2016 Stakeholder Outreach: Lender and Investor Roundtable
July 30, 2015

Oregon Housing and Community Services (OHCS) is looking forward to the 2016 - 9% low income housing tax credit (LIHTC) funding round, as well as further developing its 4% LIHTC program. As a result of the stakeholder outreach efforts, as well as 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 cycle with respect to timing and criteria.

BACKGROUND

The state of Oregon has recognized the large need for affordable housing in all its communities, both urban and rural. Over the past three years, OHCS has been transforming its competitive 9% LIHTC process from the Consolidated Funding Cycle (CFC) to a Notice of Funding Availability (NOFA). This was accompanied by a rewrite of our QAP, Oregon Administrative Rules (OAR), and program manuals. The focus was to provide as much flexibility as possible throughout all of our documents.

The outcome of this approach has been mixed. Though flexibility can be valuable, our 9% LIHTC program has not provided adequate goal posts, if you will, to provide the clarity and predictability that LIHTC project sponsors are accustomed. Therefore OHCS has engaged Novogradac & Company LLP to perform a third-party comparative study of Oregon's 9% and 4% LIHTC programs against 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.

OHCS is limited in funding 9% LIHTC projects based on the amount of annual credits the state is allocated by the federal government. Consequently we are looking to more formally develop a 4% LIHTC program that can be utilized to fund additional units. This raises the question whether or not there should be different programmatic standards from one program to the next? If so, what should be the same and what should be different?

WHY WE ARE HERE TODAY

We are looking to engage with the LIHTC Lender and Investor communities to get a better understanding of the inherent challenges, and where there may be alignments, between the numerous funders in LIHTC projects. The desired outcomes are to

1. Have a better overall understanding of the considerations various funders have when participating in an affordable housing project;
2. Understand where there is alignment across funders and where there may be differences; and

3. Recognize whether or not the various funders apply different standards for underwriting to 9% LIHTC projects and 4% LIHTC projects.

It is safe to say that all funders have the same overall outcome in mind when determining to fund a LIHTC project – The successful development and on-going operation of new, or rehabilitation of existing, affordable housing units for the benefit of low income residents.

Having a better understanding of the things that drive each of the funding groups may be helpful in gaining additional perspective and focusing the dialogue where differences are encountered.

OHCS DRIVERS

There are two (2) main things that drive how OHCS looks at any 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.

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 is our **Affordability Requirements**.

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:	Projects are often seeking recapitalization with additional OHCS resources prior to the end of the affordability period. May be a sign that the affordability period is too long.
other states:	Many states set 30 years as the affordability period for LIHTC projects, understanding that for 9% LIHTCs there is a federal preference if the project sponsor were to elect a longer affordability period.
recommendation:	HOME; 30 years LIHTC (All); 30 years GHAP/HDGP; 30 years OAHTC; 20 years WX; 10 years HELP; 10 years
mtg notes:	✓ Would they get additional points in the app for going further – yes; there would be some form of limit as to when they could come back for recapitalization. ✓ Might want to look at what restrictions occur in year 30 / ability to revisit the incomes served in order to remain viable as affordable housing

Secondly, in furtherance of our drivers, we are looking at our Underwriting Guidelines. It is our hope that we can set some guidelines and/or standards that can be used in an underwriting "lite" process that can be utilized for both 9% and 4% LIHTC transactions. The thought here is that if a project fits between specific ranges as outlined in the guidelines that the project would not require extensive analysis on the part of OHCS to determine financial viability and subsidy layering. The target for OHCS guidelines would be that they should:

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

topic:	**Underwriting Guidelines**
question:	Should the Underwriting Guidelines be the same for 9% and 4% transactions when analyzing for financial viability and subsidy layering?
currently:	OHCS's underwriting guidelines are consistent for all programs offered.
issue:	OHCS has been questioned as to the level of underwriting being done on 4% LIHTC transactions.
other states:	Obtaining third-party comparative study against 10 states that may help inform this question.
mtg notes:	May want to look at higher DCRs in 4% LIHTC/Tax-exempt Bond transactions
recommendation:	

topic:	**Underwriting Guidelines**
question:	What recommendations would this group provide to OHCS with respect to setting underwriting guidelines?

Standard	OHCS Current	Recommendation
Vacancy Rate	7%	7% as a standard, but can vary depending on the specific transaction; 5% on rent subsidized units
Escalation Income & Expenses	2% Income/3% Expenses	Income may be growing slower – based on 10 year trend of AMI in the county where the project is located
DCR	During the 1st 20 years: 1.20 w/replacement reserves 1.15 w/project based rental assistance	Generally same targets, but specific project underwriting plays a role in the sizing of the permanent loan.
Rent Levels	10% below market rents	
Operating Expenses	$4,500 per unit per year, excluding replacement reserves	$4,900 per unit per year, including replacement reserves is average, but not how it's underwritten
Expense Ratio	N/A	

Management Fee		5%-7%, typically 6%
Tenant Services		

mtg notes:

- ✓ If there is a mix of subsidized and unsubsidized; looking at the revenue a combination of 5 and 7%
- ✓ Anything around 20 units 7% vacancy is just one unit; small project underwriting is different
- ✓ The more restricted the project is as to target population or other set-asides, the higher the vacancy rate
- ✓ Why would the state put a generic guideline on operating expenses? There are typical expenses, but all deals and geographies are different, family units will be higher while senior units may be lower. Appraisals are not utilized in the underwriting process to determine appropriate expenses. Investors and Lenders are looking at their portfolios of loans and investments to determine appropriate expenses through a comprehensive analysis
- ✓ Operating expense shifts on acquisition/rehabilitation projects are not anticipated to be more than 10% savings depending on the transaction and historic project performance. Any shift greater than 10% raise flags
- ✓ HUD requires utility analysis
- ✓ Assumptions around escalation – expenses always seem to escalate at 3% or more, but income doesn't actually escalate at the assumed 2%; being realistic about income escalation makes a difference in looking at viability over the long term. A number of counties only escalate 0.5% and underwrite accordingly - -2% increase may be out of alignment with what is actually possible.
- ✓ Look at a 10 year trend for local area AMIs; try to see if they can find any cushion to be able to raise rents if needed
- ✓ Seems like most important is if the perm loan is adequately sized
- ✓ Resident services mean very different things to different sponsors / projects. Seeing a lot building services into the operating line; though RD does not allow that. Lenders and Investors require above the line for certain target populations, such as disabled populations where the services are integral to the success of the resident and project.

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topic:	**Underwriting Guidelines**
question:	• Are there differences between Lenders and Investors with respect to basic underwriting guidelines? If so, what? • Are different underwriting guidelines utilized for 9% LIHTC and 4% LIHTC transactions?
Issue:	It would be helpful to understand the basic underwriting guidelines utilized by other funders that help to ensure the financial viability of LIHTC transactions. Where those guidelines align with OHCS's, and where there may be differences and why.

Standard	Current Market Standards for Lenders/Investors
Vacancy Rate	
Escalation of Income & Expenses	
DCR	
Rent Levels	
Operating Expenses	
Expense Ratio	
Management Fees	
Tenant Services	

notes:	Notes incorporated in the Underwriting Guideline table above.

For purposes of reviewing applications it would be help to have an understanding of current market loan terms.

topic:	**Primary Debt Loan Terms**
question:	What are the typical terms of the loan provided by the primary lender?

Standard	Current Market Standards for Lenders
Interest Rate	100 BP cushion over current rate
Term	18 years
Amortization Schedule	30 years
Requirements to Convert from Construction to Permanent Debt	90 days stabilized at the underwritten DCR
Construction Loan Fees	1.0% – 1.5% of loan amount with minimum $7,500 floor
Permanent Loan Fees	
Other	

mtg notes:	✓ Look at something like a 100 basis point cushion in underwriting ✓ HUD side it is fixed; will put 50 basis cushion on those that are depending on debt cover ✓ HUD follows treasury; 275 basis points over 10 year treasury rates

- ✓ Investors don't want the term to be shorter than 18 years; don't want to still be in the deal when they need to go back to refinance
- ✓ Fees can be charged all up front or at conversion, depends on the deal

It is important for all funders to understand the potential impacts to sources and uses when equity pricing changes during the pre-closing process. To that end, we have provided our current thinking as it pertains to changes in equity pricing.

topic:	**Tax Credit Pricing**
question:	• How to set equity pricing for financial viability of a LIHTC application? • What do you do when the amount is different at time of closing?
currently:	OHCS relies on the sponsor to estimate the credit pricing in their application. It is evaluated for reasonableness based on type of transaction, location, and recent closings. Main concern when equity increases without a corresponding increase in construction costs revolves around the subsidy layering analysis. If pricing is higher at closing, OHCS is looking for the additional source to be spent on one or more of the following: • Items valued engineered out of the project between application and closing; • Additional reserves if appropriate; and/or • Cash developer fee is under the "rule of thumb" If costs have not risen, then OHCS would look at the following: • Potential reduction of other grant funds provided by OHCS; • Lower primary debt that could support lower rents being charged; Main concern when equity decreases is that if the project competed in the a 9% LIHTC NOFA, that the project is substantially the same as the one described in the application. If pricing is lower at closing, OHCS is looking at the following gap fillers: • Some level of value engineering; • Sponsor Equity; • Funds from other gap lender; and/or • Increasing deferred developer fee
issue:	In 9% LIHTC applications the tax credit pricing used by the sponsor is conservative given the early stage of development. Typically, the pricing is higher at the time of closing. Same can occur in a 4% LIHTC transaction.
mtg notes:	Build partnership management fee of 5% into the transaction; not shown able to be paid consistently, but gives room to be able to pay if cash flow is available Discussion of projects taking money out of the deal / developer fee etc; differing perspectives from the state

	Lenders appear to be closer aligned with OHCS than investors given the refinance risk sometime after year 15. Suggestion to see what other states do; not sure that there is as much concern elsewhere about the over subsidization question Reserves can be a good thing in terms of making sure the project is feasible long term; operating reserves can be an asset to provide for a refinance / soft landing.

In addition to the federally required basis boost, OHCS has identified criteria for a state designated basis boos that can bring additional equity to the funding structure.

topic:	**State HFA Designated Basis Boost**
question:	What types of projects have OHCS designated as being eligible for the state's designated basis boost?
currently:	• Involves acquisition or rehabilitation of preservation projects with at least 25 percent of the units having federal project-based rent subsidies • Projects serving permanent supportive housing goals • Projects located in an area where workforce housing needs are identified or community needs show a preference for the housing in the area • Projects located in Transit Oriented Districts or Economic Development Regions as designated by local governments, or projects in a designated state or federal empowerment/enterprise zone or Public Improvement District (PID's), or other area or zone where a city or county has, through a local government initiative, encouraged or channeled growth, neighborhood preservation, redevelopment, or encouraged the development and use of public transportation. • Projects that result in the de-concentration of poverty by locating low-income housing in low poverty areas, which are Census Tracts where less than 10 percent of the population lives below the poverty level.
meeting notes:	It was suggested to allow the state basis boost in 4% LIHTC transactions. We are not able to do this given federal program regulations. Difficult to develop areas are now going to be by zip code and not by county. May have positive and negative impacts on project currently in the pipeline.

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In addition to OHCS underwriting guidelines; there are other standards for construction and contingencies in place to ensure adequate sources for projects through the construction period. It is important for these to be somewhat aligned with the other funders involved in a transaction.

topic: **Construction Standards**

question: What recommendations would this group provide to OHCS with respect to construction standards?

Standard	OHCS Current	NOTES
Green Building Features	A green building standard of construction must be met, with the exception of projects funded exclusively with bond and/or 4% tax credits. Certification of compliance must be provided.	
ADA and Visitability	ADA must be met, and all new construction must meet Visitability policy in Oregon statute.	
Cost Containment	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	
Rehabilitation Level	Minimum as outlined by IRS Preference is $30,000 per unit	Seems reasonable; Thinks Washington has a floor Will go as low as $20k
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%	Seem right where they are; historic rehab often increases costs based on

		the specific situation
Soft Cost Contingencies	All Projects: 5%	Normally assume 2% (on bond deals) See them in almost every deal
Payment & Performance Bonds	Nice to have, but not required	
notes:		

OHCS is looking to better understand how Lenders and Investors view Developer Fee and the typical payout from transaction closing; through construction; lease-up; issuance of IRS Form 8609; and how they view deferred developer fee to be paid from project cash flow.

topic: **Developer Fee**

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

Standard	OHCS Current	Recommendation
Total Developer Fee	Cannot exceed 15% of Total Project Costs less capitalized reserves, and requested developer fee.	Can this be adjusted if it's a high-demand project?
Cash	Rule of thumb – minimum of 50% of the fee should be in cash between closing and stabilization.	
Deferred	Deferred fee should be shown to reasonably be expected to be paid by year 12.	
notes:		

In an attempt to better understand the perspectives of other funders and how they mitigate risk, we would like to understand what types and level of reserves the lender and investor community require on LIHTC transactions and under what circumstances they are released.

topic: **Reserve Requirements**

question: What recommendations would this group provide to OHCS with respect to setting reserve requirements or standards?

Standard	OHCS Current	Recommendation
Replacement Reserves (new consruction)	Seniors: $300/unit/year All Other: $350/unit/year Required to go with the property in the case of a transfer.	Higher on large family units and rehabilitation projects
Capitalized Operating Reserves	Not required – Generally	Typically includes debt

		capped at six (6) months of operating expenses, unless satisfactory rationale is provided	service
	Capitalized Debt Service Reserves	Not required – If required by Lender or Investor, must provide satisfactory rationale for requiring	
	Other Capitalized Reserves	Not required – If required by Lender or Investor, must provide satisfactory rationale for requiring	
notes:			

topic:	**Reserve Requirements**
question:	• Are there differences between Lenders and Investors with respect to reserve requirements? If so, what? • What types of reserves are required on a typical 9% LIHTC transaction? • What types of reserves are required on a typical 4% LIHTC transaction? • Are there other types of capitalized reserves required under other circumstances? • Are there restrictions on spending the reserves? If so, how can the project access the reserves when needed? • Are reserves released to the general partner/managing member within the first 15 year compliance period? If so, when (i.e., date specific; when benchmarks are reached; etc.)?
Issue:	It would be helpful to understand the backstops in place that help to ensure the financial viability of LIHTC transactions.

	Standard	**Current Market Standards for Lenders/Investors**
	Replacement Reserves	
	Capitalized Operating Reserves	
	Capitalized Debt Service Reserves	
	Other Capitalized Reserves	
notes:	Ensure there is reserve spend down language so that sponsors have the ability to spend down the reserve balances prior to exit of the investor at or around year 15.	

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It is important to understand how each funder utilizes the various studies required.

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?
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.
mtg notes:	Do our own market study; rely on the appraisal from the developer / construction appraisal (there are some specific things that they look for). Do internal market study; know that deferred maintenance impacts value & there's question about what is considered deferred (immediate vs nice to do elements) Do not look to appraisal for expenses – existing portfolio is better source of how projects will operate going forward. HUD looks at loan to cost for some programs Acquisition basis determined from appraisal Restricted vs unrestricted value;

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topic: **Other Issues**

AMI relief if Section 8 goes away to ensure fiscal viability.

Flexibility over incomes served in the long run will have an impact on long term viability

Look at transfer language associated with investor to an affiliate – to allow without consent.

Add " not unreasonably withheld" to the transfer language requiring OHCS approval.

Look into Treasury requiring trustees on private placements on 4% LIHTC transactions.

Opportunity – NOAH – Create a shared pool for operating reserves so that large reserve balances are not being built up in every project. (Investors to keen on the idea).

Keep up on potential market change related to relocation expenses not being allowed in basis going forward.

Sponsor Capacity – Need to more clearly define what adequate capacity looks like.

notes: