WASHINGTON STATE
HOUSING FINANCE
COMMISSION

Link To: [Notice of Public Hearing – August 25, 2011]

memorandum

To: Program Stakeholders

From: Steve Walker

Date: August 17, 2011

Re: Proposed Revisions to LIHTC Program Policies for 2012 Program Year

The following represents proposed changes for the 2012 Tax Credit Program Policies. These changes are the byproduct of in-house staff discussions and individual and group stakeholder discussions as well as informal input received over the past year. All changes have been discussed at public meetings held in Spokane and Seattle.

Revisions ratified by the Commission will be incorporated in the tax credit Policies and Application materials for the 2012 tax credit allocation cycle. Our preliminary estimate is that the application package would be ready for distribution in mid-September, assuming Commissioners take final action on the proposed changes on August 25th. The remainder of this memo summarizes each issue and the intent behind each proposal as well as the proposed new policy language.

1. Modify Fully Funded Policy and Eliminate the Readiness Score – Chapter 5

Issue: For funding from non-public sources, current Fully Funded policy requires a lender ordered appraisal at the time of application. This policy has worked to create a standard comparable to being "approved for funding" under a public funding process. However, it has also contributed to some unintended consequences.

Specifically, the appraisal requirement tacitly commits the borrower to the lender before having a credit allocation. This in turn may inhibit the borrower's ability to strategically and competitively package construction lending with their equity. In addition, given current FIRREA regulations (Financial Institutions Reform, Recovery, and Enforcement Act of 1989), loans must be closed within 6 months of the appraisal or else a new appraisal must be ordered. Project closings often happen more than 6 months after application; therefore, this policy can unintentionally trigger the ordering of a second appraisal.

Currently, there are two different point minimums in the Policies: an Application Point Minimum and a Fully Funded Readiness Score. The Fully Funded Readiness Score is no longer necessary given the current number of allocation point criteria and the current level of competition.

Proposed Changes:
- To be considered Fully Funded, all necessary public resources and any source of funds that is allocated on a competitive basis (e.g. FHLB AHP funds) must be fully committed at the time of application. Require that Applications include documentation of committed funds.
- For any private debt sources, a letter of interest from the expected lender must be provided. Eliminate the lender-ordered appraisal requirement.
- Eliminate Readiness Score; Change Application Point Minimum to a minimum of 132 points excluding Housing Needs points. Change the Rural Development Set-Aside minimum to 105 points excluding Housing Needs points.

2. Replace current 221(d)(3)Total Development Cost Limit policy with an alternative Cost Limit policy –Chapter 3

Issue: Total development cost (TDC) limits have always been a part of program policy. To date, the HUD 221(d)(3) Mortgage Limits have been used as the basis for the TDC Limits policy. The HFA community has found these HUD limits to be an imprecise indicator of development costs. Over the years, the policy has used various escalation factors in efforts to mitigate deficiencies. While our policy objective of cost containment remains unchanged, we want to implement a better cost gauge than the HUD 221(d)(3) Mortgage Limits.

Proposed Changes:

Cost Database - The new TDC Limits policy is based on the analysis of 3 years' worth of in-house cost data. Staff has compiled a cost database using development cost data from 105 projects comprised of 6,735 units from:
- Competitive 9% applications
- Recent final cost certifications for both competitive 9% and bond /tax credit deals
- Final development budgets for all ARRA funded projects.

New project cost information will be added on an ongoing basis.

The size of cost database provides a representative sample and is informative. However, it is limited and staff is sensitive to its restrictions. For example, there is a large enough sample of projects in King County to determine appropriate cost limits for the King County context. There is also a large enough sample to determine limits for the Balance of State. However, the samples quickly shrink when the data is parsed by county or by city; by project type (new construction or rehabilitation); or by construction type (high rise, low rise, garden style). We acknowledge that the Balance of State category is broad and accounts for little variance in development context. As the cost database grows, the potential for further refinement exists. However, staff is also mindful that the adopted model must be reasonable to maintain over time.

Furthermore, we recognize that limits based on the Cost Database may not be appropriate in every circumstance. The proposed policy waiver component and its administration is a critical part of this proposal.

In crafting this policy, a number of approaches have been considered: cost per unit limits, cost per square foot limits, cost per bedroom limits, cost per unit by project type limits (e.g. Supportive Housing, Large Household, etc.), and cost per unit by number of bedrooms limits. While each indicator above has its strengths and weaknesses, staff has determined that cost per unit by number of bedrooms is the best indicator to address the wide variety of project types funded with tax credits.

By isolating the unit cost data by number of bedrooms, staff has been able to analyze project data by project type and location. We were able to isolate outliers and examine their role in influencing the resulting cost limits. Using cost per unit by number of bedrooms is also consistent with the approach of the current policy and thus simplifies implementation.

Link to: Total Development Cost Limits Data

The Policy

Similar to the current Total Development Cost Limit policy, this new proposal imposes a Total Development Cost limit calculated using cost per unit limits differentiated by number of bedrooms in a unit.

This new Total Development Cost Policy includes the following elements:

- Total Development Cost = Total Project Cost excluding the cost of land and capitalized reserves.
- All units (including common area units) are included in the calculation.
- Supportive Housing projects (i.e. 75% Homeless) will use the King County limit schedule regardless of location.

The Total Development Cost limit is the sum of the total number of units of each bedroom size multiplied by the respective cost limits. Unlike the current policy, there will not be any escalation factors applied to these limits. The policy differentiates projects in King County from the Balance of State.

Limit Schedule

	Studio	One Bedroom	Two Bedroom	Three Bedroom	Four+ Bedroom
King County	$195,000	$220,000	$260,000	$315,000	$347,000
Balance of State	$135,000	$152,000	$184,000	$239,000	$263,000

Waiver of the Total Development Cost Limit
A waiver of the Total Development Cost Limit must be requested and approved in writing 60 days prior to submission of the Application. Applications submitted that exceed the Total Development Cost limit without an approved waiver will be disqualified and not considered further.

Waiver requests will be evaluated to determine whether additional costs are reasonable and justifiable under the circumstances, attributable to unique development characteristics, and consistent with the housing needs and priorities identified in the Policies.

If a Project exceeds the Total Development Cost Limit by 20% or less, the waiver is subject to the approval of the Tax Credit Program Director. If a Project exceeds the Limit by more than 20%, the waiver must be approved by the Executive Director prior to the submission of the Application.

Changes in Total Development Costs
The intent of this policy is to encourage the communication of any unanticipated changes in project costs. In order for any increases in TDC to be recognized in the Maximum Developer Fee calculation, such increases must be proactively communicated and approved by the Tax Credit Director. The Commission retains the right to disallow any development cost.

Any costs in excess of the Total Development Cost Limit reflected in the Final Cost Certification that have not been approved in advance by the Tax Credit Director, will not be recognized for the purposes of calculating the Maximum Developer Fee.

Cost Containment Incentive
It is the intention of staff to add a cost containment incentive in the form of Allocation Criterion points to the Policies for the 2013 tax credit allocation round.

3. Credit Per Unit Limits – Chapter 3

Issue: In 2009, as a response to coinciding increases in the cost of construction and significant decreases in credit investment pricing, the WSHFC passed a temporary increase to the program's credit per unit policy, applicable only to the 2010 and 2011 housing credit allocation rounds. As a part of that 2009 policy action, these temporarily increased limits revert back to the published 2009 level (escalating as prescribed under policy by any increases to the per capita authority rate) for the 2012 program year.

Proposed Changes: Reset Credit Per Unit Limits according to the 2009 policy.

The new Credit per Unit Limits for 2012 are as follows:

- Per unit credit limit is **<u>$14,784</u>*** per low-income housing unit.
- Per units credit limit for projects located in a QCT, DDA or deemed Eligible for the State Designated Boost is **<u>$19,181</u>*** per low-income housing unit.

*These limits include a 2.38% increase over the 2009 limits to account for the 2011 increase in the per capita authority rate ($2.10 to $2.15). Should the 2012 per capita rate be greater than $2.15, these limits will be adjusted accordingly. The per capita authority rate is typically published in December.

4. Targeted Area Points and Community Revitalization Plan Points – Chapter 6

Issue: The policy intent for the Targeted Areas point category is to give priority to proposals that are demonstrably responding to affordable housing planning efforts by local, state or federal governments.

Current policy awards 5 allocation points for projects located in one of four areas-

1. A qualified census tract (QCT)
2. A difficult development area (DDA)
3. Area targeted by the local jurisdiction
4. Eligible Tribal Area

<u>QCTs</u> are those census tracts in which 50% or more of the households are income eligible (i.e. 60% AMGI or below) and the population of all census tracts that satisfy this criterion does not exceed 20% of the total population of the respective area. In areas where more than 20% of the population qualifies, census tracts are ordered from the highest percentage of eligible households to the lowest. QCTs are often the poorest census tracts in a jurisdiction.

<u>DDAs</u> are areas (generally Counties) designated by HUD with high construction, land, and utility costs relative to its AMGI.

Unlike DDAs, projects located in Qualified Census Tract (QCT) alone do not satisfy the intent of the Commission's Targeted Area policy. Rather than award allocation priority "points" for projects simply located in QCTs, staff is investigating a better policy approach to prioritize local affordable housing needs.

Staff will be proposing a more comprehensive Targeted Area policy for implementation beginning in 2013. To initiate this process, we propose phasing out prioritizing QCTs as a targeted area.

Proposed Changes:

- Require requests for Community Revitalization Plan (CRP) points to be submitted 60 days in advance of application deadline for preapproval *[Beginning in the 2012 Allocation Round].*

- Eliminate QCT from the list of areas eligible for Targeted Area points *[Beginning in the 2013 Allocation Round].* Note: The 130% eligible basis boost for projects located in QCTs is a provision of Section 42 of the IRC and is unchanged by this policy proposal.

- Consider enhancing targeted area policy by incorporating CRP into the definition. *[Beginning in the 2013 Allocation Round].*

5. Sustainable Development Standards

Issue: Current Policy requires all tax credit projects comply with the Evergreen Sustainable Development Standard (ESDS). The ESDS is required by legislative mandate of all Housing Trust Fund Projects. In a spirit of concurrence, the Commission has followed suit with its own ESDS requirement. At the time of implementation, there was not clear evidence of other comparable sustainable development standards and the Commission determined that ESDS was most appropriate. Since that time, other national recognized standards have evolved.

Additionally, the Department of Commerce has recently replaced the original version of ESDS (v1.3) with a substantial update (v2.0).

Proposed Changes:

- Projects applying after January 1, 2012 must comply with ESDS v2.0. Projects applying prior to January 1, 2012 are subject to ESDS v1.3.
- 4% tax credit/tax exempt bond deals only - Recognize the existence of acceptable sustainable development standards comparable to the ESDS. Applicants proposing to use an alternative standard must gain approval by the Commission prior to submitting an application.

6. **State Designated Basis Boost**

Issue: Under current Policy, Rural Projects are automatically eligible for the State Designated Eligible Basis "boost;" there is no approval process. Non Rural Projects who are seeking a State Designated Eligible Basis boost must currently make a request for the boost as part of the tax credit application. Approval of these Non Rural Project state boost requests is made on a case by case basis by the Commission as part of the tax credit application review process.

This current process creates uncertainty for the Non Rural Projects who are seeking the boost since the Commission's review of the boost request is not made until after the application is submitted. By implementing a pre-application approval process for Non Rural Projects seeking the state designated boost, those applicants will have a response to their approval request prior to submitting a tax credit application and can structure their application accordingly.

Proposed Changes:

Create a pre-approval process for Non Rural Projects seeking a State Designated Eligible Basis Boost. Non Rural Projects who are seeking a State Designated Eligible Basis boost must submit a request for the boost 60 days in advance of the application deadline. *Note: There is no change to the current policy for Rural Projects, who remain automatically eligible and approved for the State Designated Eligible Basis Boost.*

Reminder: The State Designated Eligible Basis Boost is not available to tax-exempt bond financed projects.

7. **Tax Credit Regulatory Agreements**

Notice: The Commission is in the process of changing the Regulatory Agreement recording process. Beginning in 2012, the Tax Credit Regulatory Agreement will be recorded as part of the equity closing process.