

LINCOLN AVENUE CAPITAL LLC

8/26/2022

Mr. Eric Alexander
South Carolina State Housing Finance and Development Authority (SC Housing)
300-C Outlet Pointe Boulevard
Columbia, SC 29210

Dear Mr. Alexander:

Thank you for the opportunity to contribute this feedback on South Carolina State Housing Finance and Development Authority's (SC Housing) 2023 Qualified Allocation Plan. Lincoln Avenue Capital is a mission-driven affordable housing developers currently active in twenty-two states. In South Carolina we are primarily focused on developing ground-up new construction affordable housing as well as preservation of existing affordable housing utilizing 9 percent LIHTCs as well as 4 percent LIHTCs and tax-exempt bonds (TEBs).

Displacement During Rehabilitation

II.(O)(3) Rehabilitation (pg. 11)

As mission-driven developers we appreciate that it is good policy to minimize permanent displacement when properties undergo a tax credit recapitalization. We do not recommend adopted the proposed change to prohibit any permanent displacement. There are several scenarios where allowing some minimal displacement may be in the best interest of the property and the fellow residents. For example, it sometimes the case that when a developer acquires a property there are residents that are not lease compliant. Sometimes rehabilitation plans require the combination or reconfiguration of obsolete units to accommodate ADA requirements or market needs, which can also lead to displacement. We believe the current policy that allows a limited amount of permanent displacement is appropriate and gives developers and the communities the maximum flexibility they need to deliver an appropriate and quality product for the community.

Rent Increase for Households Under Lease as of An Award

II.(O)(3) Rehabilitation (pg. 11)

We urge SC Housing to reconsider the cap on rent increases for households under lease as of award. While we appreciate the sentiment of the policy, given the rapid inflation we are currently experiencing we believe it is imprudent to place a ceiling on rent increases when properties may well continue to experience operating cost increases that exceed the norm. At least until inflation crisis stabilizes, we urge SC Housing to table this change for consideration in a future QAP. We further point out that capping future rent increases will severely debt proceeds, resulting in decreased rehabilitation scope of work, which is not in the long-term interest of the asset or the residents. We believe residents and the physical asset would benefit more from the elimination of this proposed change (which reduces the ability to underwrite additional debt proceeds and thus constrains rehabilitation budgets) and replacing it with the adoption of a more robust minimum hard rehabilitation requirements (\$40,000 per door). Alternatively, if SC Housing wishes to continue to pursue this line of policy we suggest as an alternative an annual cap on rent increases of the greater

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of 7% or 2% + CPI. This cap would still be significantly lower than the national average for rent growth across the country in 2022.¹

Recapitalization Building Age Eligibility age

II.(O)(4) Rehabilitation (pg. 12)

Given the scarcity of private activity bond volume cap in South Carolina, we appreciate the intent behind the new proposed language that “all buildings must be at least twenty years old and not be deteriorated to the point of requiring demolition” to be eligible for an allocation of credits. However, we suggest that the SC Housing modify the language to allow for additional clarity and flexibility. As SC Housing is aware, many properties are sold fee simple at the end of the tax credit compliance period at year 15. If a recapitalization is not permissible at this point, preservation buyers will be required to hold these properties for ten years before they can be resyndicated to accommodate the “ten-year rule”, which is not feasible in most cases and will likely result in these properties being sold to buyers that are not preservation motivated in the long-term. We do not believe this is in the best interest of the program. Furthermore, the ability to resyndicated at year 15 will also help preserve properties that are eligible to exit the program through the Qualified Contract process. We suggest that to accommodate these dynamics, the language should be modified to allow an exception for buildings that are acquired by unrelated parties.

Additionally, as the language is currently drafted, it would prohibit the conversion of market rate apartments into affordable housing utilizing the LIHTC until they are 20 years old, which we do not believe is SC Housing intent.

Developer Fee – 9% LIHTCs

II.(P)(3) Financial Underwriting pg. 12

We appreciate that the proposed changes in the draft QAP relating to maximum developer fees for 9% LIHTC transactions are improvements. While an improvement, we suggest that the proposed developer fee policy is still too low. We currently work in more than twenty states, and in the majority of these jurisdictions the 9% LIHTC developer fee is set at 15% of TDC, which we think is a more appropriate fee structure in the current inflationary and high-cost environment. 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.

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

¹ According Yardi Matrix’s latest survey of 140 markets the average US asking rent rose 12.6% year-over-year through July of 2022. <https://www.multihousingnews.com/2022-rent-growth/>

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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.

Deferred Developer Fee

II.(P)(4)(a) Financial Underwriting pg. 12-13

It is critical that deferred developer fees are sized appropriately. The deferred developer fee policy, as written in the draft QAP, is generally appropriate; however, we suggest a minor tweak to allow additional flexibility, which we feel is appropriate in today's uncertain financing environment – which is to add language to allow the deferral of more than 50% of the developer fee on a waiver basis at the discretion of SC Housing staff.

9% County Award Limitations

Appendix C1 – 9% LIHTC (I)(B)(2) pg. 18

We do not necessarily object to the change to limit one 9% LIHTC award per county; however, we suggest SC Housing may want to further consider the implication of this policy as it balances the state's new construction and preservation needs. SC Housing may want to consider revising this cap to allow for a maximum of one new construction *and* one preservation 9% award per county. There are also several high-growth jurisdictions (Greenville, Columbia & Charleston) with demand and capacity that may warrant more than one 9% new construction project per year, particularly if they serve different tenures (e.g., family vs. senior). Lastly, we wish to further emphasize that whichever policy SC Housing adopts regarding county caps, it should *not* extend or apply that policy to 4% LIHTC awards.

Full-Service Grocery Definition

Appendix C1 – 9% LIHTC (IV)(A) pg. 24

We appreciate incentivizing properties to be proximate to critical amenities as a scoring criterion and that a full-service grocery store is an appropriate amenity to include in this scoring criteria. We suggest SC Housing consider revising the definition of full-service grocery store to omit “must be part of a chain.” There are many grocery stores (particularly co-ops and ‘ethnic’ grocery stores) across the state that otherwise meet the rest of the definition in the QAP, provide an elevated level of service and value to customers but are not associated with a chain that we think should be considered for these points.

Palmetto Opportunity Index Points

Appendix C1 – 9% LIHTC (IV)(A) pg. 25

We endorse the removal of the Palmetto Opportunity Index points in the draft QAP. We believe residents are served best by the new proximity to amenity driven points in the draft.

Other Types of Tax Credits

Appendix C1 – 9% LIHTC (IV)I pg. 27

We concur that outside leverage is a laudable goal because it stretches SC Housing's scarce resources further. Outside leverage may also demonstrate a degree of community support for a project. However, we urge SC Housing to reconsider and/or clarify its proposed point

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change to the “Funding Source/Other Types of Tax Credits” point category. Limiting this category to tax credits and removing the target amount necessary to qualify for these points lessens the policy impact and creates potential for applicants to “game the system” without achieving SC Housing intended goal. For example, an applicant could receive a de minimus amount of 45L tax credits or solar investment tax credits (e.g. install a single solar panel on site to generate a federal solar tax credit) and qualify for these points. Absent further clarification, we believe the former policy is more mission-aligned and an improvement over the proposed amendment.

Tie Breaker Criteria

Appendix C1 – 9% LIHTC (V) pg. 29

Historically, we do not believe the tiebreaker has been triggered often in South Carolina; however, with the change in the scoring criteria in the draft QAP, it is possible there will be more ties in 2023. While we appreciate that tiebreaker distributes allocations across multiple development entities, we believe the highest priorities should focus on housing need and efficiency of subsidy. To that regard, we suggest that the first 9% LIHTC tiebreaker should be for a county not served in the current or previous funding cycle, followed by projects with the lowest share of total development cost funded by the Authority. Given the mixed experience of tenant homeownership projects across the country, we do not believe that tenant ownership should be a tiebreaker.

Evaluation of Rehabilitation Applications

Appendix C1 – 9% LIHTC (VI) pg. 29-31

We strongly support the proposed changes associated with the definition of at-risk government housing resources to include projects eligible to request a qualified contract currently or within two years and federal project-based assistance contracts with less than 3 years of remaining term.

Size Requirements for Bond Deals

Appendix C2 – Tax Exempt Bonds (II)(B)(5) pg. 32

Given the current scarcity of private-activity volume cap in South Carolina, it is likely that high-quality proposals that submitted in 2021 or 2022 will not receive allocations and may be adversely impacted by the proposed change to increase the minimum number of units per application should they wish to resubmit in 2023. We recommend amending the proposed minimum size requirements language to allow projects that applied under the 2022 QAP but were not awarded an allocation of private-activity volume cap to be allowed to resubmit if they met the minimum size requirements in the 2022 QAP. This would allow deserving formerly eligible projects to proceed without having to rezone or restructure federal grant commitments. We believe this will be a small sample of properties and in all other respects would expect these properties to comply with the 2023 QAP.

Developer Fee 4% LIHTC / Bond Deals

Appendix C2 – Tax Exempt Bonds (II)(B)(8) pg. 32

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Building on our earlier comment regarding developer fees for 9% LIHTC deals, we believe that the developer fee for bond deals in South Carolina is too low. Many of South Carolina's neighboring states have higher developer fees for bond deals

To help address the rising cost and interest rate environment, we recommend that TDHCA build on the logic it has established within the current QAP we recommend that SC Housing allow bond deals to be eligible for up to a 20 percent developer fee.

Like smaller scale 9 percent developments, the risk and financing profile of these transactions warrant a different treatment. Developers take on more risk on large 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 increase fee will not deplete the overall supply of 4 percent credits, which as described above are "as of right" and uncapped.

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 help fill project gaps and/or reduce the need to obtain state tax credits. It is proven strategy that has been deployed of late by many of SC Housing's peer 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. If SC Housing finds it desirable, it could also require developers to defer any fee above the current 15 percent. We would be happy to provide case studies of active transactions we are underwriting in South Carolina to illustrate the impact of this policy on project gaps if that is helpful to the Authority'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.

Even if SC Housing does not choose to raise developer fees above 15%, we strongly urge the Authority to reconsider its \$3 million developer fee cap. Constraining the eligible basis associated with the cap on fees creates additional project gaps, requiring more projects to request state tax credits. An alternative SC Housing could consider would be to have a hard dollar cap on developer fee for projects requesting state tax credits but no cap for projects that do not request state tax credits. If SC Housing desires, it could also require all developer fee over the current \$3 million cap be deferred. Adopting a combination of these recommendations should ultimately reduce the demand for state LIHTC, allowing the authority to subsidize additional properties throughout the state.

Ranking Bond Deals

Appendix C2 – Tax Exempt Bonds (III) pg. 33

We observe that the current ranking structure as proposed would tend to favor larger unit sizes (i.e., family deals) over projects targeting seniors or serviced-enriched housing which would tend to have more one bedroom and/or efficiencies with interior corridors and

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elevators. This is not necessarily good or bad but represents a significant policy change that should be discussed explicitly and evaluated further before being finalized.

We also request that SC Housing provide additional clarity regarding the ranking versus scoring process for bond deals. It is our understanding that bond projects will be scored solely to determine if threshold eligibility is met. Once threshold eligibility is established, all eligible projects will then be ranked via the process outlined in "Appendix C2 III. Ranking" without consideration to the initial application score.

Conclusion

LAC appreciates the work of SC Housing in the issuance of its draft 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

Attachment: Filling Gaps Through Basis Maximization Strategies (Case Study)

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.