Timely and responsive actions taken by the North Carolina Housing Finance Agency ("NCHFA") over the last 18 months directly contributed to:

- securing approximately $200 million in equity for 2007 and 2008 Housing Credit projects, and
- sufficient investor interest for all 24 of the state's 2009 awards.

As a result, 70% of projects funded in the last three years have found or will find an investor, during a time when well over half the equity market disappeared from states with few major metropolitan areas. The processes and policies behind these outcomes may serve as a model for other allocating agencies.

Background

North Carolina was not spared in the national equity shortage. The difficulties began as pricing dropped precipitously toward the end of 2007. The next wave of challenges came in the third quarter of 2008, when many owners were unable to secure commitments from investors or syndicators at any price. The financial markets showed no signs of being less troubled heading into the 2009 award cycle.

NCHFA's responses to these evolving uncertainties fall into four categories:

1. assisting with lower pricing;
2. recycling previous awards using new legislative authority;
3. preparing policies for the future; and
4. continuing long-standing policies for allocation and underwriting.

Each reflects NCHFA's belief that equity investment is the essence of the Housing Credit program's success and represents the future of affordable rental housing production.

Assisting with Lower Pricing

Between award in August 2007 and year's end, equity prices dropped by 10% or more, creating substantial shortfalls for many projects. Starting in March 2008, NCHFA began re-underwriting each pipeline project using an assumption of $0.80 pricing, which was conservative at the time. Staff also held meetings with owners to discuss solutions. The review and meetings were completed by April.

The restructuring approaches varied, including allowing additional debt, deferring more developer fee, and, in the case of 15 projects, making a forward commitment of 2009 Housing Credits. Seven of these soon found equity as a result of the increased allocation. Other 2007 projects moved ahead to closing without additional NCHFA resources in part due to the restructurings.

Recycling Previous Awards Using New Legislative Authority

The actions described above did not resolve problems for all 2007 projects, and did not apply to the 2008 awards. Developers for these projects faced an unprecedented equity market in the fall of 2008.

Preparation

Upon realizing the situation, NCHFA immediately began responding. In addition to communicating with developers, NCHFA staff contacted every investor and syndicator with any history of working in North Carolina to ask what we could do to bring in more of their capital for these projects. The good news was our underwriting requirements already contained their most important criteria. Conversely, this fact also meant we had little room to maneuver.

Based on extensive input from interested parties, the most pressing need was for additional time. Many 2007 projects were facing a Catch-22: owners needed to start building promptly to ensure meeting the federal deadline to place in service by December 2009, but could not close a construction loan without equity. However, investors and syndicators did not want the risk of committing to projects with little or no flexibility in their construction schedules. The 2008 awards were in jeopardy of ending up in exactly the same situation.

The other major concern was impending gaps due to equity prices in free-fall. The $0.80 assumption used earlier was substantially above the tiny remaining market.

Approach
NCHFA adopted a two-part response. First, owners could return their 2007 and 2008 allocations for an award of the same amount from the state’s 2009 authority, which extended the deadline to place in service to December 2011. The returned Housing Credits would roll into the available ceiling for 2009, in effect recycling for 2009 awards and thereby resulting in no loss of resources to the State.

The second part responded to lower equity pricing. Owners recycling allocations also could request the agency-designated 30% boost allowed in the Housing and Economic Recovery Act, and those awarded in 2007 could ask for their allocation reflect the new 9% flat rate (the latter already was part of the 2008 cycle). Having a larger allocation meant more equity, thus fully or partially filling the gap in sources. Unlike the recycled amounts, these increases were not automatic but rather based on NCHFA’s determination of feasibility under IRS Code Section 42(m)(2)(A).

Results
Owners submitted 64 requests to recycle Housing Credits by the December deadline. Our goal was to process them quickly in order to be ready for any equity that became available in early 2009.

Staff reviewed all requests and made awards in 11 business days. The process was more streamlined than the previous year’s restructurings since time was of the essence. The total amount recycled was for $32 million in annual allocations, of which $5.4 million were increases using the 30% boost and 9% rate. Owners of 31 projects have closed on approximately $100 million in equity because of these efforts.

Preparing Policies for the Future
The third component began while contacting equity providers about 2007 and 2008 projects. At that time we also asked each of them for input on how to revise our policies in order to make 2009 projects even more attractive. The results were important but not radical changes, including

- allowing a greater maximum allocation per project;
- tightening the income and expense escalations;
- setting larger hard cost contingencies;
- increased operating expense requirements;
- allowing applications to include an additional contingency for cost overruns; and
- authorizing NCHFA to set a maximum equity price assumption.

We have heard from several syndicators about their interest level; among them there will be sufficient equity in North Carolina for all 2009 awards. Developers may even benefit from competition.

The Tax Credit Assistance Program (TCAP) provides another opportunity to encourage investment. NCHFA’s approved TCAP plan is to bridge equity for three years; one syndicator has already determined that the interim financing should increase pricing by $0.10 or more.

Long-Standing Policies for Allocation and Underwriting

Finally, NCHFA has always considered the Housing Credit allocation process to be about more than limiting subsidy. Our practice is to review applications as proposals for real estate investment. The following is an illustrative summary of the 64 recycled projects' characteristics.

- Good Sites: The rental development staff has visited and scored more than 1,000 sites during the last 10 years. This subjective point scoring is a major factor in determining the very competitive new construction awards. The two main criteria are quality of life for tenants and long-term investment viability; for example, distance to a grocery store and extent to which the area is experiencing economic growth or decline. Negative features nearby reduce the score or result in disqualification.
- Strong Markets: NCHFA's standards for evaluating markets have been consistently conservative. All studies for the recycled projects awarded in the 2008 cycle were positive, with a median capture rate of 12.5%. The median vacancy rate among comparable projects was less than 3%. Developers, working with analysts, determine the best unit mix for the market.
- Low Leverage: Bank loans account for only 8.4% of the total funding sources. The rest is covered with equity and subsidized financing, including North Carolina's unique refundable state tax credit. On average these projects expected 96% paid developer fee as of the award date.
- Experienced, Capitalized Developers: All developers must have recent and successful Housing Credit experience to be eligible for an award (without forming a joint venture). The 30 different groups awarded in 2007 and 2008 have completed an average of eight projects, and 16 have related party general contractors and/or management companies.
- Debt Coverage Ratios: The average first year DCR for the recycled projects is 1.42 (at award).
- Full Reserves: All projects must have an operating reserve equal to six months operating expenses and debt service and rent-up reserves of $300 per unit capitalized up front.
- State Portfolio: Ernst & Young's 2007 "Understanding the Dynamics IV" report on performance shows that North Carolina's current operating projects are in the top 10 among states for both DCR and occupancy rate (1.30 and 97%, respectively).
- Lack of "Hair": The recycled projects have no market-rate units or commercial space; supportive services are not funded or operated by the projects (instead local agencies enter into MOUs with owners); only one project is focused on a specialized population; and the deeper rent targeting is for 25% to 40% of the units and reasonable based county income levels.
- Green: At least 50 of the 64 projects will meet Energy Star requirements and all will incorporate many other green features such as low-maintenance exteriors and high-efficiency HVAC systems.
- Design: NCHFA's scoring criteria and threshold requirements produce a high-quality, aesthetically pleasing product. The attached photo sheet contains four typical examples.

Conclusion

The results described in this nomination would not have been possible without the efforts of developers, equity providers, and others. The close partnership between industry participants and NCHFA is perhaps the most important reason why North Carolina projects had such success in continuing the Housing Credit's model of public-private production in these very challenging times.