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Mr. Mike Blade
Tennessee Housing Development Agency
502 Deaderick Street – 3rd Floor
Nashville, TN 37243

Dear Mike:

Due to a scheduling conflict, I was unable to deliver these comments in person at THDA's April 19 Developer's Forum. We request that the following written comments be considered as our testimony on behalf of the Tennessee Developers Council and our members.

Set-asides: General

Our membership comprises 25 private and non-profit development firms active in the state of Tennessee as well as more than a dozen affiliated professionals including syndicators, investors, lenders, investment bankers, market analysts and other consultants. Collectively, the association provides a mix of housing types including New Construction, Preservation and Public Housing Revitalization and targets a variety of markets ranging from urban to suburban to rural.

Because of the diversity of membership, there is not a consensus opinion as to the appropriate size distribution of the set-asides in the QAP, although there is a general consensus that the QAP should encourage a mix of product types and market types including new construction as well as the preservation of existing aging affordable rental housing assets[1]. It should be noted there is strong

[1] "It is essential to maintain the quality and availability of existing affordable rental housing, along with building new units each year at varying levels of affordability, to keep up with the growing rental housing demand at all income levels in Tennessee. The existing affordable housing stock across the state is aging with more than 70 percent of both units and properties built more than 15 years ago. When looking at deeply subsidized project based properties, the majority were built more thirty years ago. About a third of Section 8 project based contracts will expire over the next five years. Similarly, about a third of USDA Section 515 loans will reach maturity dates in the next five years…Aging, deeply subsidized properties (S8PBRA, public housing and USDA) often must recapitalize over time to afford needed maintenance and rehabilitation while preserving affordable rent levels. At least some of these properties carry a large debt load and/or have significant repair needs. Without recapitalization that includes infusions of additional grants, rent subsidies, tax credits, or very low interest loans, the lower rents simply do not cover ongoing operation and maintenance/repair costs. If existing affordable housing units deteriorate to the point that they are no longer habitable or are converted to conventional properties when contracts expire, the need for new construction of affordable housing will increase but funding likely will not rise to meet the demand. Preservation needs are present throughout the state, but each affordable housing program has varying needs in different geographic areas. Given the high need and inadequate funding levels, state and local housing agencies

consensus of TDC's membership that THDA not create additional set-asides in the 2017 QAP that would further dilute the available credits available to New Construction or Preservation transactions. It is the strong recommendation that THDA defer creating new set-asides until 2018 when its two year 30% set-aside for the Rental Assistance Demonstration expires.

Set-asides: Innovation Set-Aside

While supportive in concept, as stated above, a super majority of TDC members recommend THDA and the development community defer adoption of the Innovation Set-Aside until 2018, when additional allocation becomes available from the RAD set-aside. There is also significant concern from both our New Construction and Preservation stakeholders that the likely resulting reduction of either or both set-asides to create room for the special projects set-asides would have significant and adverse impacts in their respective communities. Consequently it is recommended that the initial 2018 set-aside be modest in size perhaps only enough to fund a single transaction. $500,000 in annual credits would be a significant amount for a new program. Expansion could be considered in future QAPs based on interest, quality of submissions and other factors.

Furthermore, anticipating that high degree of community support and engagement will likely be necessary to submit a successful application, we believe a longer lead-time will facilitate stronger partnerships and the alignment of other critical resources in the initial year and will thus result in stronger applications. A delay in implementation will also allow THDA to adjust its allocation calendar to better facilitate implementation and application review.

If an Innovation Set-Aside is included in the 2017 QAP, it should be made very clear prior to approval and adoption ideally before the initial draft QAP is released what other set-asides are being reduced and by how much.

Set-asides: Left-Over Credits

While, our membership is open to the concept of targeting "left-over credits" for a specially targeted project (potentially Scholar House or another special needs population) there are some challenges associated with the approach. Given the uncertainty in the funding amount it may be difficult to attract strong projects and strong developers. In particular, many developers may not want to incur the necessary predevelopment costs to submit an application when the potential allocation amounts are both small and uncertain.

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will need to carefully prioritize which projects to fund and ensure that preservation funding provides a depth or quality of rehabilitation that extends the life of a property as long as possible."

Excerpt from THDA's "Aging Affordable Rental Housing in Tennessee & the Need for Preservation" Report: *https://s3.amazonaws.com/thda.org/Documents/Research-Planning/Preservation-Report-FINAL.pdf*

Set-Asides: Scholar House

TDC acknowledges that there are many merits to the Scholar House development model and that targeting this model specifically to youths aging out of foster care may be a helpful approach in addressing the needs of a very vulnerable population. Before endorsing the concept we believe it is necessary to address several additional related questions. Learning from our experience with Scholar House as well as other projects that target youths aging out of foster care, we know that these populations have a highly experienced operator and are adequately resourced with rental assistance and operating funding for the necessary supportive services if they are to succeed. If THDA is going to allocate credits (especially a smaller scale allocation) we believe it should consider in its evaluation and underwriting the developers experience operating supportive housing, soft resources that have been committed to the project, rental assistance that has been committed to the project, as well as the committed partnerships with appropriate educational institutions and/or supportive service organization along with other factors necessary for the project to succeed. The commitment of rental assistance seems particularly important for these type of projects, since we anticipate that all of the residents will be full time students. We also would like to know if county caps will apply to projects funded in the Scholar House "round"? We assume that many of the locations most suited for Scholar House project will be located in the highest ranked urban counties which could be problematic.

Set-asides: Preservation

A subset of our membership that is primarily engaged in affordable housing preservation projects recommends THDA reduce the per deal maximum (within the preservation set-aside ONLY) to -$750,000. This will spread the limited resource across a greater number of projects and potentially may make smaller and rural deals (located in high scoring counties) better able to compete. Additionally, THDA may consider further refining the eligibility of projects within the preservation set-aside to explicitly incentivize projects with project-based rental assistance contracts, which tend to be older, have greater capital needs and are at most risk of leaving the affordable portfolio in the short-term. Generally speaking, relatively newer LIHTC only "unassisted Year-15" projects should be able to be recapitalized using the tax-exempt bond given their age and condition.

County Needs Score

Many of our members still oppose assigning competitive points via the county needs score and strongly believe there are more appropriate selection criteria. We do not have a consensus as to the exact replacement but ideas that have been suggested for consideration including targeting areas that are not minority concentrated, incentivizing proximity to amenities, and leveraged.

Tiebreaker

We continue to have concerns that the current tiebreaker does not serve the long term interests of affordable housing residents, owners or the program at large. While it may be effective in breaking ties, we note that the tie-breaker:

- Can drive down construction quality which has long-term operating and cost implications.

- Drives owners to find markets with the highest tax credit rents. Higher rents allow greater debt-leverage per unit and allows less reliance on the LIHTC. This means that less affluent markets and especially rural markets with lower tax credit rents will be less competitive regardless of housing need.
- Greatly favors larger transactions which have transactional economies of scale. This results in fewer total awards in fewer locations.
- Encourages the use of 9% credits on "less needy preservation deals" as it costs less to rehab those to THDA standards that it does a more at risk and physically challenged deal.
- Limits developer's ability to finance amenities that may be especially important for resident capacity building or comfort.
- Drives counterintuitive design decisions that do not enhance a project's marketability or quality of life for its residents. This includes units that may be excessively large which are in turn excessively expensive to heat, cool and furnish.

There are many alternatives THDA may consider to replace the current tie-breaker. While we don't as a group have a consensus as to the best option, options under consideration include amount of committed, permanent leveraged soft-funds defraying residential costs, proximity to amenities, highest walk-score, high impact project metrics, voluntary basis reduction, projects in or even a lottery system. If THDA continues to use separate tiebreakers for projects funded out of the preservation set-aside, some members recommend preferences for properties that set-aside the highest percentage of units that are income restricted to 50% or below AMI households. We also observe that many state HFAs utilize multiple tie-breakers.

Developer Experience

We believe that developer experience with the LIHTC program and financial capacity is an important determinant of project success. We do not believe that the state in which that experience is achieved should be a determining factor for getting an allocation in Tennessee. Ultimately, THDA and low-income residents are best served by accessing the best quality developers and we believe it is counterproductive to effectively eliminate from competition highly experience participants that do not currently own properties located in Tennessee. We can understand holding unfamiliar or out-of-state developers to a higher standard of review or even potentially restricting the total number of transactions they can be allocated until their local experience has been proven out. We have many qualified members that operate thousands of units of LIHTC housing across the country that are effectively eliminated from competition unless they partner with a local firm that meets the experience requirement. In many cases this add unnecessary costs to a transaction that ultimately just takes resources away from the project and residents without adding any real benefit. Prefer to see meaningful criteria based on experience and capacity.

Eligibility for Resyndication

The IRS code ties eligibility for a resyndication using acquisition credits to 15 years from the initial placed-in-service date to the new placed-in-service date. We believe the current requirements in the QAP that prohibit a developer from submitting an application until 15 years after the initial placed-in-service date exceed the requirements set forth in the IRS code and has a practical effect of putting

affordable housing developers at a competitive disadvantage in the market place to option and acquire properties for preservation. We believe that THDA's policy should align with the IRS's stated minimum standards. Failing that, an alternative and more appropriate standard would be to demonstrate evidence of change of site control (for example a purchase contract) that is in excess of 15 years from the initial placed in service date. This will allow developers to prepare an application for projects that are on the cusp of the 15 year window, while guaranteeing to THDA and the IRS that the minimum 15 year window will be met. Without the availability of acquisition credits Year-15 properties in the market place (particularly those that may not be covered by lengthy extended use requirements) will be at greater risk to be acquired by market-rate developers that will exit the program at the end of the extended use requirement.

National Housing Trust Fund

On April 5, HUD announced that it would be making its allocations for the National Housing Trust Funds, with funds available to the states for use as soon as June. Law requires that at least 90% of the annual NHTF funds provided to THDA be used for rental housing – we recommend that 100% of these funds be utilized in for multifamily rental housing utilizing the LIHTC. By tying the funds to the LIHTC, THDA is able to leverage private sector dollars to make them go further than any other potential useage. Also, as THDA is aware, there is no other statewide source of gap funding for affordable rental housing in Tennessee. Furthermore, the deep-income targeting program requirements align well with public housing/RAD, Section 8, RD-Preservation and special-needs projects.

We recommend that first preference for the use of NHTF funds should be directed to qualified units that utilize the tax-exempt bond program. THDA's recently published "Aging Affordable Rental Housing in Tennessee and the Need for Preservation" indicates the strong need for additional preservation resources, particularly of the older subsidized portfolio. Additional gap funding resources for the Tax Exempt Bond (TEB) program will facilitate more preservation outside the 9% program and will similarly benefit new construction projects utilizing TEBs. Additionally, since the RAD set-aside is oversubscribed, and likely to remain so, this will create another feasible financing path for RAD projects to pursue before they lose their CHAPs.

We also recommend that THDA set-aside some portion of funds (up to the 25% allowable by law) for very low-income houses holds, which will marry well with the 4% Tax Exempt Bond income requirements. To get more bang for their buck, THDA may also consider supplementing these funds with other available agency resources.

Given our recommendation to allocate available NHTF funds to projects that leverage LIHTCs, we suggest that the most efficient way to administer the funds would be to integrate the application for these funds into the tax credit application. This one-stop-shop approach is common in other states that administer multifamily gap funds or state credits. Given the limited resources available, we suggest that THDA cap the amount of funds it will allocate by transaction and per development. We suggest $10,000 per unit or alternative $500,000 per project would be appropriate given the current overall allocation projections. We also believe that it is critical that applicants demonstrate need. We anticipate that demand will far outstrip available resources so THDA will also need to consider other potential tiebreakers. Factors THDA might consider including readiness to proceed, additional leverage, and/or age of the property or expiration of project base-subsidy (if preservation).

Tax Exempt Bond Program: Maximum Amount of Bond Per Development: Rehabilitation

TDC recognizes that as a steward of the LIHTC portfolio it is paramount that THDA have safeguards in place to ensure that sufficient standards are met when preserving existing or constructing new affordable housing utilizing the TEB program. We believe that the current tiered rehabilitation system does not account for several significant factors which creates a policy misalignment and prevents many transactions from effectively utilizing the TEB program.

Under the current program, the amount of rehabilitation required is tied to the amount of bonds required – the larger the issue, the greater the amount of rehabilitation required. It is our experience that size of the bond issue often does not correlate to the amount of rehabilitation required to keep to the property operational and in compliance for 15 years. Rather, the size of the bond issue is more often associated with the size of the property in terms of units or the acquisition cost of the property with a greater acquisition cost being indicative of a well maintained property.

Consider the following Scenario -- in the current market place, a well maintained, cash-flowing 100+ unit Year-15 LIHTC property in a competitive market like Nashville will sell at a high per unit cost that would likely put it in the moderate or substantial rehab tier. The cost of the property in this scenario is driven up because of its size and its condition. The physical needs of the property may actually be modest (because it is so well maintained) requiring only the scope of work necessary in the limited tier but the developer will be required to undergo a far costlier rehab because of the size of the bond issuance, perhaps being forced to replace serviceable systems unnecessarily or even making the deal financially unviable.

Alternatively, consider this second scenario -- A 38 unit property in a soft rural market originally developed in 1975 under the Section 8 program with substantial deferred maintenance. The per unit acquisition cost is likely to be very low because it is a small property with little prospects for rent growth and likely substantial expenses. This would be a prime candidate for substantial rehabilitation; however, under the current BPD it might actually qualify for the limited rehab tier.

TDC considered developing alternative formula's that would determine the appropriate rehabilitation tier that accounted for [Total Amount Bonds Issuance (minus) appraised land costs] / # of units. While this probably addresses some of the concerns we outlined above it also has weaknesses. Ultimately, we believe that THDA's most prudent approach would be to set an overall cap on bond authority per project (and perhaps an additional cap per unit).

TDC Recommendation (First Preference): We acknowledge that staff and the committee has rejected recommendations by TDC and others in the past to eliminate the tiered rehab requirement but we believe that the additional safeguards THDA relies upon in the 9% program to determine the proper scope of rehabilitation, namely the PCNA and architects certificate adequately protect the state's interest and that the tiered requirements could be eliminated entirely.

***TDC Recommendation (Second Preference)*:** An alternative recommendation that is preferable to the current language in the BPD would be to raise the maximum amounts in the moderate and limited rehabilitation categories as follows:

Moderate Rehabilitation: Maximum $13,000,000
Limited Rehabilitation: Maximum: $10,000,000

This will significantly address the dynamics outlined in the hypothetical above, at least for larger scale projects.

Conclusion

Once again, TDC appreciates the opportunity to provide THDA with this feedback. We would be very happy to discuss any specifics you might have regarding these comments or other subjects of concern. Please feel free to contact me directly with any questions at 202-939-1753 or tamdur@housingonline.com.

Best Regards,

Thom Amdur
Executive Director

cc: Ralph Perrey
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