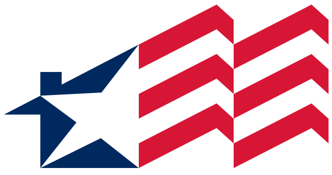

RECOMMENDED PRACTICES IN HOUSING CREDIT ADMINISTRATION

NCSHA Recommended Practices in Housing Credit Administration
Updated: December 2017

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Preface

The National Council of State Housing Agencies (NCSHA) represents the state housing agencies that administer the Low Income Housing Tax Credit (Housing Credit) program across the nation. The Housing Credit is one of the most successful and longest-lived federal affordable rental housing production programs ever, responsible for the creation of more than 3 million homes for America's low-income families since Congress enacted it in 1986. The Housing Credit produces high quality, well-designed, financially sound housing where it is most needed for low-income families, including the elderly and persons with special needs.

Congress entrusted responsibility for administering the Housing Credit to the states, recognizing that each state is better able than the federal government to prioritize and address the low-income housing needs of its residents. This delegation of authority to the states to administer a major federal tax program is unique and unprecedented. In making it, Congress recognized the value of decentralized decision making concerning each state's low-income housing needs, while establishing broad standards each state must follow in carrying out their program administration and oversight.

In the Housing Credit, Congress created a system for producing affordable rental homes that relies on tax incentives and federal oversight by the Internal Revenue Service (IRS), coupled with the market discipline of private sector developers, syndicators, lenders, and investors. Congress designed the system to provide adequate incentives to the private sector to achieve the objectives Congress intended and heavy tax penalties if it does not.

Congress made the states responsible for allocating Housing Credits, underwriting applications for them, and monitoring developments for compliance with program requirements. States take these responsibilities very seriously. Particularly in this era of more limited federal support for housing assistance, states must strive to assure, to the extent they reasonably can, that housing financed with the Housing Credit remains quality affordable rental property for the full period it is committed to low-income use. All states share an imperative to assure that housing financed by the Credit is prudently underwritten and that compliance with program requirements is maintained throughout the affordability period.

To strengthen Housing Credit administration and continue to merit and maintain congressional confidence in it, states have developed through NCSHA recommended practices in Housing Credit administration. These practices—created by states for states—not only help states meet their responsibilities, but also preserve, to the maximum practical extent, the individual state flexibility that is at the heart of the Housing Credit program and its great success.

As Congress expected, during their more than 30 years of Housing Credit administration, the states have evolved a variety of allocation, underwriting, and compliance practices appropriate to meet specific state low-income housing needs and circumstances. At the same time, the states themselves have established recommended practices for each state to consider in its Housing Credit administration.

NCSHA's recommended practices are voluntary standards in Housing Credit allocation, underwriting, and compliance monitoring that all states should consider adopting regardless of other differences among them.

These standards may be replaced by substantially equivalent standards, which individual states may adopt to achieve particular public policy objectives. To be substantially equivalent, an alternative standard needs to be based on sound underlying economics adequate to provide, under the particular circumstances of the state or development, the same long-term viability the standards recommended in this report are intended to help assure. A fundamental touchstone of state administration of the Housing Credit must be that standards producing unsound real estate cannot serve valid public policy objectives.

Finally, these recommended practices are intended to encourage prudent real estate judgments in every Housing Credit development, regardless of its sponsorship. They do not intrude, however, on the discrete housing policy objectives Congress left to each state to determine. Thus, for example, these recommended practices do not presume to judge the percentage allocation of Housing Credits between larger and smaller developers or between for profit and nonprofit entities—matters Congress, beyond a 10 percent minimum nonprofit set-aside, left to individual states to decide.

Strong and dynamic state administration is key to the Housing Credit's success. NCSHA's Housing Credit recommended practices have allowed states to achieve program excellence while maintaining the flexibility they need to best meet their unique and diverse affordable housing needs.

NCSHA Recommended Practices in Housing Credit Administration

1. Qualified Allocation Plans

Recommendation

Agencies should clearly describe in their Qualified Allocation Plans (QAPs) how all statutory selection criteria and preferences are considered in the allocation of Housing Credits. QAPs should also reference any related documents that provide additional details on selection criteria and preferences or describe other Agency requirements, policies, and procedures relevant to the allocation of Credit.

Agencies should design QAPs and/or related documents to encourage the type, location, and tenancy of affordable housing most needed in the state. As Agencies consider priorities to encourage through the QAP and/or related public documents, they should also consider the impact of these priorities on upfront development costs and long-term operating costs. Agencies should also ensure that any variations in scoring or threshold criteria between 9 percent and 4 percent Credit allocations are clearly documented in either the QAP or related documents.

Agencies should review their priorities on an annual basis, engage stakeholders as part of the process, provide a reasonable time period for public input, and, after careful consideration of such input, update QAPs and/or related public documents as necessary to reflect current housing priorities.

Discussion

The Housing Credit statute requires each Allocating Agency to develop a QAP for use in determining those developments that will receive an allocation of Credit. The QAP must include three statutory preferences: developments serving the lowest income tenants, developments affordable for the longest periods of time, and developments located in qualified census tracts (QCTs) designated by the U.S. Department of Housing and Urban Development (HUD) that contribute to a concerted community revitalization plan.

The QAP also must consider ten statutory selection criteria: project location; housing needs characteristics; project characteristics; sponsor characteristics; tenant populations with special housing needs; public housing waiting lists; tenant populations of individuals with children; projects intended for eventual tenant ownership; energy efficiency of the project; and historic nature of the project.

Beyond the basic framework of preferences and selection criteria, Congress left QAP development up to the states so they could design programs that best suit local affordable housing needs. Agencies have embraced this responsibility and used the QAP for more than 30 years as an effective and flexible policy tool to create affordable housing. Agencies typically notify industry stakeholders about any proposed QAP changes and invite their comment on such changes. QAPs have evolved over time as states identify new housing priorities and respond to program and market changes.

2. Allocation and Underwriting of Tax-Exempt Bond Deals

Recommendation

Allocating Agencies' QAPs or other Housing Credit allocation guidelines should specify that Agencies will evaluate and underwrite tax-exempt bond-financed Housing Credit properties as they do non bond-financed Housing Credit properties. This applies to all bond-financed properties, including those in which the bonds were issued by an entity other than the Agency that allocates the Credit. Agencies should consider, for example:

- The sources and uses of funds;
- The equity to be generated by the Credit;
- The reasonableness of development and operational costs; and
- The housing needs of low-income individuals the development proposes to serve, as demonstrated by a market study.

In evaluating and underwriting bond-financed properties, Allocating Agencies should apply standards substantially similar to those they apply to non bond-financed developments and disclose those standards in their QAPs or other Housing Credit allocation guidelines. In the absence of an express exemption or variation, all evaluation and underwriting requirements applicable to non bond-financed properties should be applicable to bond-financed properties.

Discussion

The Housing Credit statute requires tax-exempt bond-financed developments to satisfy the Allocating Agency's QAP. However, the statute entrusts the authority to determine the amount of Credits necessary for viability and feasibility in tax-exempt bond-financed Housing Credit developments to the bond issuer, even if the issuer is not the Credit Allocating Agency. Some bond issuers have little or no experience with multifamily housing development or the Housing Credit program. Recognizing this, many Agencies underwrite all bond-financed deals—regardless of which entity issued the bonds—while some Agencies have entered into memoranda of understanding with bond issuers to delegate the viability and feasibility determination and the Credit amount calculation to the Allocating Agency on the issuer's behalf.

This practice is designed to ensure that Allocating Agencies evaluate and underwrite bond-financed properties as rigorously as non bond-financed properties and apply substantially similar standards in evaluating and underwriting both development types. Allocating Agencies should publish in their QAPs or other Housing Credit allocation guidelines evaluation and underwriting standards applicable to bond-financed developments and assure the developments satisfy these standards.

3. Concerted Community Revitalization Plans

Recommendation

To support the statutory preference for allocating Credits to developments located in qualified census tracts that contribute to a concerted community revitalization plan, Agencies should adopt criteria for evaluating concerted community revitalization plans, describe those criteria in their QAP or other related public

NCSHA

documents, and apply those criteria in their Housing Credit application and scoring procedures. Agencies may consider factors they deem appropriate, including the extent to which the plan:

- Is geographically specific and provides a clear direction for implementation;
- Includes a strategy for obtaining commitments of public and private investment in non-housing infrastructure, amenities, or services beyond the Credit development;
- Demonstrates the need for revitalization; and
- Includes planning document elements such as setting goals for outcomes, identifying barriers to implementation, establishing timelines and benchmarks, and identifying community partners.

Discussion

The Housing Credit statute requires Agencies to develop QAPs for use in determining which developments will receive Credit allocations. These QAPs must contain three statutory preferences, the third of which requires Agencies to give preference to developments located in HUD-designated qualified census tracts (QCTs) that contribute to a concerted community revitalization plan. This preference was added to the statute in 2000 legislation. Since that time, many Agencies have developed criteria defining concerted community revitalization plans for use in their Housing Credit application and scoring procedures.

A concerted community revitalization plan does not require approval by a local elected or appointed official. Many successful community revitalization plans originate at the grassroots level with residents and community stakeholders, and Agencies can evaluate such plans to determine if the proposed development contributes to the plan and is therefore eligible for the statutory preference.

Notwithstanding the statutory preference, Agencies may still allocate Credits to developments in QCTs without a concerted community revitalization plan. While such plan is a requirement for application of the statutory preference, it is not a requirement for allocation of Credits.

The IRS issued a Notice in December 2016 stating that "although [it has] not issued guidance defining the term concerted community revitalization plan, the statutory preference fails to apply unless, not later than the date of Housing Credit allocation, a plan exists that contains more components than the development itself."

The Notice also states that IRS is considering providing guidance on concerted community revitalization plans and requested comments from the public regarding the contents of that guidance. In our comments to IRS, NCSHA suggested that further guidance from them is unnecessary, and that Agencies—not IRS—should set their own definitions of or criteria for concerted community revitalization plans for purposes of implementing the statutory preference.

NCSHA believes that a one-size-fits-all federal definition of concerted community revitalization plans is inappropriate and misguided. A recommended practice in this area will help Agencies refine criteria for concerted community revitalization plans while preserving state flexibility to establish definitions appropriate to local conditions.

4. Reducing Local Barriers to Development

Recommendation

While inviting local jurisdiction comment on proposed Housing Credit developments is required by statute, Agencies should not require local approval (for example, a letter of support) as a threshold qualification or allocate points for local approval as part of a competitive scoring system. Moreover, Agencies should not require local financial contributions as a condition for receiving an allocation of Housing Credits. In the course of developing a competitive scoring process, Agencies may choose to encourage developers to obtain additional funding sources for the project, including local contributions and tax abatement, but Agencies should not prioritize local contributions over any other source of outside funding.

Discussion

For many years, fair housing and civil rights organizations as well as other affordable housing advocates have argued that thresholds requiring and competitive scoring processes incentivizing local support and/or local financial contributions effectively give localities the ability to veto the development of Housing Credit properties and allow "Not in My Backyard" efforts to prevent affordable housing development.

In December 2016, IRS issued guidance clarifying that, while the Housing Credit statute requires Agencies to notify the chief executive officers (or the equivalents) of local jurisdictions within which proposed developments are located and provide those officials a reasonable opportunity to comment on such developments, this notification requirement is not the same as requiring the jurisdictions' approval. Specifically, IRS provides in the guidance that a "reasonable opportunity to comment means the jurisdiction has a chance to weigh in, or even object, but not that every objection will be honored." The IRS guidance further provides that the Housing Credit statute "does not require or encourage Agencies to bestow veto power over Housing Credit developments either on local communities or on local public officials." IRS suggests that Agencies should avoid points or other incentives in competitive scoring criteria for projects that demonstrate affirmative local support, including written statements of support by elected officials or neighborhood organizations, to ensure consistency with fair housing laws.

The U.S. Government Accountability Office (GAO) also addressed local letters of support in its June 2016 report on the Housing Credit, suggesting that Agency requirements for such letters raise fair housing and other concerns. Officials from HUD's Office of Fair Housing and Equal Opportunity have also cited fair housing concerns in relation to Agency QAP preferences or requirements for local approval or support due to the discriminatory influence these preferences or requirements may have on the location of affordable housing.

This suggested recommended practice seeks to balance these concerns with some Agencies' interest in maximizing Credit efficiency by incentivizing developers to find other sources of funds to help finance Housing Credit properties.

5. State Designated Basis Boost

Recommendation

Allocating Agencies should set standards in their QAPs for determining which areas and/or developments are eligible for the state-designated basis boost of up to 30 percent and should make the reasons for such determinations available to the public. Agencies should review their basis boost policies as part of their regular QAP review process to ensure that the boost continues to advance state housing priorities and is not used more broadly than necessary.

Discussion

The Housing and Economic Recovery Act of 2008 (HERA) authorized Allocating Agencies to award a basis boost of up to 30 percent to Housing Credit buildings that states determine need the boost for financial feasibility.

In its General Explanation of the Act, the Joint Committee on Taxation (JCT) wrote, "It is expected that the State allocating agencies shall set standards for determining which areas shall be designated difficult development areas and which projects shall be allocated additional credits in such areas in the State allocating agency's allocation plan. It is also expected that the State allocating agency shall publicly express its reasons for such area designations and the basis for allocating additional credits to a project."

This provision offers significant discretion to state agencies and prudent use of the basis boost is critical to sound state administration of the program. While some states have chosen to apply the boost on a statewide basis to any Housing Credit development based on financial feasibility, others have defined certain geographic areas, project types, or project characteristics that justify the boost. Examples include deep income targeting, location in areas affected by natural disasters, permanent supportive housing developments, projects exhibiting green building and sustainable development practices, location in rural or tribal areas, mixed-income and mixed-use developments, preservation initiatives, and transit-oriented developments.

Agencies have amended basis boost policies due to changes in equity pricing or other market conditions. Regular review of such policies as part of the state QAP review process will ensure that basis boost criteria continue to reflect state priorities, consistent with congressional intent.

6. Application Procedures and Site Visits

Recommendation

Allocating Agencies should endeavor, to the extent useful and practical, to streamline the application process for Housing Credit developments involving multiple subsidies by taking into account other sources of funding subject to different application and allocation schedules.

In addition, Agencies should visit proposed development sites (or hire a third party analyst to conduct a site visit) whenever possible at the application stage to assess the viability of the site and to check for nearby incompatible uses, physical barriers to development, or other significant shortcomings.

Discussion

Many Housing Credit developments, particularly those targeted to very low-income tenants, are financed with multiple federal, state, and local subsidies. Often these subsidies are administered by one or more agencies that the Allocating Agency does not manage and in cycles other than those applicable to the Housing Credit.

The Allocating Agency should, to the extent practical, consider what it can do in its own program funding cycles to accommodate the timing of other funding sources. These efforts may include consolidating funding cycles for Housing Credits with HOME, CDBG, state trust funds, or other subsidies administered by the Allocating Agency, and coordinating Housing Credit funding cycles with those of other funding sources not controlled by the Allocating Agency.

Conducting a site visit is essential to ensure Housing Credit properties are not located near land uses that are incompatible with residential occupancy. Checking the site also allows Agencies to assess whether proposed development costs such as grading and infrastructure are reasonable. Due to the size of some states and/or personnel available, having staff conduct reviews simply is not possible for some Agencies. In those cases, contracting with a third party may be the best option.

7. Development and Management Experience

Recommendation

In allocating Housing Credits, Allocating Agencies should consider the capabilities of the entire development team, including at minimum the project sponsor, developer, general contractor, architect, property manager, and key consultants. They should take into account the team's track record, financial capacity, and relevant experience in multifamily housing finance, development, construction, management, and resident services. Agencies should require development team members to report past experience with affordable housing programs, including any removals as general partner, defaults under project documents, failures to receive IRS Form 8609, or project foreclosures.

Given the complexity of the Housing Credit program and the importance of solid development and management experience, Agencies should encourage program sponsors with no Housing Credit experience to partner or joint venture with a more experienced sponsor or developer.

Discussion

The complexity of the Housing Credit program and multifamily housing development generally requires developers to possess a minimum level of development experience and financial strength. However, Allocating Agencies may deem broader access to the Housing Credit—a public resource—by new, less experienced developers a worthy public policy goal.

Evaluating the entire development team assures adequate development capacity without creating insurmountable barriers to program newcomers. It encourages partnering and joint ventures that often strengthen Housing Credit applicants.

Requesting reports of past affordable housing experience helps Allocating Agencies judge the track record of the proposed development team and may prevent entities with negative past experience from jeopardizing the program's excellent track record.

8. Market Analysis

Recommendation

The Housing Credit statute requires Allocating Agencies to obtain for each Housing Credit development a recent comprehensive market study of the housing needs of low-income individuals in the area to be served by the development before making an allocation of Credit. The study must be prepared by a party unaffiliated with the developer and approved by the Allocating Agency. The market study provider should have experience with multifamily rental housing. To ensure independence of the market analyst from the developer, Agencies may consider providing a list of approved market analysts for developers to hire or contracting for market studies directly.

Allocating Agencies (or contracted third-parties) should review each study to determine its implications for the financial viability of the property and whether it justifies the need for the number, size, and type (such as family, elderly, or other special needs housing) of rental housing proposed.

Allocating Agencies should specify in their QAPs or other Housing Credit allocation guidelines the time at which the market study must be provided to the Agency (i.e., at Credit application or reservation) and the components and analysis required in the study. At a minimum, the market study should include:

- A statement of the competence of the market study provider, detailing education and experience of primary author and including statement of non-interest;
- A site visit and description of the proposed site and neighborhood, including physical attributes of site, surrounding land uses, and proximity to community amenities or neighborhood features including shopping, healthcare, schools, and transportation;
- A map and photos of the subject site and surroundings showing location of community services;
- An overview of local economic conditions, including employment by sector, list of major employers, and labor force employment and unemployment trends over past 5-10 years;
- A description of the proposed development, detailing proposed unit mix (number of bedrooms, bathrooms, square footage, proposed rents, Area Median Income (AMI) level, utility allowances, and any utilities included in rent), proposed unit features and community amenities, and target population characteristics such as age restrictions and/or special needs populations;
- Demographic analysis of the number of households in the market area that are part of the target market (i.e., family, senior, etc.), income-eligible, and can afford to pay the rent, including a projected household base at placed-in-service date;
- Geographic definition and analysis of the market area, including description of methodology used to define market area and map of market area including proposed site;
- Analysis of household sizes and types in the market area, including households by tenure, income, and persons per household;
- A description of comparable developments in the market area, including any rental concessions these developments presently offer;
- A description of rent levels and vacancy rates of comparable properties in the market area, segmented by property type (market rate, Housing Credit, deep subsidy) and with rents adjusted

to account for utility differences and concessions or other incentives. Such description should include all existing Housing Credit developments in the primary market area and any planned additions to rental stock, including recently approved Housing Credit developments;

- Expected market absorption of the proposed rental housing, including capture/penetration rate analysis of target populations; and
- A description of the effect on the market area, including the impact on Housing Credit and other existing affordable rental housing.

Agencies may choose to adopt different standards or requirements for different types of projects (i.e., new construction vs. preservation or family vs. senior), but should reference and explain such variations clearly in the QAP or other Housing Credit allocation guidelines.

Discussion

A market study is an indispensable tool for helping an Allocating Agency determine whether a particular development is appropriate in a particular market area. However, the usefulness of the market study depends on many variables, including the factors it considers, its adherence to generally accepted methodologies and techniques, and the independence of its provider.

Housing Credit law requires a comprehensive market study of the housing needs of low-income individuals in the area to be served by the Housing Credit property. The study must be conducted before the Credit allocation is made at the developer's expense by a disinterested party approved by the Allocating Agency.

The recommended practice is consistent with the Housing Credit statutory requirement and exceeds it by specifying minimal market study components and suggesting strategies for ensuring independence of the market analyst from the developer. Though it leaves the timing of the market study submission to be determined by the Allocating Agency, it makes clear the submission must precede Credit allocation.

The original NCSHA market study recommended practice was adopted in 1998, two years prior to the statutory requirement. The minimum market study components outlined above were refined several times since to reflect state and industry experience with Housing Credit market studies.

9. Promoting Choice and Opportunity for Housing Credit Residents

Recommendation

Agencies should develop QAP and/or other program policy documents to facilitate the siting of new affordable housing in diverse locations, including low-distress, low-poverty areas that provide residents with access to various amenities—typically considered "areas of opportunity"—as well as areas that historically have had higher poverty and distress rates, but in which housing and other stakeholders seek to create new opportunities for residents through holistic community revitalization.

To identify areas of opportunity within a state, Agencies should consider available data sources related to various indicators, which may include, but are not limited to, crime rates, employment opportunities, access to transportation, school performance, and other opportunity indicators as determined by the

state. In particular, Agencies should facilitate development of a portion of the housing they finance for families with children in areas that provide these types of amenities.

While developments in areas of opportunity provide important benefits to tenants—in particular children—such investment should be balanced with investment in distressed neighborhoods to ensure diverse housing needs are addressed and that resident choice is not limited. In facilitating development in historically distressed areas, Agencies should consider community revitalization efforts, prospects for mixed-income housing, and other means of bringing new opportunities to such areas.

As Agencies seek to promote opportunity and choice for Housing Credit residents, they should consider the cumulative concentration of Housing Credit and other assisted housing in various areas and the relative need for new construction vs. preservation, urban vs. rural housing, family vs. senior housing, and other statewide housing needs.

Discussion

Research shows that locating Housing Credit developments in areas that allow for access to employment, quality schools, transportation options, health care facilities, and other necessary services and amenities, can correlate with stronger long-term life outcomes for assisted households, and especially for children in those households. In April 2015, HUD published a report entitled, Effect of QAP Incentives on the Location of LIHTC Properties, which found that states that provided incentives in their QAP for locating properties in areas of opportunity saw a statistically significant increase in the share of Housing Credit properties developed in low-poverty areas. This report, as well as other research on the effect of exposure to low-poverty neighborhoods on children's economic mobility when they reach adulthood, underscores the importance of incentivizing locating Housing Credit properties in areas of opportunity.

At the same time, affordable housing also can be a critical catalyst in bringing new opportunities to distressed areas, impacting not only those households who are tenants in that affordable housing, but also households in the surrounding community. Various research studies have found that Housing Credit investment in distressed areas correlates with increased home values and lower crime rates, and can attract a more racially and income diverse population.

For these reasons, it is important for Agencies to seek to balance Housing Credit investment in different communities throughout the state, including both areas that already provide access to opportunities and those in which Housing Credit development may help create opportunities.

10. Facilitating Rural Development with the Credit

Recommendation

Allocating Agencies should analyze recent state experience in using the Housing Credit in rural rental housing development and consider QAP incentives or other policy initiatives to ensure rural housing needs are adequately addressed. Agencies should work with rural stakeholders and program investors to study current impediments to rural development and make appropriate changes to underwriting criteria or other policies to maximize investor interest in rural areas.

Discussion

Periodic volatility in Housing Credit equity pricing can impact the ability to attract investors and structure financially feasible Housing Credit developments in rural areas.

Some states have adopted QAP incentives for rural development, including set-asides of Credit authority, additional points in the competitive scoring process, or use of the state-designated basis boost in rural areas. Others have adapted underwriting criteria in rural areas to recognize the challenges in structuring and maximizing investor interest in such developments. Some states are prioritizing rural preservation projects by using the Credit to recapitalize the aging stock of U.S. Department of Agriculture (USDA) Section 515 developments, while others are allocating HOME funds to rural Housing Credit transactions to enhance financial feasibility.

11. Encouraging Native American Housing Development with the Credit

Recommendation

Agencies should analyze recent state experience in using the Housing Credit for Native American housing development and consider QAP incentives or other policy initiatives to ensure Native American housing needs are adequately addressed. Agencies should work with relevant stakeholders and program investors to study current impediments to Native American housing development and make appropriate changes to underwriting criteria or other policies to maximize investor interest in these developments. Agencies should also be attentive to relevant state treaties, executive orders, and other documents that may impact housing development on Native American lands.

Discussion

Developing Housing Credit properties on Native American lands is challenging due to the often very low-income population, shortage of other funding sources to leverage the Credit, higher cost of construction and shortage of contractors in remote locations, and lower Housing Credit equity pricing typical of developments in these areas.

Agencies have responded to these challenges with QAP set-asides for Native American developments or scoring incentives that advantage such developments, including points for smaller projects, rural location, very low-income targeting, and nonprofit sponsorship. Some Agencies also use the state-designated basis boost to enhance financial feasibility of Native American developments. Agencies with significant Native American populations have taken additional steps to assist this type of development, including outreach to Native American entities for comment on draft QAP provisions and provision of technical assistance or capacity building to program participants.

12. Use of the Housing Credit for Supportive Housing

Recommendation

Allocating Agencies should analyze recent state experience in using the Housing Credit for supportive housing and consider QAP incentives or other policy initiatives to ensure such housing needs are adequately addressed.

Agencies should work with interested stakeholders and program investors to study current impediments to supportive housing development and make appropriate changes to underwriting criteria or other policies to maximize investor interest in these developments. Agencies should also ensure that supportive housing developments have the capacity to deliver appropriate resident services by requiring service delivery experience among the proposed development team or from identified service providers.

Agencies should consider implications of the U.S. Supreme Court's Olmstead decision relating to appropriate housing for persons with disabilities to ensure that supportive housing developed using the Housing Credit is consistent with this ruling.

Discussion

The Housing Credit is a vital tool for developing supportive housing for various special needs populations, and many Allocating Agencies have developed strategies for structuring and attracting investors to such developments. Some states have set-asides of Credit authority for supportive housing, while others provide additional points in the competitive scoring process. Some Agencies are revising underwriting standards and using the state-designated basis boost to enhance financial feasibility of supportive housing developments, while others are focusing on securing supportive service commitments and funding to enhance investor comfort with these deals.

The U.S. Supreme Court's Olmstead v. L.C. opinion held that unjustified segregation of people with disabilities violates Title II of the Americans with Disabilities Act, known as the integration mandate. The integration mandate, as interpreted by both the Supreme Court and the U.S. Department of Justice, requires that public entities administer programs and services in the most integrated setting appropriate to the needs of qualified individuals with disabilities. From a housing perspective, the mandate contemplates providing individuals with disabilities with meaningful opportunities to live and receive services in an integrated community setting. Agencies should consider how appropriate housing options for individuals with disabilities can be provided in properties developed using the Housing Credit. Many states also have Olmstead Plans, which outline the steps states will take to implement the integration mandate. Agencies should ensure their Housing Credit practices comply with such plans.

13. Sustainable Development

Recommendation

Allocating Agencies should evaluate current Housing Credit QAP incentives or other policy initiatives designed to encourage green building and sustainable development and consider ways to continue fostering innovation in this rapidly evolving and increasingly important field. Agencies should consider cost implications of sustainable development initiatives individually and in totality to ensure consistency

with development cost containment goals. This cost assessment should consider both upfront development costs and potential long-term savings in operating costs and capital expenses associated with sustainable development initiatives.

Discussion

Allocating Agencies encourage sustainable development and green building practices through a variety of QAP policies addressing sustainable site selection, energy efficiency, resource conservation, indoor air quality, and other sustainable development practices. Current state approaches vary greatly from mandatory design requirements and threshold criteria to selection criteria incentives.

An increasing number of states are now adopting holistic approaches to sustainable development, some of which include reference to state green building mandates or industry green building standards such as the U.S. Green Building Council's Leadership in Energy and Environmental Design (LEED) criteria, Enterprise Community Partners' Green Communities program, the National Association of Home Builders' Green Building Standard, and others.

While many green building and sustainable development initiatives generate cost savings over the long term, others may add costs that are inconsistent with Agencies' cost containment strategies, and should therefore be evaluated to determine whether the benefits of the green building initiative justify additional costs to the project.

14. Ensuring Reasonable Development Costs

Recommendation

In addition to carefully calculating the amount of Housing Credit allocated to eligible developments, as federal law requires, each Allocating Agency should develop a standard for limiting development costs to reasonable amounts. This standard may take the form of a development cost limit, calculated on a per unit, per bedroom, or square footage basis.

The standard should be based on total development costs, including costs not eligible for Housing Credit financing and costs funded from sources other than the Housing Credit. The standard and the justification for it should be published in the Allocating Agency's QAP or other Housing Credit allocation guidelines.

In developing its development cost standard, the Allocating Agency should thoroughly examine building construction and land costs in its state, including variations in such costs within the state. It should also examine certified cost data on existing Housing Credit developments in the state portfolio and compare that data against the actual costs of other non-luxury multifamily housing located in the same geographic areas.

This process will produce a standard that either prescribes a single cost limit applicable to the entire state or multiple limits that take into account disparities in costs due to project location, type of construction, population served, and potentially other project characteristics. In developing cost limits, Agencies should balance the efficient use of scarce resources with the need to develop affordable rental housing that is durable, attractive, safe, energy efficient, and healthy.

If an Allocating Agency receives an application for the award of Housing Credits to a development with cost in excess of its established limit for the area in which the development is located, the Agency should subject the development to a further level of scrutiny and review. Credits should be awarded to such developments only if that review reveals the additional costs are justifiable and reasonable under the circumstances and attributable to unique development characteristics (e.g., location in a difficult-to-develop area, prevailing wage rate requirements, limited commercial space, or tenant services or common areas essential to the character of the development) consistent with the housing needs and priorities identified in the Agency's QAP.

In addition to comparing a development's cost against the Agency's standard and comparable developments in the market, the Allocating Agency should compare it to the cost of other developments competing within the same allocation cycle to identify any cost items outside of the norm. The Agency should require that such cost outliers be examined and reduced unless the sponsor provides a compelling reason as to why they are warranted that is acceptable to the Agency.

The Allocating Agency should carefully limit and justify the total number of developments with cost in excess of the state's established standard, as well as the total amount of Credit allocated to such developments. The Agency should document the justification in each case.

Each Allocating Agency's cost limit standard and/or policies should acknowledge that the total cost of a development may sometimes be higher than good public policy and prudent resource allocation should allow, even if individual cost components may be justified and considered reasonable in other contexts. It should recognize that some markets, property characteristics, and circumstances individually or together may be cost-prohibitive for Housing Credit development, and that developments with costs in excess of the Agency limit may not receive Credits.

The Allocating Agency should apply the same standards and rigorous evaluation to Housing Credit developments financed with tax-exempt bonds.
To further encourage reasonable Housing Credit development costs, Agencies may supplement development cost limits with other policies such as limitations on eligible basis or incentives for reasonable development costs in competitive scoring criteria.

While encouraging cost efficient production with realistic cost limits for Housing Credit developments, the Allocating Agency should not give preference solely for lowest development costs.

Finally, each Allocating Agency should regularly review its QAP and related allocation guidelines with the goal of reducing development costs.

Discussion

In designing the Housing Credit program, Congress gave states the flexibility to respond to their unique and varied low-income housing needs and the responsibility to maximize the Housing Credit's use in producing significant numbers of low-income housing units. To that end, Congress carefully limited development costs that can be financed by Housing Credits. Congress recognized, however, that the cost of providing low-income housing:

- Is often highest in areas of greatest need, such as inner-city areas where development is frequently most expensive and difficult;

- May involve construction of facilities to support special services to low-income tenants;
- May sometimes reflect higher wage rates than other housing due to state or federal law; and
- In developments that include Housing Credit units, might also include market rate units not financed by the Credit.

Consequently, Congress did not limit either the total amount of Housing Credits that can be allocated to a single development or the total cost of any development, including costs ineligible to be financed by the Housing Credit that are financed by other sources.

Moreover, Congress required the states, in administering the Housing Credit, to give priority to developments that serve the lowest-income tenants and those that serve low-income tenants for the longest time, without regard to the higher amounts of Housing Credits that might be required to finance developments meeting these objectives. The cost of producing low-income housing, particularly special needs housing and housing located in difficult-to-develop areas, requires states to balance financing the maximum possible number of units that might be produced, if high-cost areas and developments were avoided, and serving areas and tenants of greatest need.

NCSHA recognizes preservation of the Housing Credit program depends on continued congressional and public support, and such support will be imperiled by developments, however meritorious, the cost of which exceeds an accepted standard of reasonableness. While higher costs will be justified in some developments where special tenant needs are served, there must be a standard against which even those costs are judged. At the same time, in minimizing costs, Allocating Agencies must be certain to adhere to sound underwriting practices, including assuring quality construction, if they are to achieve long-term property viability.

15. Developer Fee and Builder Fee Limits

Recommendation

Each Allocating Agency should include in its QAP or other Housing Credit allocation guidelines a general developer fee limit, including overhead. The limit should not exceed the lesser of 1) an appropriate defined per unit dollar cap on developer fee, or 2) 15 percent of total development cost. Agencies may allow exceptions to the developer fee limit for developments meeting specified criteria based upon the following factors, but only in extremely limited circumstances with documentation of the reasons justifying the exception:

- Development size - The smaller the development size, the higher the fee may be as a percentage of development costs;
- Development characteristics - Higher developer fees may be allowed as an incentive to produce hard-to-develop or socially desirable developments, such as housing for people who are homeless, single-room occupancy housing, and scattered-site developments; and
- Development location - Higher developer fees may be allowed for developments produced in difficult-to-develop areas.

Allocating Agencies should encourage lower developer fees for the acquisition portion of acquisition/rehabilitation developments.

Allocating Agencies should evaluate the amount and duration of any developer fee deferral when underwriting a development and determining its Housing Credit allocation amount. Agencies should ensure a development's cash flow projections support the reasonable expectation that deferred fees can be paid within 15 years of the development's placed-in-service date.

To the extent Allocating Agencies incentivize lower fees in establishing realistic developer fee limits for Housing Credit developments, they should take special care to assure developments' long-term financial feasibility.

Agencies should apply the same developer fee standard to Housing Credit developments financed with tax-exempt bonds.

In addition to establishing developer fee limits, Allocating Agencies should include in their QAP or other Housing Credit allocation guidelines limits on builder or general contractor charges. Generally, the standards set forth below should not be exceeded except for developments with characteristics, such as small size or location in difficult development areas that may justify higher fees:

- Builder's profit - 6 percent of construction costs;
- Builder's overhead - 2 percent of construction costs; and
- General requirements - 6 percent of construction costs.

Allocating Agencies should require in their Housing Credit applications that developers identify the existence of an identity of interest with any other party to the development. Agencies should take such identity of interest into consideration in determining maximum fees.

Discussion

Developers typically earn a fee for their work in developing multifamily housing. In market rate developments, the developer also can expect some cash flow from the operation of the property—particularly over time as rents increase faster than operating expenses. Because Housing Credit property rents are restricted, significant operating cash flow in excess of debt service is generally not expected, generally limiting the developer's compensation for developing the housing to the developer fee.

A developer fee is an accepted cost of producing affordable housing under the Housing Credit and most other subsidized housing programs. The Housing Credit statute does not limit developer fees. However, it requires Allocating Agencies to limit Credit allocations to amounts necessary to assure the financial feasibility and viability of developments as qualified low-income housing throughout the Credit period. As part of this evaluation, Agencies must consider the reasonableness of development and operating costs of the project, which include developer fees.

NCSHA first adopted a recommended developer fee practice in 1993, when there was little uniformity among Allocating Agencies in the definition of developer fee, Agency procedures for establishing such fees, or application of the fees in underwriting Housing Credit developments. Developer fee limits are now standard in Agency Housing Credit underwriting guidelines.

Agencies should endeavor to set fees commensurate with the levels of work performed. For example, in acquisition/rehabilitation developments, lower fees for land acquisition services may be warranted depending on the difficulty of the transaction. The proper allocation of developer fee between acquisition

and development costs is typically defined in a development services agreement and addressed in the cost certification.

In applying developer fee limits, Allocating Agencies may reward lower developer fees. However, Agencies should not reward sponsors with the lowest fees because unrealistically low fees provide less cushion against construction and lease-up risk and other unforeseen expenses.

Allocating Agencies may allow deferred payment of developer fees. However, the development's cash flow projections must support a reasonable expectation that the deferred fees can be paid within 15 years of the property's placed-in-service date if the developer fees are to be included in the property's eligible basis.

By setting a defined per unit or per project dollar cap on developer fee in addition to the 15 percent of total development cost standard, and limiting the total development fee to the lesser of the two, Agencies can help ensure that developer fees do not act as an incentive for higher cost projects.

While this recommended practice does not dictate developer fee payout standards, Allocating Agencies should consider the payout schedule in evaluating the reasonableness of developer fees. Developers undertake significant risk in developing Housing Credit properties and have an interest in earning the developer fee as quickly as possible and limiting the amount of any deferred fees.

16. Consultant and Professional Fees

Recommendation

Each Allocating Agency should adopt and apply a definition of consultant fees that:

- Identifies those professional fees (such as architectural, engineering, accounting, legal, environmental consulting, and construction management) reimbursable through the Housing Credit;
- Excludes costs properly allocated to and payable by the syndicator (such as SEC registration and sales commissions); and
- Requires consultant fees, other than the types of professional fees discussed above, be permitted only within the developer fee limit.

No distinctions between for-profit and nonprofit developers should be drawn for the purpose of determining the appropriate level of consultant fees.

In addition to limiting consultant fees as described above, Agencies should review professional fees—including at minimum fees for architectural, engineering, environmental, accounting, legal, market analysis, construction management, and asset management services—at project application and compare them with professional fees charged in Housing Credit developments awarded Credit in prior funding cycles and with current Housing Credit applications to assess reasonableness.

Agencies should apply additional scrutiny to any outlier professional fees and require documentation as to why the higher fees are warranted before allowing such fees to be included. In some cases, Agencies may choose to establish specific limits for some professional fees.

Discussion

Work performed by consultants is often indistinguishable from that performed by developers. Particularly in the early years of the Housing Credit program, developers employed consultants to help them understand the requirements of the new program.

Professional fees are direct costs for services that are distinct from activities that a developer might otherwise undertake. Because professional fees contribute to overall development cost and are not limited by the developer fee limit, Agencies must review such fees to assess reasonableness as required by the Housing Credit statute.

17. Verification of Expenditures and Issuance of IRS Form 8609

Recommendation

Each Allocating Agency should establish a process for requiring and analyzing cost certifications for all developments as part of the final feasibility evaluation, prior to issuing IRS Form 8609. As part of this analysis, the Agency should judge the reasonableness of the cost components. Agencies should issue Form 8609 in a timely manner after receiving all required documentation.

For developments of 11 or more units, the Agency must require the sponsor to submit for the Agency's review an independent third-party Certified Public Accountant (CPA) audit report as a part of the final feasibility evaluation.

Agencies should require additional cost certification due diligence for all Housing Credit developments. This additional due diligence may include audits of general contractors and/or sampling of subcontractor invoices to verify consistency with the developer cost certification.

Each Allocating Agency should establish a process for receiving and analyzing copies of federal cost certifications for U.S. Department of Agriculture (USDA) and HUD developments receiving Housing Credits.

Agencies should adopt the model 10 Percent Test and final cost certification letters developed by NCSHA.

Discussion

The Housing Credit law requires Allocating Agencies to limit Credit allocations to the amount necessary for financial feasibility and viability as a qualified low-income housing development throughout the Credit period. As part of their analysis, Agencies must evaluate all sources and uses of funds and the reasonableness of development and operating costs. Agencies typically verify expenditures by requiring developers to submit a detailed cost certification.

NCSHA first adopted a recommended verification of expenditures practice in 1993, when little uniformity existed among Allocating Agencies in analyzing costs in Housing Credit developments. A cost certification practice is now standard in Agency underwriting guidelines.

In January 2000, the IRS issued regulations requiring independent verification of sources and uses of funds in the form of a CPA audit report, based on an accountant's audit or examination of financial documents and certifications the development owner provides. IRS regulations exempt developments with 10 or fewer units from the requirement to obtain a CPA audit report.

Allocating Agencies require Housing Credit development owners to certify development costs for purposes of meeting the 10 Percent Test for a carryover allocation and again once the development is complete on a final cost certification. In 2000, to support the new IRS requirements, NCSHA developed standardized 10 Percent Test and final cost certification letters for Agency use to create efficiency for and common understanding among developers and other Housing Credit industry professionals. NCSHA updates these reports as necessary to comply with changes in accounting practices.

While the practice recommends Allocating Agencies evaluate federal cost certifications for USDA and HUD developments receiving Housing Credits, Agencies should note that certifiable USDA and HUD costs and fee limits may differ from those Agencies permit under the Housing Credit program.

Since taxpayers need IRS Form 8609 to claim Housing Credits, Agencies should evaluate their policies relating to this form and strive for timely issuance of it once the final cost certification and other necessary documentation is received.

18. Sponsor Certification of Project Sources and Uses of Funds

Recommendation

To ensure that Housing Credit developments do not receive Credit and other funding in excess of the amount necessary to ensure their feasibility and long-term viability as low-income housing, the Allocating Agency should require sponsors to certify to the Agency that they:

- Have disclosed all of a development's funding sources and uses, as well as its total financing;
- Have reported costs in the sources and uses statement accurately based on actual development costs incurred;
- Have disclosed any additional amounts paid to them or related parties for syndication fees, debt placement fees, guaranty fees, or other fees;
- Have identified the purchase price of a site and its allocated cost to the partnership; and
- Will disclose any future changes in funding or costs to the Agency.

Agencies should require this sponsor certification at each point of Agency evaluation and in the event of any other change in sources and uses of funds.

Discussion

Allocating Agencies are required by federal law to allocate only the amount of Housing Credit necessary to ensure a development's financial feasibility and long-term viability as qualified low-income housing for the Credit period. In making this determination, the law requires Agencies to consider all of a development's sources and uses of funds and the total financing planned for the development at three different stages of review: initial application; the allocation of the Credit amount; and the date the development is placed in service. The law further requires sponsors to certify to the Agency all other

federal, state, or local subsidies committed (or expected to be committed) to the development at each of the three stages of Agency review.

For Allocating Agencies to meet their underwriting responsibilities, development sponsors must, in turn, be required by Agencies to divulge fully to them all sources and uses of funds, as well as the development's total financing, at each stage of Agency review. To help ensure the completeness and accuracy of this disclosure, we suggest Agencies require sponsors to certify all of a development's sources and uses of funds and total financing at each point of Agency evaluation and in the event of any other change in sources and uses of funds. This is especially important due to periodic changes in equity pricing.

Whatever policies and approaches Allocating Agencies adopt, they must ensure that they satisfy the statutory requirement to allocate only as much Credit as necessary for a development's feasibility and viability and obtain the information necessary to carry out this responsibility.

19. Operating and Replacement Reserves

Recommendation

Allocating Agencies should establish operating and replacement reserve standards that consider development location, site (single or scattered), construction type, population served, projected vacancies, duration of reserves, design features, and security.

- Minimum operating reserves should generally equal four to six months of projected operating expenses plus: i) debt service payments; and ii) annual replacement reserve payments.
- Minimum replacement reserves should generally equal $250 per unit per year for new construction developments for seniors and $300 per unit per year for new construction developments for families and developments involving rehabilitation. Exceptions may be made for certain developments intended for special needs populations that may suffer less wear and tear than other properties, and for rehabilitation developments in which a current capital needs assessment supports some other reserve level. In general, replacement reserve levels for all developments involving rehabilitation should be consistent with reserve levels suggested by a capital needs assessment. In projecting replacement reserve standards, Agencies should take into account a realistic rate of inflation foreseeable at the time of underwriting.

In underwriting appropriate initial reserve levels, Agencies should consider historic portfolio reserve account usage and balances. While use of operating and replacement reserves is project specific, analysis of trends in reserve balances may suggest higher reserve requirements than the above minimums for certain developments.

In limited circumstances, Allocating Agencies may accept developer guarantees in lieu of operating reserves, taking into account the developer's demonstrated financial capacity and liquidity, its track record, and other guarantees it has outstanding.

Agencies should require reserves to stay with a development at the time of investor exit so that the owner can access the accounts should the property require access to that capital, and should review partnership agreements to ensure this policy is enforced.

Discussion

Adequately funded operating and replacement reserves are essential to a rental development's long-term financial and physical viability. Operating reserves must be adequate to cover short-term operating income shortfalls. Replacement reserves must be sufficient to cover foreseeable capital expenditures.

Adequate reserves are particularly important in Housing Credit developments, because rents are restricted and may not keep pace with operating, maintenance, and replacement costs. Unexpected increases in utility costs, property taxes, and insurance rates in recent years underscore the need for reserves adequate to cover unforeseen expenses.

In evaluating the appropriateness of operating reserves, Allocating Agencies should assess what entity would be retaining the reserve accounts, whether reserve accounts could be reduced over time after achieving project benchmarks, and how such reserves would be funded.

Use and control of reserves is a controversial topic in the development community, especially as more developments reach the end of the initial compliance period. Investors that funded the reserve accounts often seek the return of unused reserve balances at the time of investor exit, while the owner typically expects these reserves to stay with the property so that the owner can access the accounts should the property require use of that capital. Agency requirements to keep reserves with a development will facilitate preservation of and continued compliance in the Housing Credit portfolio.

20. Operating Expense and Vacancy Rate Projections

Recommendation

Allocating Agencies should promote long-term economic viability by requiring development owners to include realistic and itemized anticipated operating expenses in project proformas. In underwriting such expenses, Agencies should consider data from syndicators, investors, lenders, and their own portfolios.

Agencies should underwrite Housing Credit developments using a vacancy rate projection based on historic and projected local market conditions and other project-specific factors such as commitment of project-based rental subsidy. Vacancy rate projections may vary within a state depending on local economic and other conditions. Agencies may establish a range of vacancy rates instead of a single rate for certain markets experiencing volatility.

In underwriting both projected vacancies and operating expenses, Agencies should consider the unique risk characteristics of each development, including any deeply targeted units, market rate units, special needs targeting, or commercial income.

In consultation with development sponsors, owners, property managers, syndicators, lenders, and investors, Agencies should establish and maintain operating cost databases based on historic and current Housing Credit property experience and use them in their Housing Credit property underwriting. At minimum, the following operating expenses should be included in an Agency's operating cost database:

- Management fees;
- Administrative expenses;

- Utilities;
- Maintenance expenses;
- Real estate taxes;
- Property insurance; and
- Other operating expenses.

Agencies should require development owners to periodically report to the Agency on their operating expenses or to submit copies of operating expense reports provided to lenders, syndicators, or investors. In the absence of adequate operating cost data, an Agency should require reasonable and credible evidence of the supportability of operating expense and vacancy rate projections.

Discussion

Housing Credit law requires Allocating Agencies to assess the reasonableness of all development and operating costs in evaluating the financial feasibility of Housing Credit properties. Inaccurate projection of operating expenses at underwriting, for example, by failing to consider historic experience in trending forward expenses compared to income, is a significant cause of financial underperformance of multifamily rental properties.

Allocating Agencies can support the long-term viability of the Housing Credit portfolio by underwriting and verifying realistic operating expenses and vacancy rate assumptions in consultation with equity providers, property managers, and, most importantly, with thorough analysis of operating data from their own portfolios. Agencies now have more than 30 years of operating history for Housing Credit developments and should underwrite operating expenses and vacancy rates using data appropriate to local conditions.

Comparing a property's projected operating costs against actual expenses of comparable properties is an effective way for Allocating Agencies to judge the adequacy of the property's operating budget. Establishing and maintaining a database of actual operating costs of Housing Credit developments is a useful way for Agencies to access and analyze comparative property operating cost data.

21. Debt and Expense Coverage

Recommendation

Allocating Agencies should require a minimum debt service coverage ratio of 1.15 (1.10 in USDA properties) until initial stabilized occupancy for debt financing that would result in foreclosure if not repaid. For purposes of this standard, debt service coverage is defined as the ratio of a development's net operating income (rental income less operating expenses and reserve payments) to foreclosable, currently amortizing debt service obligations. In determining appropriate debt coverage up to and beyond the point of initial stabilized occupancy, Agencies should consider other underwriting variables, such as vacancy rates, ability to raise rents, and historic operating cost escalations customary in the marketplace, to improve the development's ability to maintain viability for its period of low-income use.

Allocating Agencies should not reward developments with the lowest possible debt service coverage. Instead, Agencies should ensure that rental income, any subsidies, and reserve funds are sufficient to cover the development's debt and operating expenses over the period of low-income use. In addition, Allocating

Agencies should structure developments such that there are incentives for quality long-term operations, including the potential for the sponsor to share in available project cash flow.

Agencies should provide an alternate benchmark—measuring projected expense coverage—for Housing Credit developments with no hard debt. This alternate benchmark would require a minimum expense coverage (defined as the ratio of projected rental income to the sum of operating expenses and reserve payments) of 1.10.

Discussion

Adequate debt coverage is essential to the long-term financial viability of Housing Credit developments. Excessive debt coverage ratios and property cash flows, however, subject the Housing Credit program to criticism that developers are becoming unduly enriched, rents are unnecessarily high, and lower income residents are not being served.

Allocating Agencies should require debt service coverage adequate to protect the financial viability of Housing Credit developments for the entire period they are set aside for low-income use, including periods of foreseeable economic downturn. One crucial element in achieving long-term financial viability is structuring development incentives to encourage responsible and efficient operations. Some Housing Credit transactions are structured such that most cash flow remaining after must-pay debt service is used to repay subsidized financing. This practice creates program income for the Agency to fund future loans, but can leave project sponsors heavily dependent on up-front fees, as opposed to compensation for responsible operation and management.

Agencies should also take care to assure the Credits awarded are no greater than necessary to fill any actual financing gap and, for tax-exempt bond developments, do not result in minimizing the mortgage in an effort to provide implicit credit enhancement to the bonds. Except in USDA developments, where the standard is 1.10, Agencies should require minimum debt coverage of 1.15.

Allocating Agencies should not consider debt service coverage in a vacuum. Prudent underwriting requires Agencies to consider several variables, including projected vacancy rates (which may require upward adjustment for small properties) and operating cost data, in conjunction with debt service coverage, in judging the long-term financial viability of properties.

Some Housing Credit developments, including many deeply targeted and supportive housing properties, do not have hard debt; therefore, the concept of debt coverage is meaningless in these developments. Some Agencies assess long-term financial viability in such developments by analyzing projected expense coverage instead of calculating a debt coverage ratio.

22. Minimum Rehabilitation Threshold

Recommendation

Allocating Agencies should establish a minimum rehabilitation threshold to assure meaningful, rather than simply cosmetic, rehabilitation of properties. Rehabilitation should be adequate to ensure the long-term physical viability of the property and supported by a capital needs assessment. Allocating Agencies should

only consider "hard" rehabilitation costs in determining whether a property meets the minimum rehabilitation threshold.

The minimum rehabilitation threshold, and any exceptions to it, should be included in the QAP or other Housing Credit allocation guidelines. Exceptions may be especially appropriate when the Credit is allocated in connection with state or federally assisted preservation efforts.

The rehabilitation scope of work for a particular development must be sufficient to address the improvements identified as necessary in the capital needs assessment. The scope of work should address any design or structural problems, identify steps necessary to achieve and maintain market viability, respond to all life/health/safety concerns, and make any required accessibility improvements. Whenever feasible and cost justified, the scope of work should incorporate environmentally sensitive design and materials or favorably impact operating costs.

Discussion

In 1986, Congress established a minimum rehabilitation threshold of $2,000 per unit for a property to qualify for Housing Credits. Congress has increased this amount twice since then, most recently in 2008 to the greater of $6,000 per unit or 20 percent of the building's adjusted basis. In many areas and for many properties today, the statutory minimum is insufficient to accomplish more than cosmetic improvements. Most Agencies require significantly more than the statutory minimum.

While limited rehabilitation may make a property temporarily more attractive, it often will not sustain the property's viability over a 15 to 30 or more year compliance period. An unrealistically low rehabilitation minimum also encourages ownership transfers by allowing use of the Credit for rehabilitating properties that simply need to address deferred maintenance.

23. Capital Needs Assessment

Recommendation

Allocating Agencies should require any award of Housing Credits for rehabilitation to be preceded by and take into account a capital needs assessment by a competent third party, such as a licensed architect or engineer. Alternatively, the Allocating Agency may perform the assessment if it has qualified construction analysts on staff.

The assessment should include a site visit and physical inspection of the interior and exterior of units and structures, as well as an interview with available on-site property management and maintenance personnel to inquire about past repairs/improvements, pending repairs, and existing or chronic physical deficiencies. The assessment should consider the presence of environmental hazards, such as asbestos, lead paint, and mold, on the site. In addition, the Allocating Agency should encourage the developer to undertake a Phase I environmental study.

The assessment should include an opinion as to the proposed budget for recommended improvements necessary for a minimum 15-year period and should identify critical building systems or components that have reached or exceeded their expected useful lives. The assessment should also include a projection of recurring probable expenditures for significant systems and components impacting use and tenancy, which

are not considered operation or maintenance expenses, to determine the appropriate replacement reserve deposits on a per unit per year basis. The assessment should examine and analyze the following:

- Site, including topography, drainage, pavement, curbing, sidewalks, parking, landscaping, amenities, water, sewer, storm drainage, and gas and electric utilities and lines;
- Structural systems, both substructure and superstructure, including exterior walls and balconies, exterior doors and windows, roofing system, and drainage;
- Interiors, including unit and common area finishes (carpeting, tile, plaster walls, paint condition, etc.), unit kitchen finishes, cabinets and appliances, unit bathroom finishes and fixtures, and common area lobbies and corridors;
- Mechanical systems, including plumbing and domestic hot water, HVAC, electrical, lighting fixtures, fire protection, and elevators;
- Potential improvements to energy efficiency, including higher-rated HVAC equipment, specification of energy efficient windows and doors, minimum insulation standards, appliance upgrades, lighting improvements, and enhanced ventilation;
- Strategies for conservation of resources during rehabilitation, including use of durable and low-maintenance building materials, water-conserving plumbing fixtures and appliances, and drought-tolerant and low-maintenance landscaping; and
- Necessary improvements to physical accessibility.

Issues identified by the capital needs assessment should be addressed in the rehabilitation proposal and considered by the Allocating Agency in establishing operating and replacement reserve requirements.

Discussion

Housing Credit properties must provide a minimum of 30 years of affordable housing use. In rehabilitating properties, developers may encounter unforeseen issues that may delay, make more costly, or even halt rehabilitation.

To minimize the risk of unforeseen issues and to help ensure rehabilitation adequate to a property's needs, Allocating Agencies should require all allocations of Housing Credits for rehabilitation to be preceded by a capital needs assessment of the property by a competent party. A capital needs assessment is a qualified professional's opinion of a property's current physical condition. It identifies deferred maintenance, physical needs and deficiencies, and material building code violations that affect the property's use, structural and mechanical integrity, and future physical and financial needs.

24. Appraisals in Acquisition/Rehabilitation Properties

Recommendation

For acquisition/rehabilitation properties, Allocating Agencies should generally limit the acquisition price on which Housing Credits are allocated to the lesser of the sale price or appraised value of the property. Appraisals should include an allocation of value between land and buildings. Agencies should apply additional scrutiny to any acquisition that involves related parties or an identity of interest to ensure that any discrepancy between the acquisition price and appraised value is justified and documented.

Discussion

The Housing Credit law allows a 4 percent Credit for the acquisition cost of an existing property. To qualify for this Credit, the development sponsor must also substantially rehabilitate the property.

States have encountered situations in which the acquisition cost of a proposed development exceeds the appraised value of the property. While Agencies may consider an arms-length, negotiated purchase price that exceeds a current appraisal for purposes of approving the overall development budget, they should generally limit Housing Credits to the lesser of the sale price or appraised value of the property.

25. Extended Use Agreements

Recommendation

Allocating Agencies should require extended use agreements to:

- Specify whether a development was allocated Credit under the nonprofit set-aside, to make clear that the current owner (and any new owner) during the compliance period must continue to qualify under that set-aside;
- Identify all requirements imposed on the development material to the award of Credit—including, for example, income restrictions, rent skewing, affordability period, reserve levels, amenities and services, and accessibility; and
- Require all mortgage liens on the property be subordinate to the low-income use restrictions, except in the event of valid foreclosure.

The extended use agreement should be executed and recorded as soon as feasible after the date on which the development (or the land on which the development will exist) has been acquired by the entity allocated Credits. Recording in a timely fashion ensures the property is subject to the requirements noted above.

Discussion

Since Housing Credit developments often take as much as two years to complete, sponsors sometimes change a development's characteristics before its placement in service to respond to market or other changes. Sponsors also sometimes alter development characteristics after the placed-in-service date.

To assure the Allocating Agency's QAP requirements and the conditions of its Housing Credit award are met, the Agency should record in an extended use agreement any development characteristic that materially affected its allocation of Credit, so the Agency has a means of enforcing it on the sponsor. Allocating Agencies should also require that all mortgage liens on a property be subordinate to the extended use agreement to ensure provisions of the agreement apply throughout the extended use period.

This practice will ensure a property's extended use agreement complies with the statutory requirement that it be enforceable on all parties, including the lender, except in the event of foreclosure. A foreclosing bank should, however, have the right to elect to maintain affordability under the extended use agreement.

26. Encouraging Preservation with the Housing Credit

Recommendation

To encourage preservation of existing affordable housing reaching the end of its affordability period—including properties initially financed with the Housing Credit, HUD programs, USDA programs, and/or other federal or state assistance—Agencies should define strategic preservation objectives by which to prioritize properties for preservation. While Agencies should approach preservation generally with the goal of preserving the housing stock as a long-term affordable housing resource, the best course of action for each development is a project-specific determination that considers the project's current financial viability, physical condition, location, the population it serves, and its relative competitiveness in the local market. These project-specific determinations should be consistent with the Agency's strategic preservation objectives. To further support preservation objectives, Agencies should:

- Evaluate available federal, state, and local financing sources for preservation financing and recapitalization;
- Review QAP and other Agency policies regarding preservation of existing affordable housing to ensure that those policies are consistent with the Agency's identified strategic preservation objectives and to eliminate any impediments to preservation;
- Develop QAP policies on the use of 9 percent and 4 percent Credits for preservation, including specific policies on Housing Credit resyndication;
- Assess whether Housing Credits and/or other recapitalization financing are necessary for each development as part of an overall preservation strategy and to determine the most efficient means of preservation; and
- Consider the cost effectiveness of consolidating affordable scattered-site properties into a single transaction for preservation.

In addition to considering the preservation needs of properties that will soon reach the end of their affordability periods, Agencies should consider the preservation needs of Housing Credit properties that are reaching the end of their initial 15-year compliance period. To accomplish this goal, Agencies should:

- Proactively assess the physical condition of existing Credit developments and any risk of loss or conversion to market rate use during the upcoming extended use period;
- Communicate with all owners of Credit developments to ensure they are aware of affordability requirements during the extended use period;
- Limit release of the low-income use restrictions on Credit developments to the two circumstances permitted by statute: foreclosure and qualified contract; and
- Analyze data on Housing Credit qualified contract activity, amendments to extended use agreements, development foreclosures, and early termination of the affordability period to determine trends and inform QAP policies on preservation and resyndication.

Discussion

The Housing Credit is a vital tool for the preservation of affordable housing. Since the inception of the program, Agencies have used the Credit creatively to preserve affordability of existing housing at risk of demolition or conversion to market rate use, including housing originally assisted by HUD, USDA, and other financing programs.

As more and more affordable housing developments reach the end of their affordability period, including Housing Credit properties financed in the early years of the program's existence, Agencies are challenged to balance the preservation needs of the existing affordable housing stock and consider their needs for production of new affordable housing with finite Housing Credit resources.

Moreover, while Housing Credit developments with post-1989 allocations are subject to extended use restrictions that require an additional 15-year minimum low-income use, the physical condition and financial viability of certain developments may suggest a need for recapitalization before those developments reach the end of their affordability period. Some Agencies encourage existing Housing Credit developments to apply for new Credits as part of a recapitalization strategy, while others prioritize Housing Credits to new developments or encourage use of 4 percent Credits for Housing Credit resyndications.

In addition to recapitalization needs, developments reaching the end of their initial 15-year compliance period present significant other issues for Agency consideration, including ownership transfers, enforcement of extended use agreements, qualified contract requests, and continued compliance monitoring responsibilities.

27. Qualified Contracts

Recommendation

To ensure that new Housing Credit properties remain affordable at least throughout the extended use period, Agencies should require all applicants to waive their right to submit a qualified contract as a condition of receiving an allocation. The waiver requirement should apply to applicants for both 9 percent Credits and 4 percent Credits financed with tax-exempt multifamily bonds.

Agencies should not promote or encourage owners of existing developments to pursue the qualified contract process, even if those owners did not waive their right to seek a qualified contract at the time of allocation. Agencies should establish in their QAPs disincentives for owners to undertake the qualified contract process for existing developments, including potentially awarding negative points on future applications. In addition, Agencies should formulate other policies that will curtail the use of qualified contracts by owners of existing developments, including conditioning the approval of transfers of Housing Credit properties or interest in Housing Credit property ownership entities on a waiver of the qualified contract option by the purchaser/transferee.

Discussion

Properties receiving Housing Credit allocations are required by law to be rented to qualified residents at affordable rents for a period of 30 years. There are two exceptions to this requirement: 1) in the case of foreclosure; and 2) if, after year 14, the owner exercises its right to a qualified contract and the Agency is unable to find a qualified buyer.

Under the qualified contract provision, an owner that desires to remove its property from the extended use restriction must first approach the Agency sometime after year 14 to give the Agency one year to find a qualified buyer who will maintain the remaining 15-year affordable housing commitment on the property. The purchase price under this qualified contract is established by statute and is designed to give

the owner an inflation adjusted return on its original equity contribution. In practice, the qualified contract formula price in most cases significantly exceeds the market value of the property, so it is rare for the Agency to find a buyer willing to purchase the property at the qualified contract price and maintain the affordability of the property for the remainder of the 30-year period. Thus, most properties for which an owner seeks a qualified contract are lost from the affordable housing stock before the 30-year affordability period would otherwise expire.

Many Agencies require applicants to waive the right to seek a qualified contract at the time a Credit allocation is made, while others provide QAP scoring incentives to Credit applicants that agree to forgo their rights to a qualified contract. Agencies without such requirements or incentives risk losing their Housing Credit properties from the affordable stock long before they would otherwise reach the end of their affordability periods.

Where owners of existing Housing Credit properties have not waived the right to a qualified contract, Agencies should discourage the exercise of this option by taking into account an owner's decision to use the qualified contract process to remove the property from the affordable housing inventory when assessing the owner's suitability as an applicant for future Housing Credit allocations.

The qualified contract option may be exercised not only by the original sponsor of a project, but by subsequent purchasers who have no ties to the Housing Credit program and no interest in affordable housing. Agencies should thus require a waiver of the qualified contract provision as a condition of approval of a transfer of any existing Housing Credit property or interests in the ownership entity.

28. Construction Monitoring

Recommendation

In addition to visiting proposed Housing Credit development sites prior to allocation of Credit, Agencies should inspect or require an independent third party inspection of Credit developments during the construction period to monitor construction progress, verify application commitments, evaluate compliance with fair housing and accessibility rules, and identify construction delays. To avoid duplication of efforts, Agencies may coordinate with investors, syndicators, lenders, or other entities to receive copies of construction monitoring reports conducted by these entities.

Discussion

Housing Credit developments must be placed in service by the end of the second calendar year following the year of Credit allocation. This strict timeframe necessitates steady construction progress, especially in states with climates that prevent construction activity in certain months of the year.

Agencies have found that site visits to developments during the construction phase are an effective tool for monitoring construction progress and identifying potential timing delays. These visits are also useful for evaluating adherence of the developments with commitments made at application and with fair housing and accessibility rules.

29. Transmittal of Development Information

Recommendation

Agencies should develop procedures for transmitting critical development information from allocation to monitoring staff. At a minimum, this information should include the completed IRS Form 8609 for the development, once obtained from the owner, and any extended low-income housing commitments that document tenant income or other property restrictions.

Discussion

Different agencies or divisions within an agency often carry out Housing Credit allocation and monitoring. Coordination and communication between them is critical to compliance staff having the development information necessary to effectively monitor. Development information included on IRS Form 8609, such as the owner's certification of the original qualified basis of the building at the close of the first year of the Credit period and the election to begin the Credit period of a building the first year after it is placed in service, is essential information for property monitoring. Extended low-income housing commitments, documenting income set-asides and other property restrictions, are also critical. Monitoring staff also needs the QAP in effect at the time of the allocation and any loan agreements, especially if the Credits were allocated by a different agency.

30. Monitoring Property Restrictions

Recommendation

Agencies should require that extended low-income housing commitments identify all requirements imposed on the development that are material to the award of Credit, including, for example, income restrictions, rent skewing, affordability period, reserve levels, amenities and services, definition of housing type, and requisite tenant qualifications. Compliance staff should monitor Credit developments to ensure extended low-income housing commitments are met, and Agencies should enforce these commitments as necessary.

Discussion

In making Credit allocation determinations, Agencies frequently award additional points to developments that elect restrictions beyond those required by statute, such as deeper income targeting, longer affordability periods, or special needs tenancies. Agencies can monitor and enforce these restrictions by incorporating them into extended low-income housing commitments.

31. Housing Credit Asset Management

Recommendation

Allocating Agencies should establish procedures for asset management of Housing Credit developments assisted under the American Recovery and Reinvestment Act of 2009 (ARRA). These procedures should detail typical asset management functions associated with the development, lease-up, and operations

phases of a project. Agencies with established asset management history and experience may apply existing procedures to ARRA-assisted developments rather than establish separate procedures applicable solely to ARRA-assisted developments.

Discussion

To ensure program compliance and the long-term viability of developments, ARRA requires state Housing Credit Agencies to perform asset management functions, or contract for such services, for all developments assisted under HUD's Tax Credit Assistance Program (TCAP) or the U.S. Department of the Treasury's (Treasury) Section 1602 Credit Exchange program. The Act provides that such asset management will be funded at the owner's expense.

While many Agencies have extensive experience conducting asset management for multifamily developments, this experience does not always include Housing Credit developments where asset management is typically a function of the investor and/or syndicator.

Since the passage of ARRA, many states have contracted with outside firms to conduct asset management on this portfolio of developments. Other states have developed asset management guidelines for internal use. Developing a set of suggested asset management procedures will help to ensure effective implementation of this new requirement and to create consistency among the allocating Agencies. Such procedures may include the following:

Development Phase:

- Review underwriting assumptions to ensure adequacy of debt service coverage, reserve levels, and other underwriting benchmarks;
- Review market studies for proposed developments to ensure reasonableness of assumptions and proposed capture rates;
- Review capital needs assessments for rehabilitation developments to ensure adequacy and reasonableness of assumptions;
- Monitor construction on a bi-weekly or monthly basis to ensure the development is progressing as scheduled;
- Monitor and approve construction draws and change orders to analyze actual development costs and compare to original budget;
- Conduct periodic construction inspections with development team;
- Establish and monitor project reserve accounts, including lease-up, operating, and replacement reserves; and
- Confirm receipt of certificate of occupancy for development.

Lease-up Phase:

- Review and approve marketing plan for development;
- Monitor marketing and lease-up of development;
- Compare actual absorption rate, rental revenue, and lease up to original projections;
- Troubleshoot potential lease-up problems and resolve issues;
- Ensure proper documentation and completeness of first-year tenant files to ensure initial tenant qualification and proper documentation for each unit;
- Analyze stabilized occupancy to confirm minimum set-aside and affordability targets; and

- Compare first-year Credit delivery to original projections.

Operations Phase:

- Conduct comprehensive on-site property inspections to assess ongoing property compliance consistent with IRS and state Agency physical inspection standards;
- Conduct comprehensive tenant file reviews to ensure ongoing tenant compliance and proper documentation for tenant recertifications and new move-ins;
- Ensure prompt correction of any physical and tenant noncompliance;
- Review annual owner compliance certifications;
- Analyze project operations, including physical occupancy reports, annual operating budget, debt coverage, cash flow trends, and other financial information;
- Compare operating data against budget, prior year operations, and state averages;
- Manage operating reserves and replacement reserves, including approval of expenditures;
- Assess adequacy of property management;
- Analyze ongoing marketability and capital needs of developments; and
- Recommend and implement workout strategies for any troubled projects.

32. Foreclosure Prevention

Recommendation

In addition to monitoring continued compliance in the extended use period, Agencies should monitor Housing Credit developments to identify properties in danger of foreclosure. If a property faces financial challenges, Agencies should examine and consider restructuring strategies to prevent foreclosure.

Agencies should adopt policies requiring that restrictive covenants and other long-term use restriction instruments are not automatically terminated upon the execution of a foreclosure or deed in lieu of foreclosure.

Moreover, Agencies should establish procedures attendant to a foreclosure (or deed in lieu of foreclosure) of a Housing Credit property requiring all entities initiating foreclosure to provide the Agency with the following information at least 60 days prior to requesting the Agency release the extended use agreement:

- The name of the lender on the note triggering the foreclosure activity;
- The original amount and date of the note, the existing balance, and the annual debt cost;
- The position of the note relative to other liabilities on the property;
- The names of all other holders of notes on the property;
- A detailed description of the circumstances that have prevented timely payment of interest on the note;
- A detailed description of efforts between the owner and the holder of the note to reach an agreement to modify the terms of the note to prevent foreclosure; and
- Any relationship between the holder of the note and the owner of the property by familial relationship, common principals, owners or employees (collectively, "affiliates" of the note holder).

Agencies should inform the entity initiating foreclosure that should the Agency determine, based on the information provided, that the foreclosure activity is part of an arrangement to terminate the extended use

agreement, the Agency will report its findings to the IRS. Using this information, Agencies should thoroughly examine the situation to ensure that the foreclosure (or instrument in lieu) is not part of an arrangement with the taxpayer the purpose of which is to terminate the extended use period on the development and, should they deem it to be such an arrangement, report their findings to IRS and request that IRS prevent the termination of the extended use agreement.

Agencies should withhold consent for termination of the extended use agreement if the owner does not provide the information outlined above, and should consider sanctions against owners that engage in a foreclosure deemed to be part of an arrangement with the taxpayer to terminate the extended use period on the development.

Discussion

The Housing Credit statute requires developments to remain affordable for a minimum 30-year period, but provides an exception to this rule if a development proceeds to foreclosure (or instrument in lieu of foreclosure). Since its inception in 1986, the program has experienced a strong track record with an extremely low incidence of foreclosure. While some developments have experienced financial challenges, Agencies have worked with owners to encourage continued program compliance.

In limited circumstances, Agencies have allowed amendment of extended use agreement provisions (i.e., extremely low-income targeting requirements) to improve the financial condition of a property and avoid foreclosure.

Some states have reported isolated incidents in which they suspect an owner may have purposely allowed the foreclosure of a property in order to terminate the affordability restrictions on that property. If a development proceeds to foreclosure (or instrument in lieu), Agencies should attempt to determine whether the foreclosure is part of an arrangement to terminate the extended use period on the original development.

33. Compliance Manuals

Recommendation

Agencies should make available a Housing Credit compliance manual, with all necessary regulations and forms, as a comprehensive resource for owners and managers. This manual may be produced and distributed in hard copy and/or made available in electronic format for download from the Agency's website. Agency monitoring staff should use such manuals to ensure consistency in monitoring developments within the state. Staff should review and update compliance manuals periodically.

Discussion

Agencies recognize that compliance requirements are extensive and complex. Manuals informing Housing Credit property owners and managers of what they must do to keep properties in compliance have proven to be invaluable tools in many states. These manuals differ in scope but frequently describe owner and management responsibilities, IRS regulations and forms, and state documents relating to compliance. While some Agencies may choose to produce and update a compliance manual, others may organize all necessary compliance information in electronic format for download from the Agency website.

34. Owner and Manager Training

Recommendation

Agencies should require owners and on-site managers of Housing Credit developments to attend or document that they have recently attended training on management and compliance prior to property lease-up, but no later than receipt of IRS Form 8609, which certifies an allocation of Credits. Agencies should require periodic training throughout the compliance and extended use periods and following significant or repeated noncompliance events. Agencies should consider requiring certification or professional designation of Housing Credit property managers.

At a minimum, owner and manager training should cover key compliance terms, qualified basis rules, determination of rents, tenant eligibility, file documentation, next available unit procedures and unit vacancy rules, fair housing and accessibility rules, Agency reporting requirements, record retention requirements, and site visits.

Discussion

Successful operation of a Housing Credit development is management intensive. Thorough understanding of Housing Credit development requirements and compliance monitoring procedures requires training of development owners and managers. This training should be provided to the property's on-site management staff before the property is occupied.

Given the complexity of compliance requirements and high turnover of property managers, many Agencies have found that periodic training throughout the compliance period is necessary to ensure on-site expertise in compliance issues. Some Agencies require management agent certification or professional designation as a test of such expertise.

35. Coordination of Monitoring Activities

Recommendation

To the extent practical, Agencies should coordinate compliance reviews for Housing Credit developments financed with multiple subsidies. Agencies may consider participation in the federal Interagency Physical Inspection Alignment Initiative to improve coordination and communication with the IRS, HUD, and USDA on developments financed with multiple subsidies.

Discussion

Developments with multiple subsidies (i.e., Housing Credit and HOME) are subject to reviews for different program compliance requirements. Furthermore, the division within the agency responsible for monitoring one program may not be the same division, or even the same agency, responsible for another program. This situation is inefficient, as each responsible party collects duplicative information. It is also a burden on property managers and the low-income tenants who must accommodate multiple property reviews.

The federal Interagency Physical Inspection Alignment Initiative was created in 2011 to streamline the inspection process for developments financed with multiple subsidies by reducing or eliminating redundant inspections by multiple agencies. More than 30 Housing Credit Allocating Agencies participate in this initiative. The enhanced coordination with the three federal agencies has resulted in a reduction of the physical inspection workload and reduced burden on owners, property managers, and tenants who no longer must accommodate multiple property inspections.

36. Distributing Income and Rent Limits

Recommendation

Agencies should make updated Housing Credit income and rent limits available to development sponsors and managers annually. These limits may be produced and distributed in hard copy or made available in electronic format for download from the Agency's website. Given the increased complexity of income limit applicability since passage of HERA in 2008, Agencies may consider providing project-specific income limits to developments on an annual basis or refer property managers to industry resources for income limit calculations.

Discussion

HUD issues revised income limits each year that must be used to qualify tenants and determine new rent limits in Housing Credit developments. Some development sponsors and managers apparently are unaware that the income and rent limits change each year and rely on incorrect limits for income qualification.

HERA significantly complicated income limit applicability. Providing project-specific income limits to developments is one way for Agencies to ensure the correct limits are applied on site. Other industry resources are also now available and Agencies may refer property managers to these resources in lieu of providing project-specific limits.

37. Utility Allowances

Recommendation

To provide flexibility for Housing Credit owners to utilize the optimal utility allowance for each development and to encourage utility allowances that accurately reflect anticipated utility consumption, Agencies should:

- Permit Housing Credit developments to select from all utility allowance options available under IRS regulation; and
- Specify requirements for application of alternative utility allowances (i.e., Agency estimate, utility company estimate, HUD Utility Schedule Model, or energy consumption model) in both new developments and existing developments that seek a change in utility allowance.

Discussion

The maximum rent in Housing Credit developments includes an allowance for the cost of any utility (other than telephone, cable television, or Internet) paid directly by the tenant. This utility allowance can differ based on federal assistance, with buildings financed by the USDA or with tenants receiving USDA rental assistance using the applicable USDA utility allowance, buildings regulated by HUD using the applicable HUD utility allowance, and buildings with tenants receiving HUD rental assistance using the applicable Public Housing Authority (PHA) utility allowance.

IRS regulations specify a number of alternative utility allowances that may be used in Housing Credit developments. These alternative utility allowances include a local utility company estimate for a unit, a utility estimate from the Agency that has jurisdiction over the unit, a utility estimate calculated using the HUD Utility Schedule Model, and a utility estimate calculated using an energy consumption model.

In the past decade, periodic spikes in residential utility costs have resulted in operating cost increases in many Housing Credit developments. During this time, technology and federal policies relating to utility allowances have evolved rapidly. Housing Credit developers have responded by adopting alternative utility allowance methodologies that more accurately reflect utility costs and that acknowledge significant advances in energy efficiency in the Housing Credit portfolio.

38. Monitoring Fees

Recommendation

Agencies should develop a reasonable monitoring fee structure taking into account the cost of monitoring to the Agency during the initial compliance period and the extended use period and the impact on developments. Given that fees may change over time, Agencies should notify the development community of any such changes in the QAP or through other state notice.

Discussion

Monitoring Housing Credit developments for the mandated compliance period is costly, and new requirements imposed by the IRS in its recent compliance regulations may make it more costly. It is reasonable for Agencies to pass this cost on to development owners in the form of compliance monitoring fees. The IRS clarified in its monitoring regulations that federal law does not prohibit an Agency from charging fees to cover the Agency's monitoring expenses.

39. Tenant File Review Procedures

Recommendation

When conducting tenant file reviews of Housing Credit properties, Agencies should review the current rent record and, at minimum, verify the following from the tenant files for the lesser of 20 percent of the development's low-income apartments or the minimum unit sample size as set forth in IRS compliance regulations:

- Rental application completed, including certification of assets and disposal of assets, if applicable;
- Tenant income certification completed for move-in and current year, including all required signatures and dates;
- Income verification(s) completed and documented;
- Assets documented and verified if total assets are more than $5,000 in value;
- Student eligibility documented;
- Lease and lease addendum completed at move-in; and
- Current year utility allowance on file.

Discussion

IRS Housing Credit compliance regulations require state Agencies to review tenant files of Credit properties on a regular basis but do not specify what must be evaluated in these file reviews. State Agencies, based on their significant experience in conducting tenant file reviews, find the above essential elements of a thorough file review.

40. Calculating Anticipated Tenant Income

Recommendation

Agencies should instruct property managers qualifying tenants for Housing Credit apartments to calculate household income using the gross income the household anticipates it will receive in the 12-month period following the effective date of the income certification or recertification. For purposes of this recommendation, anticipated income should be documented in the tenant file by third-party verification whenever possible or by an acceptable alternate method of verification with documentation as to why third-party verification was not possible. States and property managers should use current circumstances to project income, unless verification forms or other verifiable documentation indicate that an imminent change will occur. Agencies should refer managers to HUD Handbook 4350.3 for guidance on the proper calculation of income and assets.

Discussion

For purposes of calculating annual household income, IRS regulations refer to HUD Handbook 4350.3. This handbook defines annual income as the gross income the household anticipates it will receive from all sources, including all net income derived from assets, during the 12-month period following the effective date of the income certification or recertification. Third-party verification of annual income and the value of assets, including documents generated by a third-party source such as pay check stubs, is the preferred method of verification for HUD programs. Alternate methods, such as income tax returns, are allowed in the event third-party verification cannot be obtained and the file is documented accordingly.

41. Encouraging Fair Housing Compliance

Recommendation

In addition to requiring development owners to certify to the state Agency on the annual owner certification any finding of discrimination under the Fair Housing Act, Agencies should refer any fair housing complainants to the appropriate state fair housing enforcement agency and to HUD.

To further encourage fair housing compliance, Agencies should implement monitoring procedures to ensure that Housing Credit developments comply with federal nondiscrimination standards for all protected classes. Agencies should require owners and property managers to attend fair housing training prior to leasing the property and on a regular basis throughout the compliance and extended use periods, and encourage the use of affirmative fair housing marketing plans at Housing Credit developments.

Discussion

Housing Credit property owners are required to certify annually to the state monitoring agency any finding of discrimination under the Fair Housing Act, including both disparate treatment and disparate impact of protected classes. Because most state Agencies are not the designated fair housing agency for their state, they refer any fair housing complainants to the appropriate agency within the state and report any discrimination findings to the IRS as required by IRS Form 8823.

Given the importance of fair housing rules to Housing Credit property management and tenant qualification, Agencies can further encourage fair housing compliance by requiring Housing Credit development owners and property managers to attend fair housing training and by encouraging the use of affirmative fair housing marketing plans.

42. Violence Against Women Act (VAWA) Compliance

Recommendation

Agencies should adopt Housing Credit policies and procedures that support Violence Against Women Act (VAWA) compliance, including:

- Referencing victims of domestic violence, dating violence, sexual assault, or stalking under the QAP selection criterion for tenant populations with special housing needs;
- Clarifying that a domestic violence incident does not constitute good cause for eviction of the victim if the victim otherwise meets tenant occupancy rules;
- Notifying Housing Credit development owners and property managers about victims' rights under VAWA, including providing tenant notice, establishing an emergency transfer plan, and formalizing transfer request requirements;
- Amending extended use agreements to explicitly reference VAWA requirements; and
- Modifying compliance monitoring procedures to identify VAWA noncompliance.

In addition, Agencies should require owners of Housing Credit developments to implement the following practices to ensure VAWA compliance:

- Prohibiting denial of assistance and/or eviction from housing (consistent with state eviction laws) on the basis that an applicant or resident is a victim of domestic violence, dating violence, sexual assault, or stalking, if the applicant or resident otherwise qualifies for admission;
- Providing notices similar to HUD-5380 (Notice of Occupancy Rights Under VAWA) and HUD-5382 (Certification of Domestic Violence) to all tenants in existing developments;
- Utilizing a lease addendum to inform tenants they are in a Housing Credit unit and that they are protected by VAWA;
- Allowing bifurcation of tenant leases in order to evict or terminate assistance of the perpetrator and continue housing assistance for the victim;
- Developing policies on acceptable unit transfers, referencing guidance from HUD-5381 (Model Emergency Transfer Plan) and HUD-5383 (Emergency Transfer Request); and
- Training property management staff that interact with applicants and tenants on VAWA requirements.

Discussion

VAWA is a federal law passed in 1994 to protect victims of domestic violence, dating violence, sexual assault, and stalking. The Act provides funding toward investigation and prosecution of crimes, enhances judicial and law enforcement tools to combat such violence, and improves services for victims.

The 2005 VAWA reauthorization included provisions that apply specifically to the Section 8 and public housing programs administered by the HUD. The 2013 reauthorization expanded the housing programs covered by the Act to include the Housing Credit, USDA rural housing programs, and additional HUD programs, including HOME. These provisions were implemented to provide a safe place in affordable housing for victims of such violence.

HUD published VAWA regulations in 2016 and created four forms to support the requirements: HUD-5380 Notice of Occupancy Rights Under VAWA; HUD-5381 Model Emergency Transfer Plan; HUD-5382 Certification of Domestic Violence; and HUD-5383 Emergency Transfer Request. HUD also created a model lease addendum to inform tenants about VAWA protections. USDA published guidance in 2017 that closely followed the HUD guidance.

To date, the IRS has not issued VAWA guidance that applies to the Housing Credit program. Housing Credit Allocating Agencies, developers, and property managers have applied requirements of the final HUD VAWA rule as a safe harbor in Housing Credit developments, and have adopted or adapted the aforementioned HUD forms for use in such developments. Many Agencies supplement VAWA compliance with the changes to Housing Credit policies and procedures outlined above.

43. Continued Compliance in the Extended Use Period

Recommendation

Agencies should develop policies to regulate and facilitate continued compliance as Housing Credit properties reach Year 15 of the compliance period. Such policies should continue to enforce statutory compliance requirements, including income and rent restrictions, minimum set-aside election, applicable fraction, general public use requirements, Fair Housing Act compliance, habitability standards, utility allowance updates, Section 8 voucher holder acceptance, annual tenant income recertification requirements, and the annual owner certification of compliance.

Agencies may choose to establish different criteria during the extended use period for other compliance rules, including policies on student households, the next available unit rule, unit transfers, frequency of property inspections, documentation required for tenant income recertification, and monitoring fees.

Agencies should develop procedures for handling noncompliance in the extended use period and should require notification from owners in the event of ownership transfers.

Discussion

The Housing Credit statute requires developments to remain affordable for a minimum of 30 years. This 30-year period is comprised of a 15-year initial compliance period and a 15-year extended use period. During the initial compliance period, any noncompliance with program rules can result in recapture of Credits previously taken by the development's investors.

While noncompliance in the extended use period does not result in Credit recapture, Agencies can enforce affordability restrictions and other compliance requirements through the extended use agreement recorded on the property. To facilitate continued compliance in the extended use period, some Agencies have relaxed certain compliance rules while continuing to monitor for essential program requirements.

44. Compliance Issues in Resyndication

Recommendation

Agencies should develop policies on compliance issues encountered in resyndication of existing Housing Credit developments. At minimum, these policies should:

- Consider an existing household income-qualified under resyndication, as long as the household was initially income-qualified during the original 15-year compliance period;
- Specify any Agency policies on amendment of the original extended use agreement; and
- Provide guidance on applicable income limits to use in resyndications.

Discussion

The term resyndication is used to describe an existing Housing Credit development that receives a subsequent allocation of Credits following the initial 15-year compliance period. As the Housing Credit portfolio ages, Agencies are seeing an increase in resyndication activity and these transactions present unique compliance challenges.

IRS has instructed Agencies to consider an existing household income-qualified during the extended use period as long as the household was initially income-qualified during the original 15-year compliance period. This income qualification applies in the case of resyndication.

Because the extended use agreement on the original development was recorded for a 30-year period, it does not go away at the time of resyndication. For this reason, Agencies should develop policies on amendment of the original extended use agreement that can be applied in resyndications.

45. Standardized Compliance Forms and Reporting

Recommendation

Agencies should adopt the standardized documents for use in compliance monitoring developed by NCSHA.

Discussion

All states require Housing Credit development owners to use certain forms for compliance reporting. These forms differ from state to state. Standardization of some compliance forms among the states would create efficiency for developers and other Housing Credit industry professionals.

46. Agency Staff Training

Recommendation

Allocating Agencies should provide Housing Credit program staff opportunities for continuing education and training.

Discussion

To assure compliance with statutory and regulatory requirements and encourage innovation, Allocating Agencies should provide Housing Credit program staff education and training opportunities to strengthen their multifamily housing development and finance and Housing Credit program knowledge and skills.

Appendix 1: History of NCSHA Housing Credit Recommended Practices

The state agencies that administer the Housing Credit, through NCSHA, have developed and refined numerous times over more than three decades Housing Credit Recommended Practices to strengthen state Housing Credit administration, demonstrate responsible and proactive state administration to Congress and the IRS, and preempt through self-governance unworkable federal statutory and regulatory requirements. Each effort has involved executive directors and senior staff of Housing Credit Allocating Agencies and significant input from Housing Credit industry stakeholders.

The NCSHA Board of Directors established the first executive director Task Force on Housing Credit Recommended Practices in 1992, and in 1993 adopted the Task Force-proposed Recommended Practices in Housing Credit Allocation and Underwriting for voluntary adoption by Allocating Agencies.

The 1993 Recommended Practices and their implementation by states were favorably cited numerous times by the General Accounting Office (GAO) in its 1997 report to Congress on the Housing Credit and in the House Ways and Means Oversight Subcommittee consideration of it. The Recommended Practices gave Congress confidence in state competence and conscientiousness in administering the Housing Credit and played a major part in averting the Ways and Means Committee-proposed sunset threat the Housing Credit faced in 1995-1997.

In 1998, following NCSHA's successful campaign to defeat Housing Credit sunset, the organization developed several additional Recommended Practices in response to suggestions made by the Ways and Means Oversight Subcommittee in its review of the Credit. Though the 1998 Recommended Practices did not replace the 1993 practices, some further refined certain 1993 practices.

The 1998 Recommended Practices included a recommendation that NCSHA develop further guidance in Housing Credit compliance, which the organization did in consultation with agency Housing Credit staff and industry experts. The board adopted the resulting Recommended Practices in Housing Credit Compliance Monitoring in 2000. That same year, NCSHA developed additional allocation and underwriting practices on capital needs assessments, operating cost databases, and accountant opinion letters.

In 2003, NCSHA again convened a group of state agency executive directors to evaluate the efficacy of Housing Credit Recommended Practices in Allocation and Underwriting, with a resulting report that built on prior efforts.

In the seven years following NCSHA's 2003 review of the Recommended Practices in Allocation and Underwriting, the Housing Credit faced new challenges, including increasing affordable housing needs, the impact of one of the largest economic downturns in recent times, and the resulting severe disruption of the Housing Credit equity market.

The Congress made significant changes to the program during this time as well, most notably in HERA in 2008 and ARRA in 2009. Among its many changes, HERA authorized Allocating Agencies to award a 30 percent basis boost to certain Housing Credit buildings and increased the minimum rehabilitation threshold limit. ARRA created two new programs—HUD's Tax Credit Assistance Program (TCAP) and Treasury's Section 1602 Credit Exchange Program—to work in conjunction with the Housing Credit and enhance feasibility of developments during a time of critical equity market turmoil. ARRA also imposed

new asset management responsibilities on state Allocating Agencies for all developments assisted under TCAP and the Exchange Program.

In consideration of these significant program changes and to continue its proactive approach to state administration of the Credit, NCSHA's Board of Directors again created a Housing Credit Task Force in 2009, which it charged with developing practices in the use of new authority and resources provided state Housing Credit Allocating Agencies by HERA and ARRA and with reviewing NCSHA's existing Housing Credit Recommended Practices in Allocation and Underwriting.

NCSHA's Board of Directors approved the final recommendations of that Task Force at its meeting in December 2010. The following year, the Board considered and approved a revision to the Per Unit Cost Standard and a new recommendation, Sponsor Certification of Project Sources and Uses of Funds.

In 2016, NCSHA's Board of Directors again appointed an executive director Task Force to review, revise, and expand NCSHA's existing Housing Credit Recommended Practices. The resulting report includes significant revision of numerous Recommended Practices in allocation, underwriting, and compliance monitoring, combined with 13 new Recommended Practices into a single report covering the breadth of state program administration responsibilities. NCSHA's Board of Directors adopted the report at its December 2017 meeting.

Appendix 2: NCSHA Task Force on Recommended Practices in Housing Credit Administration Members

Co-Chairs:
Kim Herman (WA)
Jacob Sipe (IN)

Members:
Steve Auger (FL)
Tia Boatman Patterson (CA)
Sarah Carpenter (VT)
Doug Garver (OH)
Tom Gleason (MA)
Audra Hamernik (IL)
Brian Hudson (PA)
Gerald Hunter (ID)
Jolene Kline (ND)
Bob Kucab (NC)
Ralph Perrey (TN)
James Rubin (NY)
Dennis Shockley (OK)
Bob Strickland (AL)
Mary Tingerthal (MN)
Grant Whitaker (UT)
Cris White (CO)

National Council *of*
State Housing Agencies

State Housing Finance Agencies (HFAs) share a public purpose mission to provide affordable housing help to the people of their jurisdictions who need it.

The National Council of State Housing Agencies (NCSHA) is a national nonprofit, nonpartisan association that advocates on behalf of HFAs before Congress and the Administration for affordable housing resources. NCSHA represents state HFAs as well as the HFAs of the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands.

Learn more at ncsha.org.

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@NCSHAPGA

NCSHA
444 North Capitol Street NW, Suite 438
Washington, DC 20001
202-624-7710
info@ncsha.org
ncsha.org