation: If THDA is not able to adopt TDC's preferred recommendation above we suggest as an alternative THDA consider eliminating the "substantial rehabilitation" tier from the BPD and increasing the volume cap limitations from the limited and moderate rehab categories. From the perspective of our membership, this is a less desirable option but would still address some of the scalability challenges referred to above and would facilitate additional TEB transactions.

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. 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 (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~~ 17,250,000

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~~ 9,500,000

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.

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

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.

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

Cc: Ralph Perrey
Judith Smith
Ed Yandell
Donna Duarte
Phil Baggett
Phil Chamberlain
Kendra Cooke
David Lillard
Larry Martin
Mike Stevens
Greg Turner

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.