October 13, 2023

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 2024 Draft Qualified Allocation Plan and Appendix. We look forward to collaborating with the North Carolina Housing Finance Agency (NCHFA / the Agency) as you develop your affordable housing priorities. Lincoln Avenue Communities (LAC) is a mission-driven affordable housing developer currently active in twenty-six 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 Conditions

Inflation and escalating construction and operating cost environment are significant challenges for affordable housing developers. While construction materials pricing and supply chain disruptions have stabilized some, they are still a significant challenge, adding hard costs as well as delays. The industry is also experiencing significant inflation in the cost of insurance and land prices and building acquisition costs remain stubbornly high and labor costs are a significant barrier to financing and delivering quality affordable housing communities to the market.

To make matters worse, rising interest rates have reduced the debt proceeds we are able to leverage to offset these increased costs.1 Four percent LIHTC transactions are financed primarily with tax-exempt debt, making up approximately 70 percent of the capital stack, so the impact of even small increases in interest rates is magnified significantly for these transactions. This rapid growth in interest rates has resulted in an over 30% reduction in mortgage proceeds over the past two years. Most debt products are indexed to the 10-YR Treasury Rate, which over the past two years, has increased from 1.60% in October 2021 to over 4.60% currently. For a 180-unit new construction family community in the Charlotte MSA, this results in a loss of almost $11 Million in first mortgage proceeds ($33.5MM to $22.6MM), all else being equal, which creates a significant gap in project feasibility. See Appendix 1 for additional details.

Developer Fees

Pg. 31 – First Draft QAP

We appreciate that NCHFA is proposing to increase developer fee limitation for new construction projects from $20k to $22.5k per unit and we are appreciated that NCHFA's has retained its change in

[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. As of 10/9/23, the ten-year treasury is at 4.73% - the highest it has been since 2007, and up more than325 BP since the beginning of 2022. Furthermore, given the Fed's difficulty in reigning in inflation, we anticipate rates could continue to rise in the coming year.

2023 QAP eliminated the hard total dollar cap on developer fee. These are both positive developments; however, the per unit ceiling is still relatively low, especially compared to peer agencies. Increased developer fees (particularly for 4% LIHTC TEB transactions), generate additional eligible basis and additional federal tax credit equity.

Furthermore, NCHFA it did not raise developer fees for rehabilitation projects. The methodology for calculating developer fees for rehabilitation projects results in a below market developer fee, fully omitting acquisition basis as well as other costs in eligible basis (e.g., GC overhead, GC profit, PMP, developer fees). In summary, developer fee can only be generated by hard construction costs. While the percentage appears to be relatively high (28.5%) when normalized to include excluded eligible basis is below market and results in the preservation of many existing affordable communities being infeasible.

Maximizing developer fees for bond transactions, 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 help fill project gaps and/or reduce the need to obtain scarce state and local soft finance resources. 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 and only limited by the availability of private activity bond (PAB) volume cap. North Carolina currently has excess capacity of PAB volume cap authority2 and is effectively leaving federal 4% LIHTC dollars on unutilized as a result.

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. It should also be noted that developers 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.

Deferred Developer Fees Negative Points

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[2] Per the NCSHA most recent (2021) HFA Fact Book: Of its annual allocation of $590 million, North Carolina only utilized $336 million in PAB cap in 2021. It carried forward $1.6 billion in PAB cap in 2021 and let $11 million expire. Utilization in 2022 and 2023 is comparable.

Current QAP policy penalizes developers for deferring more than 25% of the developer fee, resulting in a point deduction. This policy discourages developers from investing internal capital in affordable housing transactions, reduces the ability of developers to use developer fee as additional construction contingency and reduces the amount of subsidy a transaction may be able to generate by reducing the potential eligible basis of the property.

Additionally, investors and their tax counsel scrutinize deferred developer fee very closely as part of their underwriting. Investor tax counsel will not issue a tax opinion for a transaction if there is not a reasonable expectation that the deferred developer fee will be paid in full during the compliance period. Additional and more conservative constraints on deferred developer by NCHFA is unnecessary from either a compliance or an underwriting perspective and limits the amount of eligible basis and federal subsidy that can be generated by the transaction, particularly if the state takes further steps to increase the developer as recommended above.

NCHFA should eliminate the point penalty in its QAP for deferring more than 25% of developer fee. If NCHFA require additional comfort, it could request developers have their equity providers submit a letter of support indicating their comfort with the amount of deferred developer fee if it exceeds 50%.

Application, Allocation, Monitory and Penalty Fees

Pg. 10 - First Draft QAP

Generally, the proposed fee increases in the draft QAP are appropriate; however, we urge NCHFA to reconsider the increase in the non-refundable allocation fee for projects financed with tax-exempt bonds. This increase will decrease overall project leverage at a time when developers are still incurring increased construction costs, operating costs, and higher interest rates, making more projects infeasible.

Maximum Project Development Costs

Pg. 17 – First Draft QAP

Until the current construction markets stabilize, we urge NCHFA to reinstate the language it struck from the QAP and waive cost restrictions and negative points related to construction costs for 2024 applications and table its proposed additions.

> Cost restrictions and negative points related to construction costs waived for ~~2023~~ 2024 applications.
>
> ~~(a) The Agency will assess negative points to applications listing more than the following in lines 5 and 6 of the Project Development Costs (PDC) description, as outlined in Chart A below. The point structure in Chart B will apply to the following:~~
>
> - ~~all units are detached single family houses or duplexes,~~
> - ~~serving persons with severe mobility impairments,~~
> - ~~development challenges resulting from being within or adjacent to a central business district,~~
> - ~~public housing redevelopment projects, or~~
> - ~~building(s) with both steel and concrete construction and at least four stories of housing.~~
>
> ~~The per-unit amount calculation includes all items covered by the construction contract, ENERGY STAR, certifications for green programs, and any other costs not unique to the specific proposal.~~

~~Chart A~~ ~~Chart B~~
~~$130,000 -10~~ ~~$145,000 -10~~
~~(b) The Agency will review proposed costs for historic adaptive re-use projects and approve the amount during the full application review process.~~
See Section VI(B) for other cost restrictions.

Development Experience

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Under the current QAP, to be eligible for a 9% Tax Credits, at least one Principal must have successfully developed, operated, and maintained in compliance either one 9% Tax Credit Project in North Carolina or six separate 9% tax credit projects totaling in excess of 200 units. The projects must have been placed in service between 1/1/2016 and 1/1/2023. The principal must become a GP or managing member of the ownership entity, remain responsible for overseeing the project and operation for at least two years.

Current policy creates impediments that discourage qualified developers that are "new" to the state from participation limits capital investment in North Carolina, discourages diversity within the affordable housing ecosystem and concentrates risk. As fiduciaries of the state limited affordable housing resources, NCHFA should further develop experience policies that encourage the nation's most experienced and best capitalized affordable housing developers to invest in North Carolina. Likewise, as industry stewards with a long-term outlook, it should also develop experience policies that welcome and assist next generation, emerging and MWB development companies to invest in the state.

Development experience is an important indicator of future success but there are several significant flaws to this policy:

- It is very difficult for experienced developers that may lack *local* experience or tax credit as well as emerging developers of color from gaining the necessary experience to compete.
- It sets too high a bar for out of state experience.
- It discounts experience with the 4% LIHTCs; which, if anything is more valuable experience given the scale and difficulty of the transactions, compared to 9% transactions.
- It discounts relevant experience that professionals may have earned (either in state and/or out of state) performing the function of the developer if they were not principal of the company. An individual may have led the successful development of thousands of units of affordable housing as an employee of another firm and receive no credit under the current policy if they switch firms.
- It conflates development experience with guarantor capacity. While both are important indicators of success, they should be evaluated.

We recommend that NCHFA consider the following policy changes in its QAP:

- Treat in-state and out-of-state experience with parity. If NCHFA requires a higher standard of experience for out of state developers, we suggest 3-5 properties placed in service (over the past 5 years) is sufficient.
- Allow experience from 4% LIHTC transactions to count towards the experience requirement for 9% developments and vice-versa.

- Allow an “inexperienced” developer to submit applications to earn experience (but potentially limit the number of awards for first time developers

Tiebreaker Criteria

Pg. 23-24 – First Draft QAP

We recommend NCHFA eliminate entirely the proposed 3rd Tiebreaker in the First Draft QAP, which gives a preference to the earliest preliminary application submittal. We do not believe this will result in better projects, cost efficiency and/or other outcomes that further the Agency’s affordable housing goals and mission.

Criterial for Selection of Rehabilitation Projects – General Threshold Requirements

Pg. 25, 27 – First Draft QAP

We urge NCHFA to reduce the proposed increase to the minimum rehabilitation language for 9% applications in the threshold requirements to \$30k from the proposed \$50k (pg. 25). This would be aligned with NCHFA’s proposed change for projects leveraging tax exempt bonds (pg. 27). We believe the agency’s policy objective with this proposed change is to ensure that sufficient rehabilitation scope of work is undertaken to maintain a project up to reasonable standards during the 15-year compliance period. We concur that this is an important policy priority; however, we observe that setting the minimum rehabilitation threshold at \$50,000 will severely limit debt financing options for projects financed with tax exempt bonds. As NCHFA is aware, one of the most common tax-exempt bond preservation transaction structures utilized in today’s marketplace is the short-term cash-collateralized bond structure where the tax-exempt bonds are taken out with a taxable FHA 223(f) loan.

FHA 223(f) loans have several desirable qualities for preservation transactions including low-interest rates, 35-year amortization and, unlike the FHA 221(d)4 program, does not trigger Davis-Bacon wage scales. Unfortunately, FHA 223(f) loans per unit loan limits are far below the \$50,000 rehab threshold. The current FHA 223(f) loan limit threshold in the highest cost adjustment areas is \$45,854 per unit. Even accounting for tax credit equity, if NCHFA were to enact this change it would effectively eliminate the ability for tax credit developers to utilize this preferential financing because acquisition costs for a typical Year 15 and/or Section 8 community in today’s marketplace range between \$70,000 and \$150,000 per unit. The proposed minimum rehabilitation threshold also eliminates the ability of developers to utilize this structure in order to qualify for acquisition credits on a project that has a broken 10-year hold, which makes the resyndication of these communities infeasible and makes it much more likely that the affordability of these communities will not be preserved past the existing extended use period.

Furthermore, while many properties require significant rehabilitation scope of work, others that have been maintained well may require significantly less than \$50,000 per door of rehab scope of work. We do not believe it is a responsible use of scarce financing resources to ‘over-scope’ rehabs if the Capital Needs Assessment (CNA) confirms that a lesser scope of work is appropriate.

Additionally, we observe that well maintained properties in desirable markets where there is significant rent advantage between subsidized units and comparable market units are most at risk to be lost from the program and will also command the highest acquisition prices. Setting the rehabilitation threshold too high for these assets will make them unfinanceable as affordable assets and will increase the likelihood that they will be sold to conventional buyers or converted either via the qualified contract process or at the end of a projects extended-use period. This is a highly undesirable outcome that should be avoided at all costs.

Conclusion

Lincoln Avenue Communities appreciates the opportunity to work with NCHFA on the drafting of its 2024 Low-Income Housing Tax Credit QAP. We 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 at 646-585-5526 or tamdur@lincolnavenue.com.

Regards,

Thom Amdur
Senior Vice President, Policy & Impact

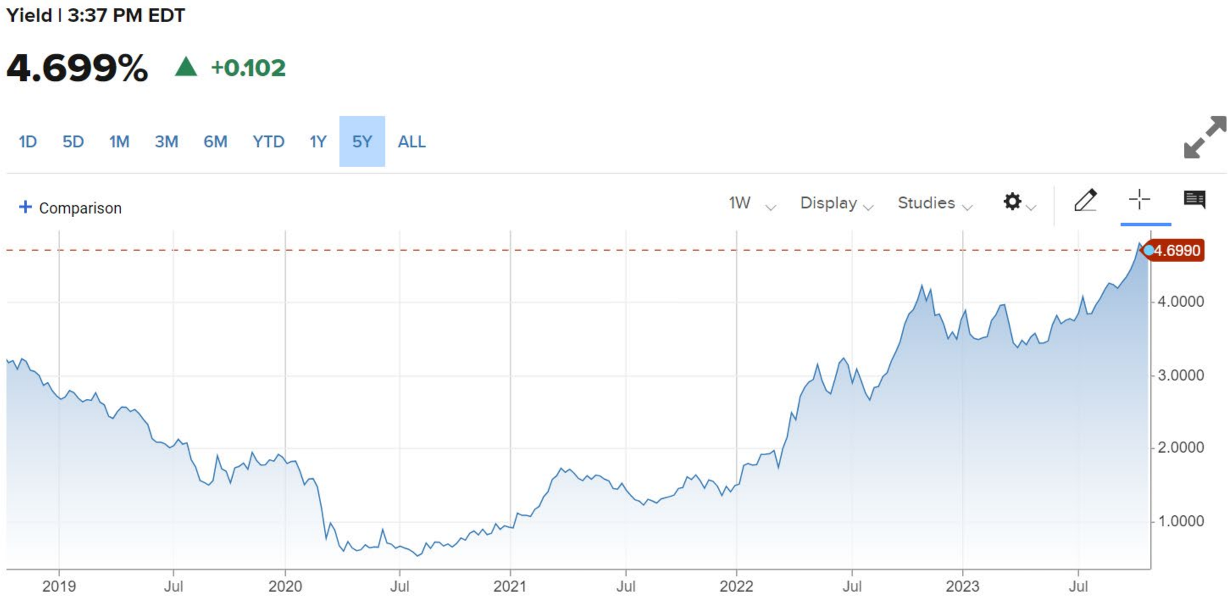
Cc: Jordan Richter
Rusty Snow

About Lincoln Avenue Communities

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 26 states, with a portfolio of 136 properties comprising 25,000+ units.

Appendix 1

Many affordable housing debt products are indexed and/or correlate to the ten-year treasury. The following chart illustrates the rapid inflation in interest rates since the start over the past five years. The following chart was updated on 10/12/2023.



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