

## One Housing Finance Agency's Response to the Equity Shortage

By Mark Shelburne, North Carolina Housing Finance Agency

Through June and July of 2008, the North Carolina Housing Finance Agency's (NCHFA) rental development staff worked on a new task: underwriting all low-income housing tax credit (LIHTC) project applications using two different sets of assumptions. The first assumed that the status quo would be maintained while the second presumed Congress would enact the Housing and Economic Recovery Act (HERA). The legislation became law on July 29, 2008.

Because of these concurrent analyses, the LIHTC awards that the agency made on August 15 incorporated both HERA's additional ceiling and new 9 percent minimum rate. The timing worked out well and we were glad to be past what felt like a fast-moving process with a great deal of uncertainty. We hoped the rest of the year would be back to normal.

Not quite.

September began a series of months that made us nostalgic for the relative calm of the summer's dual application review. North Carolina was not spared in the national equity shortage and many good projects were unable to secure commitments from investors or syndicators (more on those projects later). NCHFA has always considered developers and equity providers to be partners, so we were determined to figure out how to help.

### Determining What Was Wrong

The first step was gathering information. In addition to communicating with developers, we contacted investors and syndicators to ask about their plans. We also asked what NCHFA could do to bring more of their capital to North Carolina. The good news was that our underwriting requirements already contained equity providers' most

important criteria (described below). On the flip side, this fact also meant we had little room to maneuver.

The next step was to identify problems. Based on extensive input from interested parties, the most immediate and pressing need was for time. Many projects awarded in 2007 were facing an impossible Catch-22. Owners needed to start construction promptly to ensure properties would be ready to place in service by the December 2009 federal deadline; yet they could not do so without equity in hand. However, investors and syndicators did not want the risk of committing to projects that provided little or no flexibility in their construction schedules. The 2008 awards were in jeopardy of ending up in the same situation.

The other major concern was the impending gap in sources due to falling equity prices. In March 2008 NCHFA held meetings with owners to determine deal-specific responses to a hypothetical 80-cent equity price (this assumption was substantially less than used in the 2007 applications). These responses that included financial restructuring and forward commitments of additional LIHTCs addressed market conditions at the time. Unfortunately many deals were not able to close, and in just six months 80-cent pricing went from conservative to optimistic.

### Help for '07 and '08 Awards

With information gathered and problems identified, NCHFA developed a three-part plan, the first two parts were intended to help pipeline projects and the third was developed for the 2009 Qualified Allocation Plan (QAP).

On October 2, 2008 NCHFA announced that owners would have the option of returning their 2007 and 2008 LIHTC allocations in exchange for an award of the same amount from the state's 2009 authority. This action, known as re-

*(continued on page 2)*

# One Housing Finance Agency's Response

(continued from page 1)

cycling or refreshing, pushes back to December 2011 the projects' federal deadline to place in service. The extension relieves the pressure to start construction, thereby removing a risk that had impeded securing equity commitments.

The returned credits will roll into the available ceiling for 2009, resulting in no loss to the state. The exchanged 2009 LIHTCs are non-competitive and automatic. Although this is a first for NCHFA, allocating agencies have always had the ability to recycle allocations. Some have done so for reasons such as giving more time to address NIMBY challenges or other regulatory delays.

The second part of the plan responds to lower equity pricing. Owners seeking exchanged allocations could also ask for the agency-designated 30 percent boost as allowed in HERA, and those awarded in 2007 could request their LIHTCs reflect the new 9 percent minimum rate. (As mentioned above, the latter was already part of the 2008 cycle.) Having a larger allocation should mean more equity, thus fully or partially filling the gap

in sources. These increased amounts were not automatic but rather based on NCHFA's determination of feasibility as required under Internal Revenue Code Section 42(m)(2)(A).

## Rapid Results

The deadline for requests was December 1, 2008. The goal was to process them quickly so that owners would be ready to hit the ground running for any equity that may be available in 2009.

Owners submitted 64 requests. Rental development staff processed them in 11 business days, obtaining approvals on December 16. The total was for \$31.9 million in annual LIHTCs, of which \$5.4 million is to increase allocations for 46 projects. Reservation letters went out to owners that week.

The restructuring of sources assumed 60-cent equity pricing in order to be conservative. This is not the expected outcome; NCHFA hopes that owners will be able

(continued on page 3)

### Journal of Tax Credit Housing Editorial Board

**Publisher** ♦ Michael J. Novogradac, CPA

**Editor** ♦ Jane Bowar Zastrow

**Managing Editor** ♦ Alex Ruiz

**Staff Writer** ♦ Jennifer Dockery

**Technical Editor** ♦ Robert S. Thesman, CPA

**Contributing Writers** ♦ Mark Shelburne, Brandi Day,  
Brendan Kelly, Buzz Roberts

**Production** ♦ James Matuszak

### Journal of Tax Credit Housing Advisory Board

**Frank Baldasare** ♦ CW Capital

**Bud Clarke, MAI** ♦ MMA Financial

**Jana Cohen Barbe** ♦ Sonnenschein Nath & Rosenthal LLP

**Tom Dixon** ♦ Boston Capital

**Wendy Dolber** ♦ Standard & Poor's Corporation

**Rick Edson** ♦ Housing Capital Advisors Inc.

**Anthony Freedman** ♦ Holland & Knight

**Richard Gerwitz** ♦ Citi Community Capital

**John Lisella** ♦ SunAmerica Affordable Housing Partners Inc.

**Philip Melton** ♦ Grandbridge Real Estate Capital

**Stephen Ryan** ♦ Cox, Castle & Nicholson LLP

**Sheldon Schreiber** ♦ Pepper Hamilton LLP

**Arnold Schuster** ♦ Sonnenschein Nath & Rosenthal LLP

**Rob Wasserman** ♦ U.S. Bancorp Community Development Corp.

### Journal of Tax Credit Housing Information

Address all correspondence and editorial submissions to:

Jane Bowar Zastrow

Telephone: 415.356.8034

Address inquiries regarding advertising opportunities to:

Carol Hough

Telephone: 415.356.8040

Editorial material in this publication is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding the low-income housing tax credit or any other material covered in this publication can only be obtained from your tax advisor.

© Novogradac & Company LLP, 2009 All rights reserved.

ISSN 1940-4980

The Journal is printed using non-toxic soy-based ink. Novogradac & Company LLP encourages readers to recycle

Novogradac & Company LLP  
246 First Street, 5th Floor  
San Francisco, CA 94105  
E-mail: cpas@novoco.com



# One Housing Finance Agency's Response

*(continued from page 2)*

to find better offers.

An important note is that that some of these projects had a commitment of equity at the time or obtained one after the recycling notifications.

## Project Characteristics and Underwriting

NCHFA has always considered the LIHTC allocation process to be about more than limiting subsidy. Our practice is to review applications as proposals for real estate investment. The eight-person rental development staff includes construction, underwriting, legal/policy and managers and collectively has 120 years of real estate experience, nearly half of that experience being in the private sector.

Because of this perspective and excellent work by developers, any difficulties in securing commitments from investors and syndicators are not due to the projects themselves. The following is a summary of the recycled projects' characteristics as they relate to equity considerations.

- **Good Sites:** The rental development staff has visited and scored well over 1,000 sites during the last 10 years. This point scoring is a major factor in determining the very competitive new construction awards. The two main criteria are quality of life for tenants and long-term investment viability; for example, distance to a grocery store and extent to which the area is experiencing economic growth or decline. Negative features nearby (e.g., wastewater facilities) reduce the score or result in disqualification.
- **Strong Markets:** NCHFA's standards for evaluating markets have been consistently conservative, even to the point of being critiqued for being too conservative. All studies for projects awarded in 2008 cycle were positive, with a median capture rate of 12.5 percent. The median vacancy rate among comparable projects was less than 3 percent. Results from 2007 awarded applications were similar. Developers working with analysts determine the best

unit mix for the market, as opposed to following QAP preferences.

- **AMI Growth:** The area median income has been increasing for all counties in which one or more of the 64 projects are located.
- **Low Leverage:** Bank loans account for only 8.4 percent of the total sources. The rest is covered with equity and subsidized financing, including North Carolina's unique refundable state tax credit. On average, these projects expect a 96 percent paid developer fee (as of the award date).
- **Experienced, Capitalized Developers:** All developers must have recent and successful LIHTC experience to be eligible for an award. The QAP does not encourage capacity building nor does it reward joint ventures. The 30 different development groups awarded in the previous two years have completed an average of eight projects, and 16 have related party general contractors and/or management companies.
- **Debt Coverage Ratios:** The average anticipated first year DCR for the recycled projects is 1.42 (as of the award date).
- **Full Reserves:** The QAP requires all projects to have an operating reserve equal to six months operating expenses and debt service, and rent-up reserves of \$300 per unit; both are capitalized up front.
- **State Portfolio:** Ernst & Young's 2007 "Understanding the Dynamics IV" report on performance shows that North Carolina's current operating projects are in the top 10 among states for both DCR and occupancy rate (1.30 and 97 percent, respectively).
- **Green:** At least 50 of the 64 will meet Energy Star requirements and all will incorporate many other green features, such as low-maintenance exteriors and high-efficiency HVAC systems.
- **Lack of "Hair":** The recycled projects have no market-rate units or commercial space, there are no supportive services funded or operated by the projects, only one is focused on a spe-

*(continued on page 4)*

# One Housing Finance Agency's Response

*(continued from page 3)*

cialized population, and the QAP deeper rent targeting is for only 25 percent to 40 percent of the units and is reasonable based county income levels.

## Upcoming for 2009

The last stage of our three-part plan was to change the QAP in order to make 2009 projects even more attractive to equity providers. These were important revisions but not radical departures from the past. They included: changing the income and expense escalations, increasing hard cost contingency and operating expense minimums, allowing applications to include an additional contingency for cost overruns, and authorizing NCHFA

to set a maximum equity price assumption.

We now know better than to think that this is the last challenge NCHFA, developers, investors and syndicators will face in 2009. The new year promises to be just as fast-moving and uncertain as the end of 2008. ❖

*Mark H. Shelburne is counsel and policy coordinator for NCHFA's Rental Investment Department. Previously he was in-house counsel for a regional LIHTC syndicator. He can be reached at [mshelburne@nchfa.com](mailto:mshelburne@nchfa.com) or 919-877-5645. Mark would like to dedicate this article to Steve Culnon, former director of rental development who is now happily retired in Las Vegas.*

---

*This article first appeared in the February 2009 issue of the Novogradac Journal of Tax Credit Housing.*

© Novogradac & Company LLP 2009 - All Rights Reserved

*Notice pursuant to IRS regulations: Any U.S. federal tax advice contained in this article is not intended to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties under the Internal Revenue Code; nor is any such advice intended to be used to support the promotion or marketing of a transaction. Any advice expressed in this article is limited to the federal tax issues addressed in it. Additional issues may exist outside the limited scope of any advice provided – any such advice does not consider or provide a conclusion with respect to any additional issues. Taxpayers contemplating undertaking a transaction should seek advice based on their particular circumstances.*

*This editorial material is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding property compliance or any other material covered in this article can only be obtained from your tax advisor. For further information visit [www.taxcredithousing.com](http://www.taxcredithousing.com).*