September 30, 2022

Tara Hall
North Carolina Housing Finance Agency
3508 Bush Street
Raleigh, NC 27609

Dear Ms. Hall:

Thank you for the opportunity to contribute this feedback, which we hope will inform the development of the State of North Carolina's 2023 Draft Qualified Allocation Plan. We look forward to collaborating with the North Carolina Housing Finance Agency (NCHFA / the Agency) as you develop your affordable housing priorities. Lincoln Avenue Capital (LAC) is a mission-driven affordable housing developer currently active in twenty-two states. In North Carolina we are primarily focused on developing ground-up new construction affordable housing as well as preservation of existing affordable housing utilizing a combination of 9 percent LIHTCs and 4 percent LIHTCs with tax-exempt bonds (TEBs).

Market Context

As affordable housing developers, the biggest challenge we face today is inflation and the escalating cost environment. The combination of rapidly rising land costs, building acquisition costs, construction materials costs and labor costs is a significant barrier to financing and delivering quality affordable housing developments to the market. Increases in construction costs have been well documented but we are experiencing cost inflation in many other critical areas impacting development proformas. Over the past 12 months we have experienced:

- 42.7% increase in property casualty insurance premiums
- 31.8% increase in property management payroll
- 61.2% increase in contract services costs
- 54.2% increase in general & administrative (G&A) expenses
- 59.9% increase in turnover related expenses
- 63.7% increase in owner-paid utilities
- ~50%+ YOY increase in projected development costs for projects around the country

At the same time, rising interest rates have reduced the debt proceeds we are able to leverage to offset these rising costs.[1] 4 percent LIHTC transactions are financed primarily with tax-exempt debt, comprising approximately 70 percent of the capital stack, so the impact of even small increases in interest rates is magnified significantly for these transactions. We believe the current market dynamics are important to share as they provide context and urgency for many of our recommendations below.

[1] Our industry had benefited from historically low interest rates; however, as monetary policy has shifted, we believe there is an added sense of urgency to take additional action. Since the beginning of the year the yield on the 10-year Treasury has tripled, increasing from 1.5% to as high as 3.96% on September 26, 2022. Furthermore, given the signaling from the Federal Reserve, we anticipate rates to continue to rise in the coming year.

Draft QAP Comments

II. (A) Set-Asides

We appreciate that NCHFA prioritizes the construction of new housing units in its 9% program. In recent years, the low-interest rate environment has made it possible to preserve many affordable assets using tax-exempt bonds and 4% LIHTCs. As interest rates and inflation continue to take their toll, we believe many high-priority preservation assets will no longer be feasible as bond deals without additional resources. We suggest NCHFA consider raising its Rehabilitation Set-Aside to help address these needs.

II. (B)(2)(v) Redevelopment Projects

We request NCHFA clarify the definition of "donation of at least one parcel of land" in the context of II(2)(v). Many jurisdictions are willing to contribute or make available municipally owned land for affordable housing as part of a redevelopment project in the form of a long-term below-market land-lease. We believe this meets the spirit and intent of the above provision and recommend that NCHFA amend this section to make clear this is permissible what terms.

We further suggest NCHFA consider contributions of land from other community stakeholders to qualify. In our experience, many successful redevelopment projects have had land contributed by other stakeholders including houses of worship, community land trusts, philanthropic institutions or the business community. We suggest that contributions of land from other stakeholders, in concert with a municipalities resolution to address deterioration in the designated area should meet the definition of "donation of at least one parcel of land."

II. (E)(3) Agency-Designated Basis Boost

We appreciate that NCHFA will permit a discretionary basis boost for deeply income-targeted new construction projects as well as projects located in Opportunity Zones. Given the rise in interest rates and ongoing inflation relating to construction costs we recommend NCHFA consider raising the discretionary boost to the statutory maximum of 30% if costs warrant. We also suggest expanding the types of projects eligible for a discretionary basis boost to also include high-impact preservation properties including expiring Section 8 projects as well as projects nearing the year-30 decontrol period.

III. (A) Application and Award Schedule

We appreciate that NCHFA has a rolling application for projects financed with tax-exempt bonds and 4% LIHTCs. We urge NCHFA to extend the window in which it will receive bond applications, ideally accepting applications closer to the beginning of the year through the end of October. Given the current velocity of sales of raw land and existing multifamily buildings, limited window application cycles may not align with the expectations of the marketplace and sellers may be unwilling to consider purchase offers with lengthy options.

One of the most attractive features of the four percent LIHTC program to developers is the relative certainty and speed of execution. Developers that can meet the threshold and can execute quickly and flexibly in capital markets have a high degree of confidence of a potential award and can

commit to shorter option periods, making them more competitive in the acquisition marketplace. Extending the length of the window will also allow developers to conduct additional due diligence on the front-end of transactions, which should lead to better applications. We recognize that it may be necessary to increase the number of NCHFA board meetings to coordinate with an extended application window. Given the ability to host public meetings and board meetings remotely we hope this can be accommodated without too much disruption or cost.

III. (B) Application, Allocation, Monitoring and Penalty Fees

We believe it is important that NCHFA assess fees sufficient to cover their costs to efficiently administer the LIHTC. As such, we think it is appropriate for the Agency to raise its program fees from time-to-time as market conditions evolve. As explained in the "market context" section of these comments, affordable housing developers are also experiencing significant rising costs and reduced financing proceeds due to rising interest rates. Every project we are currently working on around the country is currently grappling with new project financing gaps that we are currently working on fill by attempting to raise new gap financing resources, value engineering and as well as increasing the amount of deferred to developer fees.

Given these conditions, we respectfully ask NCHFA to reconsider the scope of the fees increases it is proposing in the draft 2023 QAP. We hope that conditions will stabilize over 2023 and that fees can be reevaluated in the next QAP. If it is critical for the operations of NCHFA to raise program fees, we respectfully ask the agency to reconsider the amount of the increase.

III. (C)(7) Application Entity

We appreciate that NCHFA requires a single point of contact to coordinate with through-out the application process and that the point of contact the agency coordinates with should have appropriate decision-making authority. We suggest that this requirement be modified slightly so that the "applicant" need not become the managing member or general partner of the ownership entity. This requirement may preclude a non-profit or emerging developer to work with an experienced partner on a turn-key basis when they that might otherwise exit the partnership once a project has been completed and stabilized.

IV. (C)(1)(a) Maximum Project Development Costs

We appreciate that NCHFA is proposing to revise the threshold for its Maximum Project Development Costs negative points. Given the unprecedented market conditions relating to construction costs, we recommend eliminating this provision entirely in the 2023 QAP. Until the market stabilizes it is difficult to determine what are appropriate development costs and eliminating this provision will save NCHFA the burden of having to do a mid-year update or adopt waivers. Furthermore, there are other incentives in the QAP that will motivate developers to contain costs. If NCHFA is determined to retain cost caps, we suggest increasing the thresholds by at least 50% percent and then to commit to review this number periodically during the year and make further adjustments as market conditions evolve.

IV. (C)(2)(a)(iv) and (vii) RPP Awards

We appreciate and support NCHFA increasing the RPP funds maximum award to $1,000,000 and the maximum award to any one principal to $2,000,000.

IV. (D)(1)(a)(ii) Development Experience

We believe that a successful track-record of LIHTC development experience is an indicator of likely success. We believe that the criteria established in VI(D)(1)(a) are largely appropriate with one exception – as indicated above, namely that the principal must become a general partner or managing member of the ownership entity. We believe that this will make it more difficult for non-profits, PHAs, and emerging developers from building out their local experience as well as their respective balance sheets, which is critical to their future success as independent developers. We believe that so long as the “experienced” developer remains contractually engaged in the transaction through the stabilization period in a responsible capacity they should not need to be part of the general partnership or serve as the managing member. Alternatively, NCHFA might consider a different level of participation in the partnership to be sufficient (for example a Class B LP/SLP).

IV. (E)(3) Unit Mix and Project Size

We do not think the QAP should assess negative points for the inclusion of market-rate units. There is an abundance of research that demonstrates that low-income residents living in mixed-income communities have better outcomes. Furthermore, many communities across the country require or incentivize the development of mixed-income communities. Additionally, the cross-subsidization provided by the market rate units may be integral to completing the capital stack. Lastly, this policy may also preclude the inclusion of a manager’s unit, which may be desirable. While we appreciate that the QAP has some mitigating factors to allow exceptions from this penalty we do not believe the policy ultimately serves the interests of the community. We also observe that if NCHFA has market concerns at individual relating to the mixed-income nature of a project it can reject the application based on the results of the market study.

We also believe the strength of the housing market should also dictate the overall size of tax-exempt bond funded projects. We do not believe that project sizes should be capped at 200 units in the QAP if the market supports larger projects and a market study indicates an ability to absorb the proposed units. There are several sub-markets in the Charlotte and Raleigh-Durham metros where there is strong market demand for affordable housing. In some cases, the land is entitled for projects exceeding the 200-unit limit. These sites may be highly desirable for affordable housing, but a LIHTC developer will be unable to compete with a conventional developer if they are constrained by the number of units that can be developed in the QAP. While we appreciate that the agency can approve larger projects on a waiver basis, we think this policy limits the pool of developable sites and may even drive up land costs in some cases. We suggest that the market study and availability of funding resources are more effective tools for determining appropriate project size. If this cap is not eliminated, we suggest that NCHFA consider outlining conditions in which a developer can be confident that the waiver will be issued (for example, if the project has an overall capture rate not to exceed 15%).

IV. (F)(3) Units for the Mobility Impaired

We appreciate NCHFA desire to increase the number of units in new construction projects for the mobility impaired. We request that NCHFA also clarify if the following clause applies to all projects (including rehab projects) or if it only applies to new construction projects: "if laws or codes do not require mobility impaired units for a project, a total of ten percent (10%) of the units must be full accessible." While most preservation projects currently funded by NCHFA will have accessibility requirements dictated by HUD, we observe that while desirable in the unassisted portfolio, many year-15 LIHTC properties will not be able to generate the proceeds necessary to make additional units accessible while also addressing other critical life and safety issues. In this situation, we do not believe that setting a 10% threshold for accessible units would be in the best interest of the program.

IV. (F)(4) Targeting Program

We appreciate NCHFA's desire to serve individuals with disabilities and persons who are homeless. We are concerned that this requirement may be difficult to achieve for shallow subsidy 4% LIHTC projects that are dependent on achieving 60% AMI rents for underwriting (especially acquisition-rehab projects) unless project-based vouchers are made available to the project. As the agency knows, not all housing authorities have vouchers which they can project-base, which may ultimately leave some communities underserved. While we also appreciate that NCHFA may be willing to waive this policy if the agency determines they are not feasible, we recommend the QAP be updated to explicitly define the parameters in which the agency will issue a waiver. This predictability enhances our ability to execute on transactions.

IV. (F)(5) Olmstead Settlement Initiative

We understand that because of Olmstead, projects are incentivized to have 1-bedroom units, but it is unclear to us why the standard for bond deals is different than the point standard for 9% LIHTCs. We recommend that this should be brought into parity by setting the floor for the number of 1-bedroom units for bond deals at 7.5%.

IV. (F)(7) Tiebreaker Criteria

While we appreciate the individual components of the tiered tiebreaker in the QAP, we suggest NCHFA consider reweighting the items to focus on serving the greatest housing needs. We believe at present that the project with the lowest average income targeting should be the first or second tiebreaker.

IV. (H)(1) Replacement Costs

We appreciate that NCHFA is revising the threshold for its maximum replacement costs. Like our recommendation above, we recommend raising this threshold by 25% to $175,000.

V. (A) Order of Priority for the Allocation of Bond Cap

We believe that there is a fundamental supply shortage of affordable housing in the state of North Carolina, particularly in the largest metro areas. We appreciate that the state heavily prioritizes new construction in the 9% program via its set-asides. We believe that the current prioritization

structure for the bond program may result in no new unit production via the 4% LIHTC in today's private activity bond (PAB) cap constrained era. While we do believe it is important that the bond program support preservation, we also believe that the highest need and generally larger urban and suburban markets would benefit from larger scale new construction affordable housing projects. As such, we suggest that NCHFA revise its QAP to create a set-aside of PAB for new construction high priority projects financed with bonds. We believe a set-aside of not less than 25% would be appropriate. If there is insufficient demand for this proposed new construction set-aside it could be released back to a general pool under the current prioritization order at some point mid-way through the application cycle.

V. (B) Eligibility for Award

LAC has acquired more than twenty thousand affordable apartments across the country over the past six years and we typically undertake at least $25,000 per door in hard rehabilitation expenses and often two to three times more, particularly when we recapitalize the asset with LIHTCs. We believe it is a reasonable best practice to set a minimum rehabilitation threshold but suggest that an alternative approach may be more effective in meeting NCHFA mission requirements. We conduct a comprehensive physical capital needs assessment as part of all our LIHTC rehabs. This is required by NCHFA and our financing partners and helps us devise an appropriate scope of work and capital plan for the asset.

As NCHFA is aware, the needs of assets vary considerably. For example, we have acquired year 15 LIHTC assets out of Qualified Contract that have been well maintained by their prior owners. Presumably, the prior owner maintained the property to a high standard because of their intention to decontrol and attract higher income market rate clientele. An asset with this fact pattern would benefit from the extended affordability of a tax credit recapitalization even if its rehab scope was limited. Conversely, we have acquired aged assets where the PCNA has identified a scope of work that exceeds $100,000 per unit. Rather than raise the minimum floor to $40,000 per door in hard rehabilitation expenses, we recommend amending this section to retain the current floor but clarify the rehab scope be the greater of the needs identified in the PCNA or $25,000 – 30,000 per unit floor.

VI. (A)(5) Concentration

We believe deconcentrating poverty and providing affordable housing in communities of opportunity are important allocation policy goal. We generally support NCHFA's threshold requirement forbidding development in areas of minority and low-income concentration unless there is a community revitalization plan. However, we urge NCHFA to consider a more holistic evaluation of the ineligible areas. There are sites that may be adjacent to higher-income, less concentrated census tracts that would be disqualified because they are on the proverbial wrong side of the street. We believe this will be particularly prevalent in opportunity zones. We recommend that NCHFA add language allowing for additional exceptions for sites that are within a reasonable distance from eligible census tracts.

VI. (A)(6) Displacement

We concur with NCHFA that all rehab projects should have a relocation and tenant displacement plan. We do not believe that NCHFA should apply the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 unless they are a covered asset. This additional compliance

requirement may add additional costs that are not necessary for the scope of the rehab and the tenant needs.

VI. (B)(4) Reserves

We appreciate and support the elimination of the rent up reserve in the drat QAP. We recommend that the agency amend its policy on Operating Reserves to apply only through the initial compliance period. This will give owners more flexibility in the extended-use period to refinance or recapitalize the asset, potentially without the need of additional LIHTCs. We also suggest revising the replacement reserve for rehab projects to greater of $300 per unit per year or the amount specified in the PCNA. This will help make more preservation transactions financially feasible when there are extensive rehab budgets.

VI.(B)(5) Deferred Developer Fee

It is critical that deferred developer fees are sized and underwritten appropriately. It is a standard requirement that before a syndicator or investor closes a transaction that they will get a “should” tax opinion from a reputable tax attorney that that amongst other things demonstrates a high degree of confidence in the financial projects that all deferred developer fees projected to be paid off within the 15-year compliance period. In short, deferred developer fees are scrutinized very closely by multiple external parties on the financial team to ensure tax compliance.

With this as context, we urge NCHFA its policy of assessing negative points if deferred developer exceeds 50% of the total amount as of the full application. Given the level of third-party scrutiny on deferred developer fees sizing and pay-in schedules we believe there is already a high level of market alignment that we hope will give NCHFA sufficient comfort. There is also a significant public benefit that is enhanced by having a more flexible deferred developer fee sizing policy, as it can allow developers to leverage additional equity proceed and thus rely less on NCHFA or local agency soft-funding sources to fill gaps. It is common for developers to defer equity pay in schedules and defer additional developer until later in the process (after the construction period) to improve investor yields and thereby drive additional equity proceeds. Likewise, while it is not our preference, we have on several occasions deferred more than 50 percent of our developer fee to get transactions closed. In today’s inflationary environment, we believe it is preferrable for developers to have maximum flexibility in structuring equity and fee schedules to help fill gaps.

VI. (B)(7) Developer Fees

We suggest that NCHFA’s developer fee caps are low as compared to your peer states and that this is constraining affordable housing production in the state. We believe the low developer fee structure makes it very difficult to preserve year-15 LIHTC properties, which creates a long-term preservation risk for post-year-15 LIHTC properties.

The reality is that increased developer fees generate additional eligible basis and additional tax credit equity. We defer a substantial portion of this fee to fill project gaps and with uncertainty in the cost environment the additional fee effectively will serve as additional construction contingency, much

drawn on today as construction costs skyrocket. While there are sometimes hard dollar developer caps as well, the proposed caps are still low in our estimation.

To help address the rising cost and interest rate environment, we recommend that NCHFA raise the maximum developer fee for bond financed rehab transactions in North Carolina to be a flat 20 percent of *all* eligible basis, including acquisition basis if the seller of the property is unaffiliated with the buyer. Likewise, we recommend adopting a flat 20% developer fee for new construction bond transactions. If NCHFA finds it desirable, it could also require developers to defer any fee above the current maximum fee under the current methodology.

Maximizing developer fees, within the constraints of the tax law, regulation, and reasonable underwriting, is a proven and successful method of generating additional LIHTC eligible basis, and in turn, equity proceeds which <u>help fill project gaps and/or reduce the need to obtain state tax credits</u>. It is a proven strategy that has been deployed of late by many of NCHFA's peers HFAs in the region including Kentucky, Oklahoma, Ohio, and Tennessee, all of which have developer fees for bond transactions ranging between 20 and 25 percent.

Furthermore, developers take on more risk on bond deals because of the extended pre-development period and the high proportion of foreclosable debt, for which the developer is responsible. The developer fee compensates developers for these risks. The additional eligible basis generated by the increased fee will also generate more tax credit equity which will help offset reduced debt proceed brought on by rising interest rates and help plug gaps brought on by rising construction costs. Unlike 9 percent transactions, the additional eligible basis generated by the increased fee will not deplete the overall supply of 4 percent credits, which as described above are "as of right" and uncapped.

We believe it is important to acknowledge the role developer fees play in affordable housing transactions as well when you consider the appropriate fee setting mechanism. The IRS permits the inclusion of developer fees in eligible basis because these fees serve as the primary form of compensation for LIHTC developers. They pay for overhead of essential functions, including accounting, human resources, information technology, asset management, insurance and legal fees and many others. Developer fees also serve as the primary form of reimbursement for pre-development costs and resident services.

We would be happy to provide case studies of active transactions we are underwriting in Kansas to illustrate the impact of this policy on project gaps if that is helpful to the agency's decision making. We have attached a brief case study as an appendix to these comments to illustrate the potential impact of revising the 4% LIHTC developer fee methodology.

Appendix B

In addition to our comments relating to the draft QAP, we urge NCFHA to consider the following suggestions relating to the agency's design criteria.

Appendix B: II. (C)(2) Interior Design – Dining Area

We recommend further amending these criteria to allow an island with seating capacity or breakfast bar to fulfill the dining area requirement for 1- and 2-bedroom units.

Appendix B: II. (C)(16) Interior Design – Elevator

We recommend amending the elevator requirement to provide one elevator for every 100 units. We believe this will provide sufficient service for residents while helping control construction costs.

Appendix B: II. (C)(24) Interior Design – Finished Walls

We agree that all areas accessible to residents should have finished walls, floors and ceilings. We do not believe it is appropriate to finish areas that tenants do not have access to, such as maintenance rooms, locked utility or mechanical closets, etc…This adds expense and impeded access for maintenance techs to access utilities, wiring, etc…

Appendix B: II. (C)(25) Interior Design – Mechanical Equipment

In most situations we believe this proposed requirement is appropriate; however, we observe that there is some new high efficiency HVAC mini-split technology that now incorporates hot water heaters that are designed to be installed through the wall. We do not think its appropriate for this technology to be installed in a separate mechanical closet.

Appendix B: II. (D)(4) Bedroom – Aid Station

While we appreciate the desire to require a "call for aid" mechanism in Type A units, we suggest that a hard-wired connection is no longer the industry standard. We suggest that NCHFA to allow for wireless and other tech solutions as an alternative to meeting this requirement.

Appendix B: V. (G)(1) – Refuse Collection Areas

We suggest that the appendix allow for additional fencing options for refuse areas. Treated lumber will typically needs to be replaced for during the tax credit period. Allowing for a more durable solution such as chain-linked fencing or painted concrete blocks should be appropriate alternatives, particularly if they are not located on the primary façade of the building.

Appendix B: VI. (B) - Unit Interiors

While we appreciate that bi-fold and accordion doors are less desirable than hinged doors, we suggest that as a cost containment measure, the appendix should not require their replacement if they are in good working conditions. If the doors most be replaced, then we agree they should be replaced with hinged doors. Likewise, we find that it can be a hardship on tenants to repaint the entire interior of a unit in an occupied rehab. We suggest that all unoccupied units should be painted in their entirety and that all units upon initial turn should be painted in their entirety.

Appendix B: VI. (B) - Electrical

We suggest that all receptacles, switches and cover plates must be replaced only if identified in the PCNA. Given the decline in the utilization of land lines and cable TV we do not think it is necessary that bedrooms have a cable and telephone jacks. A phone and cable jack in the living room should be sufficient.

Conclusion

LAC appreciates the opportunity to provide NCHFA with this feedback ahead of the development of the 2023 QAP. We would welcome the opportunity to discuss them with you further at your leisure and/or answer any questions you may have regarding our feedback. I can be reached directly at 860-287-1635 or tamdur@lincolnavecap.com.

Regards,

Thom Amdur
Senior Vice President, Policy & Impact

About Lincoln Avenue Capital

Lincoln Avenue Capital is one of the nation's fastest-growing developers, investors, and operators of affordable and workforce housing, providing high-quality, sustainable homes for lower- and moderate-income individuals, seniors, and families nationwide. LAC is a mission-driven organization that serves residents across 22 states, with a portfolio of 112 properties comprising 20,000+ units.