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January 7, 2021

Shannon Friel
Private Activity Bond Manager, Finance
Colorado Housing and Finance Authority
1981 Blake Street
Denver, CO 80202

Dear Ms. Friel,

On behalf of the National Housing & Rehabilitation Association (NH&RA), I am writing to provide comments on the Colorado Housing and Finance Authority's (CHFA) Draft 2021 Private Activity Bond (PAB) Pool Guidelines. NH&RA appreciates the opportunity to provide comments regarding projects financed using the four percent Low-Income Housing Tax Credit (LIHTC or credit) and multifamily tax-exempt bonds (TEBs).

Formed in 1971, NH&RA is a national trade association representing private and non-profit developers of multifamily affordable rental housing. Our members are active owners and developers of LIHTC, HUD-Assisted, USDA RD-515 and Public Housing Revitalization properties in Colorado and around the country. After extensive dialogue and analysis with multifamily bond developers and state housing finance agencies, NH&RA developed our Multifamily Tax-Exempt Bond Toolkit (attached), which is designed to highlight policies and best practices that will increase the production and preservation of affordable housing through the four percent LIHTC. The toolkit highlights policy best practices adopted by housing credit allocating agencies (HCAAs) from around the country. It was our goal to design a resource that individual jurisdictions could review and select strategies and policies that best suit their communities and needs. The following comments and recommendations are drawn from this toolkit and tailored to address potential opportunities to expand resources and outcomes in CHFA's Draft 2021 PAB Pool Guidelines.

> *CHFA will accept applications for 4 percent housing credit projects seeking CHFA PAB Pool volume cap resources until 5:00pm MT on the first business day of each month from March 2021 to November 2021. Per the QAP, a letter of intent is due 45 days prior to submitting an application. A concept meeting with CHFA staff is required in advance of submission.*

We applaud CHFA's decision to allow rolling applications for four percent Low Income Housing Tax Credit (LIHTC) and PAB developments. However, we encourage CHFA to go a step further and expand the time frame for applications to year-round or year-round with the exception of August and February since CHFA staff will be receiving the other competitive applications.

The compelling financial attribute of the four percent LIHTC program is the "as of right" credits that come with meeting the Internal Revenue Code Section 142 requirements along with the threshold requirements set forth in a HCAA's QAP. While private activity bond volume cap is a limited resource, the credits associated with tax-exempt bond transactions are only limited by the amount of eligible

basis. This is a significant difference from the nine percent LIHTC program where the allocation of annual credit authority is capped. Developers need certainty of execution in today's real estate market, in which low interest rates are increasing pricing and demand while simultaneously decreasing seller's willingness to accept long timer periods in purchase agreements.

We also point out the need for further clarification. Will the private activity bonds be allocated on a first-come, first-served basis or will there be an even amount spread out over each month? Low interest rates combined with the recently fixed four percent credit will likely drive unprecedented demand. What does CHFA intend to do if demand outstrips supply?

CHFA will limit 4 percent housing credit applications seeking CHFA PAB Pool resources to one project per applicant, affiliate, or turn key project services developer per year. Please see QAP definitions for applicant, affiliate, and turn key project services.

The restriction of one project per applicant, affiliate, or turn key project services developer per year is very limiting, particularly for multiphase projects. Given Colorado's severe shortage of affordable housing, we believe that experienced developers that have demonstrated ability to handle more than one project per year should be allowed to do so. Multi-phase projects, ostensibly by the same developer, should not be limited to this arbitrary cap, but rather by construction and investor timelines.

New construction, existing projects without housing credits, and existing housing credit projects in year 25 or later of their extended use period may apply.

We encourage CHFA to considering lowering the threshold for existing housing projects from 25 years to 15 years. At year 15, owners are often faced with buying out limited partners in order to acquire independent ownership of the property. A capital event, such as a recapitalization or refinance, can serve as the impetus and necessary capital for that transaction to occur. Furthermore, at year 15, major systems like roof structures, wall or floor structures, foundations, plumbing, HVAC and electrical systems begin to reach the end of their life cycle and are in need of replacement. This is especially true for deals that started as preservation deals, with systems that can be upwards of 50 years old.

Properties with limited cashflow often defer critical maintenance until they are able to recapitalize or refinance. The general rule-of-thumb is that each property will accrue $1,000 of maintenance needs per unit, per year. Setting a 25-year minimum requirement simply defers vital maintenance work for ten years and postpones a valuable buy-out option.

Existing housing credit projects serving homeless and special need tenant populations in year 16 or later of the extended use period may apply.

No comment.

To drive shovel-ready projects:

- *Applicants are expected to close by the construction loan closing date stated on the initial preliminary 4 percent housing credit application.*
- *Applications will not be accepted if the construction loan closing date stated is more than 12 months from the date of application.*
- *Reservations of CHFA PAB pool volume cap will expire 10 business days after the construction loan closing date stated on the initial preliminary 4 percent housing credit application.*

- *A $10,000 non-refundable PAB pool volume cap reservation fee due at time of reservation.*

2020 and the COVID-19 pandemic have been a case study in delays beyond the control of even the most well-prepared development team. Deals with U.S. Department of Housing and Urban Development financing are especially subject to delays beyond the control of the developer. While we understand CHFA's desire to only solicit serious, shovel-ready applications, we also understand the world in which those applicants must do business. Unexpected delays are par for the course and we believe CHFA's guidance should anticipate and accommodate those delays, within reason. We suggest including at least one 30-day extension for applicants that can demonstrate good faith efforts.

Thank you again for the opportunity to provide comments. Please feel free to contact me directly at 202-939-1753.

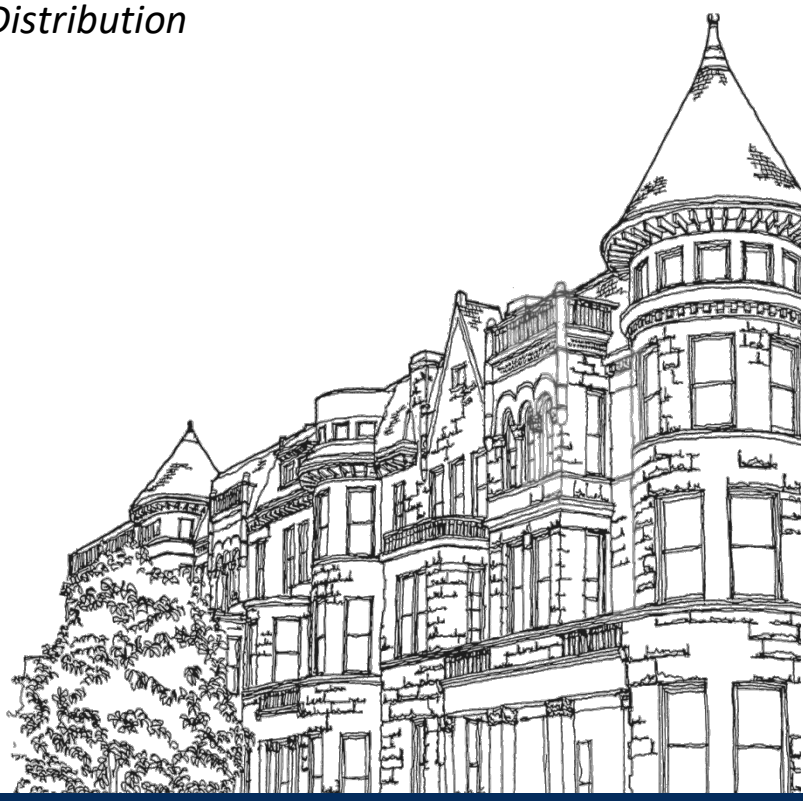
Sincerely,

Thom Amdur
President

Multifamily Tax-Exempt Bond Toolkit

June 7, 2019 Draft

Not for Distribution



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Dear Affordable Housing Stakeholders,

Multifamily tax-exempt bonds represent an existing but under utilized resource that can make a significant contribution to the expansion of affordable housing opportunities. The Council of Development Finance Agencies found that only states issued all or almost all of their private activity bond volume cap in 2017. After implementing some of the best practices within this toolkit, Tennessee went from financing 512 units through the bond program in 2013 to 4,442 units in 2018; and Tennessee's nine percent Low Income Housing Tax Credit (LIHTC) financed 1,526 units of affordable housing while the four percent LIHTC and private activity bonds financed 4,442 in 2017.

The National Housing & Rehabilitation Association undertook this project with the goal of increasing production and preservation of affordable housing through the four percent LIHTC. While there is a national need for more affordable housing, locally the individual market needs, policy environment, tools and resources vary dramatically and as such, require custom solutions. This resource is designed so that it can be tailored to the individual needs of a jurisdiction. We present this toolkit for consideration by housing credit allocating agencies, as well as state and local governments as a menu of options that policy makers may select from to increase housing production through the four percent LIHTC. Not all options will make sense for every jurisdiction. Some may be implemented relatively easily through regulation while others may require enacting legislation.

We recognize that to fully realize the potential of the four percent LIHTC the federal government must also act. The Affordable Housing Credit Improvement Act of 2019 would greatly complement and enhance the recommendations in this toolkit by providing needed reforms for the LIHTC program and increasing both the annual allocation authority and small state minimum by 50 percent, phased in over five years. The bill would also fix the four percent credit rate at four percent. In 2015, Congress fixed the nine percent credit rate at nine percent but has yet to do so for the four percent LIHTC. This federal legislation to strengthen and expand the LIHTC is critically important – the National Housing & Rehabilitation Association supports the efforts of the ACTION Campaign and its members as we work with Congress to enact a legislative fix.

The Affordable Housing Credit Improvement Act of 2019 also includes a private activity bond (PABs) recycling provision that would allow recycled multifamily PABs to convert to single family PABs. Recycling would allow issuers to recapture volume cap from prepayments, redemptions and other retirements of PABs to put towards other housing needs. This potential change could go a long way to help states effectively manage volume cap in a resource scarce environment.

Taken together, the passage of the Affordable Housing Credit Improvement Act along with the adoption of the state and local policy recommendations contained within this toolkit would go a long way towards addressing the affordable housing needs of this country. We thank you for your time and consideration and look forward to continued dialogue. Please feel free to contact me at (202) 939-1753 or tamdur@housingonline.com with any questions.

Sincerely,

Thom Amdur
President

Introduction

Nationwide, the lack of supply of affordable housing is reaching crisis proportions. New production has not kept up with demand and as older affordable housing programs have matured and the existing affordable housing portfolio is at risk of conversion to market-rate. The nine percent Low Income Housing Tax Credit (LIHTC or credit) is already oversubscribed and, absent a major expansion, cannot meet current demands on its own. In contrast, in most states Private Activity Bonds (PABs) and the accompanying four percent credit are undersubscribed. In its most recent analysis, the Council of Development Finance Agencies (CDFA) found that only 8 states issued all or almost all of their private activity bond (PAB) volume cap in 2017.[i] When accounting for new PAB cap, as well as carry-forward allocations, states had over $90.4 billion in private activity volume cap available in 2017. Only $24.9 billion was issued, while an additional $44.2 billion was carried forward. Utilizing even a portion of the unutilized $30 billion for additional multifamily housing would go a long way towards closing the affordability gap. Through the development of this toolkit, the National Housing & Rehabilitation Association highlights strategies and best practices that can increase the production and preservation of affordable housing through the use of multifamily PABs.

The toolkit is organized into several components: it highlights the factors that lead to successful bond transactions and explores policy options that housing credit allocating agencies (HCAAs) and state and local governments can implement to increase their current production. A detailed 101 section provides an entry point to users unfamiliar with the bond program. Case studies highlight the implications of public policy choices and the types of projects that have been successfully developed or preserved using tax-exempt bonds (TEBs). This resource is intended for HCAAs and state and local governments seeking to increase production and preservation of affordable housing through PABs the four percent LIHTC.

Private Activity Bonds and the Four, Nine Percent Credits Explained

The four and nine percent LIHTCs, while similar, vary in significant ways. The nine percent LIHTC is a deep subsidy program designed to generate equity proceeds to cover about 70 percent of the eligible depreciable costs (eligible basis) for new construction and substantial rehabilitation projects. Nine percent LIHTCs are limited by the amount of federally apportioned LIHTC allocation. In 2019, the nine percent LIHTC allocation was set by the Internal Revenue Service (IRS) as the greater of $2.75625 multiplied by the state population or a small state minimum of $3,166,875. Nine percent credits can also be paired with a four percent acquisition credit. In every state the nine percent credit is significantly oversubscribed. The award process for nine percent credits is highly prescribed and hyper-competitive due the depth of the subsidy and the scarcity of the resource. Allocation amounts are limited on a per-project, per-unit and/or per developer basis. Developers compete vigorously amongst themselves to achieve the HCAAs design, policy, cost efficiency and/or other goals in order to secure an allocation.

In contrast, the four percent LIHTC that is paired with PABs is a shallow subsidy program designed to generate tax credit equity covering about 30 percent of eligible depreciable costs. When a project is financed utilizing multifamily tax-exempt bonds, four percent LIHTCs are generated “as of right.” In order to receive four percent credits, developments must meet threshold requirements in HCAAs Qualified Allocation Plans (QAPs), as well as tax-exempt bond rules. These credits do not count against the nine percent volume cap. They are only limited by the amount of PAB volume cap available to the project and the project’s eligible basis. In 2019, the IRS set the PAB volume cap at the greater of $105

multiplied by the state population or a small state minimum of $316,745,000. Generally speaking, given the comparative lack of demand for PABs, multifamily tax-exempt bonds are available on a first-come first-serve basis and the resource itself is far less competitive.

It should be noted that PABs, and by extension the four percent LIHTC, have higher fixed-costs compared to the nine percent LIHTC. The majority of these costs are associated with cost of issuing TEBs. These include fees associated with trustees, bond counsel, underwriters and credit raters or enhancers.

50 Percent Test

To be eligible for four percent credits, developers must finance at least 50 percent of basis in the building and land with PABs. Since four percent credits are as-of-right, the 50 percent test serves as gate-keeper for the four percent credits to ensure that the developments are able to pass the various requirements of PABs, like obtaining approval at a Tax Equity and Fiscal Responsibility Act (TEFRA) hearing and having support from the state or local PAB issuer.

Managing Volume Cap

Once a state receives its annual allocation of PABs it must decide how to allocate the resource among the various possible uses, including sewage facilities, mass commuting facilities, qualified residential rental projects, qualified mortgage bonds, small issue bonds and student loan bonds. Not all types of PABs are subject to the volume cap; for the sake of simplicity we have excluded bonds that are not subject to the volume cap from discussion in this toolkit.

Tax-exempt qualified residential rental projects are the only type of PABs that generate another federal subsidy, the four percent LIHTC. The program was designed so that PABs cover about 60 percent of the total development costs (TDC) and four percent LIHTCs cover about 30 percent of the total development costs. Gap funding and a deferred developer fee often finance the remaining ten percent of total development costs. Every $1 of PAB that expires unused or is allocated towards something other than tax-exempt qualified residential rental projects forfeits a federal resource that generates approximately 50 cents of four percent LIHTC equity.

Of course, it is probably not feasible that all PABs be allocated to tax-exempt qualified residential rental projects – states must determine how to balance many competing priorities. However, we maintain that given the need for affordable housing and the generation of the associated four percent LIHTC, to the extent possible, HCAAs should maximize PABs allocations for multifamily affordable housing.

Bond Execution Types

In today's market place there are many ways to execute tax-exempt bond financing:

1. **Freddie Mac Tax-Exempt Loan (TEL)**
   Under Freddie Mac's TEL, a third-party construction lender funds the construction of affordable housing and is responsible for taking the real estate risk. At conversion, the tax-exempt loan is sold to a Freddie Mac seller/servicer, who then sells it to Freddie Mac who will then service the loan through its life.

2. **Fannie Mae Mortgage Backed Security (MBS) as Tax-Exempt Bond Collateral (M.TEB)**
   Under Fannie Mae's M.TEB, a third-party construction lender funds the construction of affordable housing and is responsible for taking the real estate risk. At conversion the bonds are replaced with Mortgage Backed Securities, in which the bonds are rated Aaa or AA+. Importantly, the interest on construction loan and gross bond interest are includable in eligible basis for LIHTCs and TEBs.

3. **Short-Term Cash-Collateralized Tax-Exempt Bonds**
   Short-term tax-exempt bonds equal to 50 percent of the project costs are issued with a maturity close to, or shortly after, the anticipated place-in-service date of the project. The bond documents create a "project fund" and a "collateral fund" that are invested in highly rated investments. A simultaneous deposit to the "collateral fund" is made equal to an amount of tax-exempt bond proceeds disbursed from the "project fund" to pay project costs. The "collateral fund" is typically funded with the proceeds of a sponsor, a government sponsor or a taxable security such as, Fannie Mae, Freddie Mac or Ginnie Mae securities or a Federal Housing Administration (FHA)/U.S. Department of Housing and Urban Development (HUD) loan. Approaches have been developed to minimize or even eliminate negative arbitrage associated with this structure.

4. **Federal Housing Administration (FHA) Risk Share**
   Through the FHA Risk Share program, the FHA and state and local HCAAs share the risk and mortgage insurance premium on multifamily housing transactions. The HCAAs serve as both the issuer and lender and are responsible for providing full underwriting. This execution can take 90 to 120 days and trigger the Davis-Bacon Prevailing Wage Requirements, which may increase construction costs.

5. **Private Placement & Direct Purchase Structures**
   In a private placement execution, the bonds are sold to a select group of investors. The bonds do not go through an enhancement process for sale on the open market, which can save time and money for both the seller and purchaser. The execution is particularly popular with financial institutions that are subject to the Community Reinvestment Act (CRA)[ii], which requires banks to invest in the communities from which they receive deposits. In private placements and direct purchases the investor can serve as a construction, permanent, equity and/or bridge lender. Furthermore, private placements are often funded on a "draw-down" basis, as loan advances are made, thereby eliminating negative arbitrage.

There is no "silver-bullet" bond execution that meets the demands of every affordable housing development. Developers should compare and contrast their options to determine which execution best meet their needs in terms of speed of execution, amortization periods, interest rates and lender requirements like Davis Bacon.

A note on CRA: Lending is heavily weighted in financial institutions CRA examinations and affordable housing loans count as community development loans. Because of this, financial institutions structure their programs as loans in order to receive more favorable CRA credit. There is little difference in

substance between tax-exempt bond and loan programs; it is merely a difference in terminology, albeit one with important regulatory consequences.

Policies Strategies to Drive Development

There are several policy strategies that HCAAs and state and local governments can adopt in order to increase production of affordable housing through the four percent LIHTC and PABs, and we present these strategies as a menu of options. Not all options will make sense for every jurisdiction. Some are easy to implement while others may require legislative changes.

1. Differentiating Criteria Between Four and Nine Percent Credits

   The four percent and nine percent LIHTCs are qualitatively different programs and should be subject to different considerations in their administration. The nine percent LIHTC is a deep subsidy program designed to generate equity proceeds to cover about 70 percent of the eligible depreciable costs for new construction and substantial rehabilitation projects. Due to the deep level of subsidy, applications for nine percent LIHTCs are highly competitive and oversubscribed in every state. Given the competitive nature of the nine percent program and the deep level of subsidy, housing credit allocation agencies appropriately require project amenities that conventional developers may not otherwise include, like in-unit washer/dryers, community spaces, energy efficiency certifications, parks, gazebos, walking trails and computer rooms, in addition to deeper affordability requirements.

   In contrast, the four percent LIHTC, paired with TEBs, is a shallow subsidy program designed to generate tax credit equity covering about 30 percent of eligible depreciable costs. As a result, four percent TEB projects rely heavily on leverage and the most significant portion of its capital stack is hard foreclosable debt. Furthermore, in most states, PABs are not oversubscribed and as a result, the multifamily TEB program is not competitive. Amenities and deeper income targeting that may be wholly appropriate and supportable in a nine percent transaction are often times not financeable with TEBs.

   Recommendation: Reasonable application thresholds should be set that are achievable for both nine percent and four percent TEB transactions. HCAAs should adopt further independent competitive program requirements for nine percent and four percent TEB transactions. If PAB volume is not competitive, HCAAs should consider minimal additional requirements beyond threshold for four percent LIHTC transactions. This will facilitate more production in the four percent TEB program without sacrificing policy goals in the nine percent program.

   HCAA Best Practice: Oregon Housing and Community Services (OHCS) bifurcates the four and nine percent credit applications and states that four percent, "credits are not subject to OHCS preferences or selection criteria outlined in the QAP."[iii] Applicants must meet Internal Revenue Code (IRC) Section 42 statutory preferences, standards of financial feasibility and viability project monitoring procedures and program specific requirements.

2. Rolling Application Deadlines for Four Percent Credits

   Because of highly competitive nature of the nine percent program most states have one or two application rounds per year for the nine percent credit, which allows applications to be scored against each other. Fixed application cycles make sense when administering a competitive program with limited resources; however, they are not without their downsides. Given the current velocity of sales of raw land and existing multifamily buildings, application cycles do not align with the expectations of the

marketplace and sellers may be unwilling to consider purchase offers with lengthy options. One of the most attractive features of the four percent LIHTC program to developers is the relative certainty and speed of execution. Developers that are able to meet the threshold and have the ability to execute in capital markets have a high degree of confidence of a potential award and are able to commit to shorter option periods, making them more competitive in the acquisition marketplace. Rolling applications that are considered and processed speedily by HCAAs facilitate quicker and more efficient closings and allow affordable housing developers to better compete with conventional buyers.

Recommendation: HCAAs should consider awarding four percent LIHTCs on a rolling basis as applications are submitted. To the extent that competitive gap funding is made available to support TEB transactions HCAAs and local jurisdictions should consider having rolling deadlines for these resources or adopt multiple application deadlines throughout the year. HCAAs and issuers should also schedule regular meetings of their governing boards (ideally monthly) to assure that applications, waivers and appeals can be reviewed on a timely basis.

HCAA Best Practice: The California Tax Credit Allocation Committee meets six times a year to consider four percent LIHTC applications.

3. <u>Prioritize Subordinate & Gap Funding to Support Bond Transactions; Structure Soft Sources to Maximize Leverage</u>

Federal resources for affordable housing are in high demand and have not kept up with the growing need and rising construction costs. As changes to federal programs like the Affordable Housing Credit Improvement Act of 2019 are pursued, state and local governments should consider prioritizing gap funding resources to support production through the four percent LIHTC program, particularly if their PAB authority is not already oversubscribed. Relatively modest investments in gap funding are often the last dollars into a project, which means the difference between a project closing and dying on the vine.

Ideally, gap funding resources will come in a form that does not reduce the ability to maximize leverage. To maximize debt proceeds, soft debt sources should be structured with the following features:

- Payable out of cashflow;
- Serviced after deferred developer fees are paid;
- Interest-only payments set at Applicable Federal Rates;
- Loan term in excess of the LIHTC compliance period;
- Assumable;
- Subordinate to major permanent funding sources, such as FHA, Fannie Mae, Freddie Mac or HCAA debt;
- Terms and affordability requirements that overlap with other major funding sources such as LIHTC, HUD's HOME Investment Partnership Program and the Federal Home Loan Banks' Affordable Housing Program, so as not to require additional compliance costs; and
- Compliance monitoring and developer fee limits should defer to the HCAA policy as the primary source of subsidy.

State tax credit programs and/or Payments in Lieu of Taxes (PILOTs) are a complimentary alternative to soft debt. Likewise, local or state legislation exempting affordable housing properties from property taxes are very effective.

Soft Debt Best Practice: Multiple, contact NH&RA for details.

State Affordable Housing Tax Credit Best Practice: Georgia, Colorado

Affordable Housing Assessment Legislation Best Practice: Indiana

4. Maximizing Eligible Basis

The compelling financial attribute of the four percent LIHTC program is the "as of right" credits that come with meeting the IRC Section 142 requirements along with the threshold requirements set forth in a HCAA's QAP. While PAB volume cap is a limited resource, the credits associated with TEB transactions are only limited by the amount of eligible basis. This is a significant difference from the nine percent LIHTC program where the allocation of annual credit authority is capped. Given the competitiveness of the nine percent LIHTC program, it is wholly appropriate that HCAAs place limits on the total amount nine percent credits available to a sponsor and/or project. QAPs should be structured to allow for differing credit limitations between the nine percent and four percent program.

Recommendation: To the extent that PAB volume cap is a limited resource in a given state, HCAAs should place limits on the total amount of volume cap available to a project and/or sponsor and not constrain the total amount of four percent credits available. Maximizing the amount of credits available to the project will reduce the overall amount of necessary debt leverage, making more projects viable as four percent TEB projects.

Recommendation: Land is never included in eligible basis; however, HCAAs can take affirmative steps in their QAPs to maximize eligible acquisition basis in four percent projects and thus maximize the amount of tax credit equity available to the project. To a certain extent, appraisals are both an art and a science and appraisers have some discretion within the confines of the Uniform Standards of the Professional Appraisal Practice (USPAP) to take into consideration many factors in assigning value to the land versus the building. Appraisals should always consider sales comparison, replacement value and income approaches in any valuation; however, they should have the discretion to weigh one methodology over another where appropriate. To the extent that a credible appraisal by a trained professional with experience and understanding of multifamily affordable rental housing concludes a value, state policy should generally affirm this valuation. State policy should not artificially limit the appraisal to a single approach or set fixed limits to acquisition basis, though consideration can and should be taken as part of the underwriting and financial viability analysis.

Where federal policies exist as to the appraisal methodology, state policy should defer and conform to the federal policy. For example, the U.S. Department of Agriculture has set the acquisition price for Rural Development Section 515 properties as the as-is restricted value plus favorable financing value of the existing Section 515 loan and the transferred replacement reserve account balance. Likewise, HUD has developed its own valuation policy for projects financed under the Rental Assistance Demonstration Program that is designed to maximize four percent LIHTC equity.

Recommendation: Incentivize Development in DDAs & QCTs.

Section 42 of the IRC requires HCAAs to include a 30 percent basis-boost for developments in Difficult to Development Areas (DDAs) and Qualified Census Tracts (QCTs). The basis boost is a powerful financial incentive that increases the amount of tax credit equity available to the project. While HCAAs have the ability to apply a discretionary basis boost for nine percent projects, this discretionary basis boost is not

available to four percent TEB transactions. Furthermore, Section 42(m)(1)(B)(ii)(III) of the IRC requires HCAAs to give preference in allocating credits to projects located in qualified census tracts. Despite this legislative directive, in response to the *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.* Supreme Court case, which centered on the disparate-impact of the location of LIHTC developments under the Fair Housing Act, HCAAs may be wary of incenting LIHTC development in areas with a concentration of racial minorities and/or poverty, areas that often overlap with DDAs and QCTs.

To achieve the aims of the Fair Housing Act, we must both build pathways of opportunity for low-income people in already high-opportunity areas and turn low-opportunity areas into high-opportunity areas. This means investing in both strategies and building LIHTC properties in an array of areas. HCAAs should ensure that their QAPs do not unwittingly disincentivize or make impossible the development of affordable housing in QCTs and DDAs. The 30 percent basis boost in DDAs and QCTs will generate more LIHTC equity for the development, allow developers to build additional units, provide resident services and/or secure prime land near transit options.

Recommendation: Differentiate caps on TDC and/or total per unit cost between nine and four percent transactions.

Given the public resources involved, HCAAs should adopt policies that ensure affordable housing projects are neither over-subsidized nor over-built. LIHTCs must be allocated reasonably and efficiently; and these policies should consider the significant differences between the nine percent and four percent projects. TDC caps should consider the similar hard development costs between nine percent and four percent projects and should also account for the significant soft costs associated with TEB transactions, namely the costs of issuance, that are not incurred by nine percent transactions.

Recommendation: Leverage developer fees to maximize eligible basis.

Developer fees serve many purposes in LIHTC developments. Given the rent and income restrictions associated with program, cashflow is very limited on LIHTC transactions. Developer fees serve as the primary form of compensation for LIHTC developers, which pays for overhead of essential functions, including accounting, human resources, information technology, asset management, insurance and legal fees and many others. Developer fees also serve as the primary form of reimbursement for pre-development costs and resident services and are a de-facto construction contingency. In short, LIHTC developers have significant fixed costs outside of the sources and uses of a specific development that are critical to allowing a business to operate and build affordable housing. Developer fees must be sufficient to cover these costs and compensate for the risks inborn in affordable housing transactions if the industry wants to continue to attract and retain the highest quality developers.

Limitations on reasonable developer fees, particularly deferred developer fees, hurts the financial viability of projects and disincentivizes committed, high-quality developers from participating in the program. Developers, especially in the nine percent LIHTC, take on a large risk when submitting a LIHTC application due to the highly competitive nature of the program. Both four and nine percent developers must take on risk in acquiring properties and forecasting construction pricing. The four percent tax credit tax-exempt bond transactions have a high proportion of foreclosable debt, for which the developer is ultimately responsible. The developer fee compensates developers for these risks, for

which they may not receive any compensation for up to four to six years of pre-development work and overhead.

Maximizing developer fees, within reason and the constraints of the law and regulation, is a proven and successful method of increasing eligible basis, raising additional LIHTC equity and generating more production through the TEB program. In effect, progressive approaches to structuring developer fee policy can serve as an alternative to gap financing in a project, allowing HCAAs to prioritize soft dollars for other needs.

HCAAs should consider separate developer fee policies from their nine percent programs that include the following features:

- Developer fee calculation will include all eligible basis of the property (i.e. acquisition basis and hard costs), less reserves.
- Fifteen percent cap on paid developer fees.
- Allow for additional total developer fee in excess of 15 percent provided that this additional increment of developer fee is *deferred* for projects demonstrating documented need, and perhaps meeting additional criteria as defined the HCAA. To comply with tax law, developers and investors must size deferred fee to demonstrate that it can be reasonably paid by year 13 of the compliance period.
- No fixed dollar amount or per unit limitation on developer fees.

Recommendation: Include all documented and reasonable acquisition costs in eligible basis to maximize viability of preservation transactions.

TEBs are particularly well suited for preservation transactions and QAP policies should be designed to encourage their use for the preservation of existing LIHTC, Section 8 and USDA Rural Development properties. So long as it is supportable by a credibly conducted, methodologically sound, independent and disinterested third-party appraisal, HCAAs should allow for all reasonable acquisition costs to be included in eligible basis. Policies should not penalize related party transactions or the use of seller-financing as long as it is supported by a credible appraisal and complies with the IRS regulations governing related party transactions and true-debt.

5. <u>Allow Developers to Choose Financial Partners</u>
Public policy governing TEB programs should be aligned to allow developers to select the financial executions most suitable for the given project and their business model.

Recommendation: HCAAs should allow developers to choose from the broadest set of financial products as possible so that developers can leverage the financing that makes the most sense in their particular set of circumstances. Gap funding should not be tied to a specific permanent loan product. Additionally, program requirements should align with and subordinate to common products like Fannie Mae's MBS Tax-Exempt Bond Collateral, Freddie Mac's Tax Exempt Loan and Bridge to Re-Syndication FHA's Section 223(f) and Section 221(d)(4) loans. State and local governments should ensure that their laws do not preclude the use of such products.

6. Driving Efficiency in the Underwriting Process

Many parties have a significant stake in ensuring that multifamily TEB transactions are thoroughly underwritten. Developers, issuers, investors and lenders all have a significant financial interest in the underwriting process, while HCAAs and soft-lenders may be more concerned with compliance and policy. While essential, underwriting, particularly when multiple parties are involved, can also be a source of significant delays, which may impair a transaction from closing and create transactional inefficiencies (particularly if third-party reports become stale or construction costs must be rebid). In some states both the HCAA and the bond issuer may fully and sequentially underwrite a transaction, leading to costly and unnecessary delays.

Recommendation: When conducting a financial underwriting of four percent LIHTC transactions, HCAAs, conduit issuers and soft lenders should rely on and defer to the underwriting conducted by the issuer, investors and permanent lenders, which have the most capital at risk. HCAAs can create a more efficient underwriting process by narrowing their underwriting to threshold, programmatic and compliance issues and delegating the financial assessment to at-risk capital providers as much as possible.

Recommendation: When possible, HCAAs and soft lenders should consider entering into MOUs or interagency agreements to further align, delegate, streamline and/or eliminate duplicative programmatic underwriting. At a minimum, when multiple agencies are involved, underwriting should be conducted on a parallel rather than a sequential basis to facilitate more timely processing.

7. Encourage Policy Flexibility, Transparency & Transactional Velocity

TEBs benefit from flexible and transparent policies that are applied quickly and predictably.

Recommendation: QAP should clearly give HCAA's the ability to waive non-statutory program requirements at their discretion to help facilitate more transactions. HCAAs should routinely publish all approved waivers so that others in the development community can be aware of agency policy and seek waiver approval.

Best Practice: OCHS includes the following in its 2016 QAP:

> "All OHCS policies other than those mandated by Section 42 are considered as guidelines and may be waived. A written request for a waiver or exception, accompanied by justification, may be submitted to OHCS. QAP waivers will be documented for all projects and regular periodic publications of waivers will identify the applicant, the QAP provision waived and the reason for waiver. In addition, the summary for projects recommended for funding may identify and explain waivers granted for any projects listed.
>
> At least 30 days prior to the construction/equity closing date for applications, applicants, lenders or syndicators must request a waiver or exception to a policy in writing with a full justification. Furthermore, OHCS reserves the right to waive any provision or requirement of the QAP that is not stipulated in IRC Section 42 in order to affirmatively further fair housing.

If OHCS acts contrary to or fails to take action in accordance with this plan or any other program requirement, such act or omission does not constitute a waiver by OHCS of a project, person or other entity's obligation to comply with the provisions of this plan, other program requirements, or establish a precedent for any other project, person or entity. In any event, no waiver, modification, or change of OHCS Program Manuals or any other program requirement will be binding upon OHCS unless it is in writing, signed by an authorized agent of OHCS and consistent with law."

8. Allow & Encourage the Average Income Election

The Average Income (AI) election allows affordable housing communities to serve a wider range of income and in doing so, subsidize the rents of lower-income tenants through the rents charged to higher-income tenants.

Recommendation: HCAAs should adopt regulations that allow developers to make the AI election on TEB transactions, so long as they also comply with the Section 142 minimum set-aside elections. Policies should further permit TEB transactions that demonstrate need to utilize gap funding resources designed to reach very low-income residents such as the National Housing Trust Fund and/or rental vouchers in conjunction with AI to serve lower-income tenants.

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[i] Council of Development Finance Agencies. 2018. *CDFA Annual Volume Cap Report: An Analysis of 2017 Private Activity Bond & Volume Cap Trends*. Columbus, OH: Author.

[ii] At the time of publication, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Reserve (the three CRA regulators) were working in concert with the U.S. Department of the Treasury to modernize the CRA. As a result, the tests and assessment areas for financial institutions may change dramatically, thereby altering how financial institutions invest in affordable housing.

[iii] Oregon Housing and Community Services. 2016. *Low Income Housing Tax Credit 2016 Qualified Allocation Plan*. Salem, OR: Author.