1400 16th Street, NW
Suite #420
Washington, DC 20036
P: (202) 939-1750
F: (202) 265-4435
www.housingonline.com

August 11, 2017

Jennifer Schwartz
Assistant Director for Tax Policy and Advocacy
National Council of State Housing Agencies
444 North Capitol St. NW, Ste. 438
Washington, DC 20001

RE: NCSHA's Recommended Practices in Housing Credit Administration

Dear Ms. Schwartz:

On behalf of the National Housing & Rehabilitation Association (NH&RA), I would like to thank NCSHA for the opportunity to provide public comment on the most recent revision to the Recommended Practices in Housing Credit Administration ("Draft Recommendations"). NH&RA is a professional trade association of organizations involved in affordable multifamily housing. Our members include private and nonprofit developers, owners, and operators, as well as lenders, syndicators, investors and other professionals engaged in the affordable housing industry. Our comments on these proposed Recommended Practices are a product of conversations with NH&RA staff and our developer members. These comments are delivered in the order presented in the Draft Recommendations.

4. Local Approval and Support of Developments

NH&RA endorses the proposed recommendations on this topic. "Not in my backyard" issues have plagued affordable housing efforts in many communities, placing unnecessary costs on the affordable housing industry and denying opportunities for residents to live in communities of choice. We further support the recommended practice that state agencies should not require local financial contributions as a condition for receiving allocation. If leverage is incentivized in a QAP it should be neutral as to the source of funding.

8. Market Analysis

NH&RA believes that market analyses performed for allocation purposes must be conducted by a fully qualified, independent and objective analyst. Our affiliate the National Council of Housing Market Analysts (NCHMA) was founded in recognition of consumer's need for competent, unbiased advice, professional guidance, and sound judgment concerning real estate

matters relating to the affordable housing and residential real estate markets. We believe that NCSHA and its members can ensure greater independence by adopting NCHMA's Model Content Standards for Rental Housing Market Studies[1] and requiring analysts to comply with NCHMA's Code of Ethics and Standards of Professional Practice[2].

There are many additional strategies that states can employ in addition to our generally accepted professional and ethical standards including adopting approved lists and hiring third party reviewers to assist the states; we do not support states hiring market analysts directly. While this practice may also ensure independence, it degrades the consultative value of a market study during pre-development, potentially forces developers to use analysts that have proven either ineffective in the past or are inappropriate for a particular project type or region, and creates unnecessary delay and potentially duplicative costs, amongst other issues. As indicated above, NCHMA is an affiliate council of NH&RA and, we are happy to delve further into these issues, providing unique insight from both developers and market analysts:

I. PERMITTING DEVELOPERS TO HIRE MARKET ANALYSTS DIRECTLY

A. Consultative Value of a Market Study

The market study is an important consultative tool that developers use to refine their project's scope, unit mix, marketing plan, rent projections and many other features to ensure they propose the best possible project prior to submission to the state agency. When the agency contracts directly with the market analyst, the developer must either forgo this resource or pay for it separately in an inefficient use of funds.

This consultative process increases the quality of applications received by HFAs, ensuring that state employees spend less time reviewing applications irrelevant to the state's needs, creating efficiency for the agency. The vast majority of housing finance agencies administering the LIHTC program elect for developers to hire analysts directly and we urge NCSHA to recommend they continue for the abovementioned efficiencies.

B. NCHMA's Standards and Ethical Guidelines Protect State Interests

One argument for having agency-hired analysts is to address concerns regarding potential conflicts of interest. It's wholly appropriate for agencies that utilize market studies for allocation purposes to require a disinterested 3rd party to perform the market study. This is also

---

[1] https://www.housingonline.com/councils/national-council-housing-market-analysts/model-content-standards/ and https://www.housingonline.com/wp-content/uploads/2014/09/Final-Model-Content-V3.0.pdf

[2] https://www.housingonline.com/councils/national-council-housing-market-analysts/ethics-professional-responsibility/ and https://www.housingonline.com/wp-content/uploads/2014/04/NCHMA-Code-of-Ethics-Final-New-Logo.pdf

a foundational requirement of NCHMA and its market study guidelines. Many states already require that all market analysts working in the state maintain NCHMA's Professional Member Designation and we suggest that NCSHA recommend this practice. NCHMA analysts adhere to the organizations best practices, including its ethical guidelines. States can take further precautions by explicitly requiring every analyst to endorse these guidelines, under penalty of perjury or disbarment, as part of their approved list or within the submitted market study.

The NCHMA Professional Member Designation involves annual professional continuing education requirements, positive affirmation to stringent standards of ethics and professional responsibility, and peer-review. NCHMA also has formal mechanisms to report complaints relating to ethics or deficiency in standards to ensure continual improvement in the quality of members' work. In severe cases, the NCHMA grievance process can result in sanctions or revocation of membership.

The decision to accept a market study opinion lies ultimately with the state and states are not precluded from creating any number of additional requirements – whether that be reviewing market studies in-house, hiring a third party to review all applicants' market studies, creating stringent guidelines for market analysts to follow in producing market studies, or requiring requested updates.

II. ADOPTING NCHMA's MODEL CONTENT STANDARDS

The Model Content Standards (the "Standards") have been rigorously reviewed by our membership and an advisory committee of developers, state HFAs and syndicators. These Standards are continually updated as the best practices of the market analyst industry are refined and improved. We have also developed a series of white papers on key aspects of the discipline including defining market area, comp selection, rent derivation and many other topics that serve as supporting documentation for the Standards. NCHMA's Model Content Standards have been adopted by more than half of all housing finance agencies and the Affordable Housing Investors Council, and have been incorporated into HUD's MAP guide (though in a slightly different format). If there are additional items states would like in their studies, nothing precludes them from adopting additional requirements.

In sum, we suggest NCSHA recommend that states:

1) Require developers to hire from a list of approved market analysts
2) Adopt NCHMA's Standards
3) Require that market studies over 6 months old be updated

4) Require that market analysts perform a physical site visit in drafting a market study

<u>13. Green Building and Sustainable Development</u>

NH&RA endorses the proposed recommendations on this topic. Furthermore, we believe that all policy encouraging green building and sustainable development should be pro-actively focused on the goal of creating cost-savings over the life of a property. Certain green and sustainable strategies fail to provide long-term savings for the property yet still increase costs; these practices may be prime for states to consider when balance green building and cost containment priorities. Examples include policies that require the use of local building materials and policies that require costly certifications such as the LEED certification (while meeting LEED standards and adhering to them over the life of a property may create savings, this is independent of paying additional money to receive the certification which places no long-term requirements on a property).

<u>15. Developer Fee and Builder Fee Limits</u>

We do *not* support the proposed changes to the recommended practices relating to developer fees. We believe that the *current* best practice, as adopted in 2011, which limits developers to a developer fee of no more than 15% of total development costs (with some limited exceptions) is wholly appropriate compensation that has been widely accepted by the IRS, Congress, tax counsel, debt and equity providers and the development community for more than thirty years. While individual states may choose to proscribe fees further, we believe that amendment as proposed is unnecessary, overly proscriptive and would likely drive high qualities developers from the program. We further suggest, as NCSHA does, that several scenarios require a fee greater than 15%, and we provide examples of such exceptions below.

It is well accepted that adequate developer fees are vital to the success of affordable housing development. An adequate developer fee is what attracts quality developers to this industry. Without appropriate incentive, the industry's quality developers will leave, resulting in poorer quality developments. Since these deals by design do not generate cash flow, a developer fee is a necessary component of the public-private partnership which makes the LIHTC program so successful. There is a great deal of uncertainty and risk in affordable housing development, combined with long timelines. The developer fee compensates developers for this risk, where they may not receive any compensation for potentially four to six years of pre-development work and overhead. It is important to remember that in this industry, the developer fee does not merely act as a developer fee would in the market-rate development world.

I. DEVELOPER FEES FOR AFFORDABLE HOUSING SERVE SEVERAL IMPORTANT PURPOSES

A. The developer fee often serves as a de facto construction contingency and operating reserve

Limiting developer fees further will result in the need for developers to raise additional liquidity elsewhere to satisfy the market-driven need for construction contingencies and operating reserves for these projects. Lenders and syndicators/investors also require financial cushions in transactions as part of sound underwriting. If fees are further diminished developers will be forced to incur new costly facilities like letters of letters of credits, capitalize further reserves and more financial guarantees, all of which ultimately add cost to the project, put additional stress on balance sheets without actually providing any real benefits to the residents.

B. An overly stringent limit on developer fees fails to recognize that developer fees should be commensurate with risk taken on by the developer

Due to scale, location, targeted population or other factors, some projects may carry greater risk than others, and a developer fee is one way of compensating a developer for risk taken-on for any deal. Ultimately, the developer is responsible for construction risk up front and funding operating deficits in the long run. Placing additional stringent limits on the developer fee will likely chill interest in pursuing any higher risk properties, which may be priorities for the state's mission of providing affordable housing to citizens in need.

C. Developer fees often pay for resident services

By decreasing developer fees, the resources for providing resident services also diminish. This is contrary to the purpose of the Low Income Housing Tax Credit program, where the main goal is to provide affordable, quality housing and improve the lives of low-income individuals. Where other sources of funding are not available, the developer fee serves as the sole source for providing resident services.

D. The developer fee pays for overhead

The developer fee also pays for essential operations which keep the property in operation such as asset management, and provides revenue for any times of operation deficits as well as a construction contingency.

II. EXCEPTIONS TO THE 15% DEVELOPER FEE

NH&RA agrees as a rule that an appropriate fee for most projects should not exceed 15 percent of total development cost. NCSHA's current recommendations provide that small deals, difficult to develop deals, and socially desirable deals could be excluded from this limit. We agree, and suggest the recommended practices be amended further also include the following scenarios excepted from a 15% developer fee limit:

A. Tax Exempt Bond Deals that Demonstrate Need

4% tax exempt bond deals, allow for an extremely efficient use of resources to produce or continue providing affordable housing. However, the transactional costs associated with tax exempt bonds are greater than equivalent 9% deals and the subsidy is shallower. As such, we believe that in many circumstances this necessitates a greater development fee. Several states have found that increasing developer fees for transactions that can demonstrate need can dramatically increase production of TEB financed transactions in the absence of soft funds.

B. **Projects Where the Increased Increment of Fee is Used to Ongoing Resident Services**
C. **Rural Deals**
D. **Deals located in states lacking soft funds or state credits**

16. Consultant and Professional Fees

NH&RA agrees that states should monitor consultant and professional fees; however, this process must be done with care. As no two projects are the same, no two corresponding sets of professional fees will be the same. For this reason, making an “apples to apples” comparison regarding these fees is difficult. Furthermore, it is very difficult for developers to defend themselves in a disagreement with an HFA over fees because due to privacy laws, they will not likely have access to all the other applications, internal models, contracts, etc.… We do not endorse any best practice that would result QAP incentivizes for the “lowest” professional fee as part of scoring or other criteria.

It is also worth mentioning that, in the interest of cost containment, consultant and professional fees are not to blame for recent dramatic hikes in costs, as these costs have only increased incrementally. Shortage of labor force, cost of land, and costs of building supplies have played a larger role.

21. Debt and Expense Coverage

Incentivizing developers to take on as much debt as possible is potentially unwise. Agencies should take care when implementing policies requiring low debt-service coverage rations at the outset of the project. We observe that despite the current practice which recommends that “allocating agencies should not reward developments with the lowest possible debt service coverage” many states effectively set a 1.15 DSC as a floor but also a ceiling in their underwriting. Given that expenses will rise in both anticipated and unanticipated fashions, we think this puts agencies and properties at great financial risk and recommend that the current best practice be amended to clarify this. Should a natural disaster create a spike in insurance costs, or should the cost of utilities dramatically increase for any number of reasons, this could be detrimental for a property with such a debt ratio. While this

strategy saves soft funds and tax credits, it leads to financially unsafe situations for the development.

We would be more than happy to discuss these remarks with you further at your convenience.

Regards,

Thom Amdur
Executive Director
National Housing & Rehabilitation Association