MFA 2016 Low Income Housing Tax Credit (LIHTC) Initial Underwriting Supplement

This underwriting supplement outlines the standards that MFA will use when underwriting Initial Applications submitted for consideration in the 2016 LIHTC competitive allocation round. MFA underwrites Initial Applications for two purposes: 1) to determine the amount of credits that may be allocated to each proposed Project and 2) to determine the financial feasibility of each proposed Project. MFA will use the more conservative of the financing terms listed in this underwriting supplement, the 2016 QAP or the proposed Project's Financing Commitment(s) or letters of interest.

<u>Credit Pricing</u>

MFA will not use a single credit pricing factor for 2016 Initial Applications. MFA has established a floor of $.88 and a ceiling of $.98 for the credit pricing factor and will underwrite the Project using the factor contained in the letter of interest (LOI) from the proposed credit syndicator or investor as long as it is within this range. In no case will MFA underwrite using a credit pricing factor outside of this range unless, in MFA's sole discretion, a drastic change in market conditions at the time of underwriting necessitates a change.

<u>Debt Financing Terms</u>

First mortgage permanent must-pay debt: Will be underwritten using the interest rate contained in the LOI from the proposed financing source plus a 50 basis point contingency factor but not to exceed 6.5% all-in rate. If no LOI is provided, a 6.5% rate will be used. MFA will underwrite to a maximum 30 year amortization for bank loans. Federal financing provided by USDA Rural Development, HUD MAP Lenders or MFA 542(c) Risk Sharing loans will be underwritten to a maximum of 40 year amortization for new construction or 35 years for rehabilitation unless otherwise stated in an LOI.

Subordinate permanent must-pay debt: MFA Housing Trust Fund loans may be underwritten at 3% interest and 30 year amortization. MFA HOME loans will be underwritten per the 2016 HOME/LIHTC term sheet (i.e. as necessary for financing gap) but not to exceed 0% interest and 80 year amortization due in 40 years. Both of these sources may be used during construction for up to two additional years. HOME funds provided by the cities of Albuquerque or Las Cruces will be underwritten to terms provided by those jurisdictions.

<u>Minimum Debt Service Coverage</u>

Cash flow proformas must reflect the ability to repay all must-pay debt with an aggregate minimum debt service coverage ratio (DSCR) of 1.20:1 on all must-pay debt. Projects that fail to produce sufficient cash flow may be deemed financially infeasible and may be rejected. Conversely, MFA may reduce the Tax Credit award and/or other loans and/or subsidies, increase the interest rate on MFA subordinate loans or shorten loan amortization if a Project has a DSCR on all must-pay debt in excess of 1.40:1. MFA will consider total annual cash flow as well as DSCR when making this determination.

<u>Deferred Developer Fee</u>

Unless otherwise stated in the investor LOI, MFA may assume that up to 100% of the developer fee can be deferred but not to exceed cumulative projected excess cash flow.

<u>Project Operating Assumptions</u>

Proposed Project operating expenses (excluding reserves and resident social service expenses) should be between $3,300 per unit and $4,800 per unit. Applicants proposing operating expenses below $3,300 must provide historical documentation supporting their ability to successfully operate similar LIHTC Projects at that level.

Applicants proposing operating costs above $4,800 per unit must provide documentation justifying higher expenses.
All projects will be underwritten using a maximum inflation factor of 2% for rent and other income and a minimum inflation factor of 3% for expenses. An exception to this is that a 2% inflation factor will be used for management fees & related gross receipts taxes since these fees are usually charged as a percentage of net revenue. A vacancy factor of 7% will be applied to all rental income unless a higher vacancy factor is recommended by a market study. For projects with at least 90% of all units covered by a federal rental assistance contract MFA will use the market study vacancy factor but not less than 5%.

Operating Reserves
Operating reserves must be a minimum of six months operating expenses (including replacement reserve payments and social service delivery costs) and all must-pay debt service.

Construction Contingency
New construction costs will be underwritten to include minimum construction contingency of 5% of hard construction costs. Adaptive Reuse and rehabilitation construction costs will be underwritten to include a minimum construction contingency of 10%. For this purpose hard construction costs are defined as the amount listed in MFA Schedule D "VII. Total Construction Costs". Note that Contractor Overhead & Profit, General Requirements and gross receipts tax (GRT) tax are not to be included.

Acquisition/Rehabilitation Developer Fee Split
The amount of developer fee included in 30% basis will be proportional to acquisition cost divided by total development cost (TDC). For example, if acquisition costs are ¼ of TDC, ¼ of developer fee will be included in 30% basis. No deductions are made from TDC for the purpose of calculating the developer fee split.

Investor Letters of Interest
In addition to stating a credit pricing factor, investor letters of interest must include standard underwriting terms such as minimum DSCR, minimum reserve requirements, income and expense inflation factors, investor fees, and equity pay-in schedule.

Adjusted Gross Median Income and Rents (AGMI & AGMR)
MFA will underwrite using the LIHTC AGMI & AGMR in effective as of its November 12, 2015 Qualified Allocation Plan (QAP) training. These be found on the MFA website via the following link "Effective March 6, 2015": http://www.housingnm.org/developers/income-and-rent-limits