July 3, 2023

Marni Holloway
South Carolina State Housing Finance and Development Authority (SC Housing)
300-C Outlet Pointe Boulevard
Columbia, SC 29210

Dear Ms. Holloway:

Thank you for the opportunity to contribute this feedback on South Carolina State Housing Finance and Development Authority's (SC Housing) forthcoming 2024 Qualified Allocation Plan. Lincoln Avenue Capital is a mission-driven affordable housing developer currently active in twenty-three states. In South Carolina we focus on developing ground-up new construction affordable housing as well as the preservation of existing affordable housing utilizing 9 percent LIHTCs as well as 4 percent LIHTCs and tax-exempt bonds (TEBs).

Maximum Developer Fees, Developer Overhead, and Consultant Fees (QAP pg. 11)
We appreciate that SC Housing updated the 2023 QAP relating to the maximum developer fee for 9% LIHTC transactions. These are appreciated improvements; however, we suggest that the developer fee policy is still too low. We currently work in more than twenty states, and in most 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 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 (QAP, pg. 11-12)
It is critical that deferred developer fees are sized appropriately. The deferred developer fee policy, as written is 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.

Developer Fee Tax Exempt Bonds (Appendix C2 pg. 3-4)
We appreciate the positive improvements that SC Housing made to the Appendix C2 last year as it relates to developer fee for bond deals. That being said (and 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 still too low and as a result, the state is missing an opportunity to finance more affordable housing. 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 SC Housing 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 the increased 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 $5 million developer fee cap as well as the $25,000 per unit gap. 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 $5 million cap and/or $25,000 per unit be deferred. Adopting a combination of these recommendations should reduce the demand for state LIHTC, allowing the authority to subsidize additional properties throughout the state.

Utility Allowance Methodologies (QAP, Pg. 4)
We encourage SC Housing to clarify the language in the QAP on pg. 4 relating to permissible utility allowances methodologies.[1] The IRS permits developers of LIHTC properties to select from four valid utility allowance methodologies (PHA Schedule, Actual Usage and Rate Estimates provided by the local utility, HUD model Schedule Model, Energy Consumption model). SC Housing's current allowed UA options does not include the opportunity to utilize an engineered energy consumption model.

There are several important advantages to using an energy consumption UA model.

- Traditional utility allowance schedules (i.e., methodologies 1-4) do not differentiate between energy-efficient and typical units or buildings with substantial investments in renewable energy – this creates "split-incentives"
- Public Housing Units, which are the base dataset for the PHA UA, are typically some of the least utility efficient rental units.
- UA's that reflect prospective investments in renewable energy and utility efficiency allow owners to leverage utility savings in their capital stack and overcome split-incentives

They are particularly impactful in helping developers leverage energy efficiency and solar investments to fill project financing gaps. We have numerous projects around the country that are able leverage millions of dollars of additional permanent debt proceeds when we maximize our solar and sustainability scope of work in conjunction with an engineered model. This has been an important gap filler in today's rising cost environment. Engineered Consumption Model UAs have been deployed for many years successfully around the country including in California, Colorado, Georgia, New Mexico, Utah, and other states.

Conclusion
LAC appreciates the opportunity to provide feedback to SC Housing as it begins development on its 2024 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 [redacted] or [redacted]

Regards,

Thom Amdur
Senior Vice President, Policy & Impact

[1] Note: properties with Project-Based Rental Assistance and/or USDA RD funding are governed by different rules and are more limited in the choice of utility allowance methodologies available to them.

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 23 states, with a portfolio of 120 properties comprising 22,000+ units.

cc: Julie Davis
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