2016 Stakeholder Outreach: 4% LIHTC Roundtable
August 13, 2015

Oregon Housing and Community Services (OHCS) is looking forward to further developing its 4% LIHTC program. As a result of the stakeholder outreach efforts, and engaging Novogradac & Company LLP to perform a comparative program analysis, we anticipate that there will be recommended changes to the state's Qualified Allocation Plan (QAP).

The guiding principles that OHCS is seeking to utilize throughout this process are:

- Clarity – We are looking to continually improve our funding processes to be ***clear*** to all stakeholder participants as to the eligibility requirements and desired policy outcomes.
- Consistency – We are seeking to provide ***consistent*** responses to all stakeholder participants and apply standards ***consistently*** across all applications for funding.
- Predictability – Our goal is to have a ***predictable*** funding process with respect to timing and criteria.

BACKGROUND

The state of Oregon has recognized the large need for affordable housing in all communities, both urban and rural. In order to best address the need, it is imperative all programs operate as efficiently and effectively as possible. OHCS understands that this resource has the potential to create additional affordable units and preserve existing units.

OHCS has engaged Novogradac & Company LLP to perform a third-party comparative study of Oregon's 9% and 4% LIHTC programs with ten other states. The study will be utilized to recommend changes to our current practices including changes to the QAP, OARs, program manuals, etc. We are looking to incorporate best practices, and add clarity to our programs.

WHY WE ARE HERE TODAY

We are looking to engage with the 4% LIHTC stakeholders to get a better understanding of perspectives, recommendations, and feedback about how the application process and policies impact project design and implementation. The desired outcomes are to:

1. Develop a better overall understanding of the roles of participating parties in a 4% transaction;
2. Identify where financial guidelines pose challenges when they are not aligned with outside requirements; and
3. Understand where there is and is not clarity throughout the process.

A successful development should allow for the on-going operation of housing units for the benefit of low income residents in a way that furthers statewide and local efforts and reduces the need for additional subsidy in the future.

A better understanding of the challenges, good ideas and feedback from stakeholders who participate in this competitive process will allow OHCS to improve the measures and standards that are implemented in the upcoming NOFA.

OHCS DRIVERS

There are two (2) main things that drive how OHCS looks at any 4% LIHTC transaction:

1. Affordability – OHCS views an award of LIHTCs as purchasing affordability for the period of time that is outlined in the land use restrictive covenants.
2. Subsidy Layering – As the state Housing Finance Agency, OHCS has the fiduciary responsibility to ensure that the amount of subsidy that is being provided to a project is appropriate for the project's financial viability for the entire affordability period and that the project is not over subsidized based on the scope of work and accompanying sources and uses available.

DISCUSSION GUIDE

What follows is a listing of topics for discussion; identifying overarching questions and known issues with spaces for participants and staff to take notes about experiences and recommendations for each topic.

The issue of roles has been a topic that has come up in multiple transactions when OHCS is not the bond issuer. This will be a place where OHCS will be interested in providing clarity to potential project sponsors so that the question of roles has been asked and answered. It is anticipated that this clarity will be added to the QAP.

topic:	**Roles**
question:	- What are the roles of the Housing Finance Agency and the bond issuer when allocating 4% LIHTCs? - What are the appropriate parameters for valuation?
currently:	OHCS has the responsibility for verifying both the projects alignment with the QAP as well as the verification that no excess credits are awarded.
issue:	Transactions must stand on their own merit; the credits are intended for the specific real estate transactions in the application, not intended to subsidize other activities outside of the real estate transaction. The real estate transaction must be based on defensible and consistent variables for valuation and underwriting for a sustainable project.
stakeholder input:	- Valuations that are accepted by Lenders and Investors should be accepted by OHCS - If there are deferred fees, doesn't that indicate an appropriate subsidization? - Find the balance between maximizing credit with other public resources and scarce cash resources - Must meet the needs test; there is no requirement that no other part of the project should be allowed to be funded with the transaction. These are different issues - It's not an issue if the transaction is funding something else; that perspective skews the underwriting process - Doesn't incent cash investment (to be more stringent) above what might be covered when actual equity comes - M letter does not allow for the review / update of credits; should indicate that at 8609 it will be evaluated - Oregon vs Washington M letters; different perspectives and culture reflected - Want Gap funds that work with the 4% LIHTC/Tax-exempt Bond transactions; more leverage - Preservation projects have other sources of gap funds - 4% LIHTCs only cover 30% of the cost so there are huge costs that could be addressed with gap funds - Could leverage more by incorporating 4% LITHCs with other funds - 4% LIHTCs are a great way to stretch other public dollars - Need to maximize equity from 4% LIHTCs - Work to INNOVATE; how can we stretch the way they are used - OHCS risks deterring lenders / investors from working in Oregon by facing too many challenges in maximizing equity investment
recommendation:	

In an attempt to meet our policy objectives and regulatory requirements we are looking at a number of our programmatic policies and procedures. First and foremost are our Affordability Requirements and Restrictive Covenants.

topic:	**Affordability Period**
question:	What is the appropriate affordability period for all OHCS programs given the subsidy that is being provided to a project?
currently:	60 year standard on all programs, with the exception of 4% LIHTC which is currently 30 years.
issue:	- Affordability period does not always align with the timeline of the resource subsidy (for example: OAHTCs go away after 20 years at which point the subsidy that lowers the rent no longer exists in the project). - 60 years is not within the useful life of a multifamily housing project. - Other funders worry about the ability to change the extended use agreement over a 60 year period of time.
stakeholder input:	- OAHTC – 20 years, after that time rental subsidy is extinguished - 30 year affordability for 4% LIHTCs is not clear enough in the QAP - Affordability requirements should be in line with fund sources - Documents should be consistent, and cop vs partner – transfer provision
recommendation:	

topic:	**Restrictive Covenants**
question:	Should OHCS restrict the ability for projects to come back in for additional funding?
currently:	No restrictions currently.
issue:	Funding the same projects within their affordability period impedes investment in new projects and may reflect projects not adequately funding reserves or performing routine maintenance. Reinvestment may be necessary to preserve housing.
stakeholder input:	- Cost of bond issuance; should compare that against other funding - No restriction on coming back, if reinvestment not warranted that should come up in the underwriting process - 30 years should be the expectation
recommendation:	

It is our hope that we can set guidelines or standards that can be used in an underwriting "lite" process. Ideally if a project fits between specific ranges, as outlined in the guidelines, the project would not require extensive analysis on the part of OHCS to determine financial viability and subsidy layering. The target for OHCS would be that the guidelines:

- Provide for sustainable projects throughout the affordability period; and
- Be aligned with standard operating guidelines of other industry funding partners.

topic: **Underwriting Guidelines**

question:
- What feedback can this group lend about the current guidelines?
- Where do you see that OHCS is not aligned with other funders?
- What causes issues in the funding process for projects?

Standard	OHCS Current	Other Funders
Vacancy Rate	7%	5-7% generally
Escalation Income & Expenses	2% Income/3% Expenses	Expenses 3% Use trend analysis of HUD AMI for income; rarely see 2% income gain in current market

DCR	During the 1st 20 years: 1.20 w/replacement reserves 1.15 w/project based rental assistance	1.15-1.20 generally
Rent Levels	10% below market rents	Market study and portfolio comps
Operating Expenses	$4,500 per unit per year without replacement reserves	Extensive analysis using their historic LIHTC portfolios
Expense Ratio	N/A	
Management Fee		5-7% generally
Tenant Services		Above the line when services are integral to the target population being served

stakeholder input:

- Need to lessen unnecessary hurdles
- Standards (Op Expense) create problems; projects operate differently (varying populations / geographies, etc.
- Asset Management Fees – above the line; internal vs external property management, needs to account for costs accepted by other lenders/investors
- Policy vs Practice – if the intent is to be open and just want an explanation, make sure staff have the ability (and practice of) to accept out of guideline figures
- Previously used to be able to explain line by line which gave this opportunity on the front end
- Process question: when challenges to expenses occur? They should happen earlier vs later in the underwriting process
- Process / timing issue: when letters are issued and timing of when issues with pro forma are raised
- Process: should have council give "up to" approval earlier instead of waiting for final approval once everything is figured out, this holds up the process and leaves a huge unknown for too long
- Can the state defer to lender/investor analysis of Operating expenses?
- Perhaps a flexible approach around operating expenses that leans toward lender/investor?

notes:

In addition to OHCS underwriting guidelines, there are other standards for construction and contingencies in place to ensure adequate resources for projects through the construction period. OHCS recognizes that it is important for these to be aligned with the other funders involved in a transaction.

topic: **Construction Standards**

question:
- What feedback can this group lend about the current standards?
- Where do you see that OHCS not aligned with other funders?
- What causes issues in the funding process for projects?

Standard	OHCS Current
ADA and Visitability	ADA must be met, and all new construction must meet Visitability policy in Oregon statute. (ORS 456.506; excludes 4%) [plus Section 504 sensory impaired units when using HOME]
Rehabilitation Level	Minimum as outlined by IRS Preference is $30,000 per unit
CNAs	All rehab requests must have CNA which thoroughly assesses maintenance, repair, and health and safety issues in addition to considering longer term physical needs and replacement reserve analysis.
Soft Costs	30% of Total Project Costs or less
Hard Cost Contingencies	New Construction: 5% Rehabilitation: 10%
Soft Cost Contingencies	All Projects: 5%
Payment & Performance Bonds	Nice to have, but not required

stakeholder input:
- HUD/RD doesn't require 100% unit inspection for CNA; HUD and RD are coming out with a joint approach that OHCS should consider adopting.
- Rehab standard is it a min vs a max; sometimes it is treated as a max by loan officers
- Post rehab CNA, useful for knowing the useful life / reserves

notes:

In an effort to ensure long-term financial viability, OHCS understands the need for appropriate reserves.

topic: **Reserve Requirements**

question:
- What feedback can this group lend about the current requirements?
- Where do you see that OHCS is not aligned with other funders?
- What causes issues in the funding process for projects?

Standard	OHCS Current
Replacement Reserves	Seniors: $300/unit/year All Other: $350/unit/year Required to go with the property in the case of a transfer.
Capitalized Operating Reserves	Not required – Generally capped at six (6) months of operating expenses plus debt service
Capitalized Debt Service Reserves	Not required
Other Capitalized Reserves	Not required

issue: What happens to capitalized reserves during the life of the transaction?

stakeholder input:
- Contingencies – address issue of putting money elsewhere, allow higher percent if can be used to add more to construction / rehabilitation
- Reserves should vary by new / rehab ; based on size of the building / size of the units.
- Not sure a standard makes sense for reserves
- RD reserves are higher
- Post rehab CNA is useful for understanding the useful life and reserves
- Maintenance reserves – using an average isn't good enough, results in deferred maintenance
- Maintenance costs vary by bedroom size
- RD reserves are so much higher and always need to be justified for OHCS

notes:

OHCS is looking to provide clarity to sponsors as to how much developer fee is allowed and the breakdown between cash and deferred fee to be paid from project cash flow, as well as any differences between developer fees for non-arm's length acquisitions.

topic: **Developer Fee**

question: What recommendations would this group provide to OHCS with respect to developer fee?

Standard	OHCS Current
Total Developer Fee	Cannot exceed 15% of Total Project Costs, including acquisition, less capitalized reserves, and requested developer fee.
Cash	Rule of thumb: 50% of the fee should be in cash between closing and construction completion.
Deferred	Deferred fee should be shown to reasonably be expected to be paid by year 12.

stakeholder input:

- Developer assumes long term risk of the project; if higher or deferred they should get them
- Exclude acquisition costs when calculating developer fee
- Developer fee isn't just the cost of the brick / mortar
- Developer fee is the cost of development / pays for the risk
- OHCS should allow the maximum amount of developer fee, cap cash fee if that is an issue and allow for deferred fees that can be paid out over time.
- 15% of total development cost is not a safe haven in determining reasonable developer fee
- Clear understanding of how OHCS wants to see the fee calculated would be helpful

notes:

topic: **Cost Containment**

question: Should the 4% LIHTC Program have a cost containment objective?

currently: Used as a soft threshold; projects need to explain if they don't meet the cap as defined which is based on the previous 5 years of LIHTC projects.

Threshold in 9%; excludes acquisition cost

	Metro	Balance
0 Bdrm	$200,000	$145,000
1 Bdrm	$222,000	$180,000
2 Bdrm	$272,000	$220,000
3 Bdrm	$306,000	$260,000
4 Bdrm	$325,000	$275,000

issue: Doesn't incentivize lower cost projects; there are no points currently associated with the exception of Preservation projects as it pertains to prudence of investment.

stakeholder input:

recommendation:

topic: **Subsidy Level**

question: Should OHCS establish subsidy cap per unit, or other measure?

currently: No cap

issue: With questions surround Subsidy Layering, could this provide shorthand criteria that would provide clarity around appropriate subsidization?

stakeholder input:

- Shouldn't leave basis on the table that you can reasonably access – doesn't attract equity investment

recommendation:

topic:	**Acquisition Credit; Arm's length vs Non-arm's length**
question:	- Should acquisition credits be available to projects doing a related party transaction? - If available, how much is reasonable to limit the acquisition credit in a related part transaction as required by code?
currently:	Required by code to limit valuation for an allocation credit in a related party transaction; OHCS currently allows a limited credit.
issue:	Analysis plays a role in subsidy layering
stakeholder input:	- Related party transactions have sincere 3rd parties engaged and investing so it's not a literal internal transaction so shouldn't be treated as though it was - 3rd party appraisal and operations/income; if you don't base it on that what is the rationale for a reduction? - Acquisition cost needed - There are rules around the value of the land; not just putting money into the building - If seller financing is OK and necessary to make deal - Acquisition credit minimizes need for gap funding - Separate the issues of valuation from what the money is used for - Shouldn't leave basis on the table that you can reasonably access – doesn't attract equity investment - Need to expand the use of 4% LIHTCs for new construction and rehabilitation of existing projects - Acquisition credit is a critical tool in making 4% LIHTCs work; don't eliminate
recommendation:	

topic:	**Market Studies/Appraisals/Valuation Considerations**
question:	• Do Lenders and Investors require separate Market Studies and Appraisals? • If so, what is the primary purpose of each in the underwriting process? • What values are important to the various project funders? • Should OHCS order their own appraisal?
currently:	OHCS requires a FIRREA appraisal and market study, though the market study components may be included in the appraisal. OHCS utilizes the market study information to ensure there is adequate need in the area and anticipated LIHTC rents are below market. OHCS utilizes the appraisal to determine acquisition credit, if applicable, and provides a data point for anticipated expenses.
issue:	
stakeholder input:	- Dangerous to bring two different valuations when criteria are the same, how would they be reconciled? - Expensive to order more than one appraisal, not in-line with cost containment - Difficult in income streams / timeline- future values vs today; different valuations have different focus and are used for different things; can't use one for the other - Could add parameters to existing appraisals or pick on that you want - Timing question – valuation comes after pro forma, so it should be OK when the values change - Should have a work group around valuation
recommendation:	

topic:	**Other Issues**
notes:	