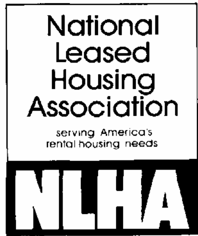

1818 N Street, NW, #405, Washington, DC 20036

January 22, 2004

Regulation Division
Office of the General Counsel
Department of Housing and Urban Development
Room 10276
451 Seventh Street, SW
Washington, DC 20410-0500

Re: Mixed-Finance Development for Supportive Housing for the Elderly or Persons with Disabilities and Other Changes to 24 CFR Part 981; Interim Rule [Docket No. FR-4725-I-01]

Dear Sir or Madam:

On December 1, 2003, HUD published in the Federal Register the subject Interim Rule which implements statutory changes to the section 202 and 811 programs made be Congress in the American Homeownership and Economic Opportunity Act of 2000 ("AHEO"). The following are comments from the National Leased Housing Association ("NLHA") with respect to the Interim Rule. NLHA is comprised of both public and private sector housing organizations and agencies engaged in the provision of affordable rental housing and its members have a significant amount of experience in the mixed-finance development of affordable housing. NLHA commends HUD's effort to base its section 202/811 mixed-finance rule on the successful mixed-finance efforts in the HOPE VI and public housing programs and trust that HUD will show the same flexibility in this program as HUD has shown in the public housing mixed-finance program. In particular, we welcome HUD's reversal of the earlier positions taken in the NOFAs that low-income housing tax credits ("LIHTCs") may only be used to develop additional units and not to fill a funding gap on the section 202/811 units. As you know, in many high cost areas of the country the section 202/811 capital advance funds are not sufficient to develop the number of units reserved by HUD for the project. Over the years, sponsors and owners have filled such funding gaps with HOME funds, AHP funds, and other private and public funds. The ability to use LIHTCs to fill such funding gaps in the future will be very beneficial to the section 202/811 programs, particularly in high cost areas where affordable housing for the elderly and persons with disabilities is such a critical need.

We offer the following comments in an effort to help HUD revise the rule to achieve a more successful mixed-finance program.

For-Profit Owner

The change made by AHEO to the definition of "private nonprofit organization" in the 202 program and "nonprofit organization" in the section 811 program opens the door to the participation of for-profit organizations in section 202/811 projects. The definition of *Mixed-finance owner* in 24 CFR 891.805 tracks the statutory language with respect to the eligibility of a for-profit limited partnership of which the sole general partner is a Single Purpose Nonprofit Organization (in the case of section 202 projects) or a Single-Purpose Nonprofit Organization with a 501(c)(3) tax exemption (in the case of section 811 projects). A number of our members have raised the question about the possible eligibility of for-profit limited liability companies in which the sole managing member is an eligible nonprofit corporation. Many affordable housing projects today are developed using LLCs rather than limited partnerships. In the HOPE VI/mixed-finance projects, HUD has treated LLCs and limited partnerships equally. The statutory provision would appear to allow for an interpretation that an LLC is an eligible for-profit organization in its use of the phrase "or a corporation wholly owned and controlled by" an eligible nonprofit organization.

Also, section II of the Interim Rule states that the nonprofit general partner "must have been created by a sponsor that has received a Section 202 or Section 811 fund reservation." There does not seem to be any requirement in the statute that the sponsor creates the nonprofit entity. So long, as the nonprofit general partner meets the statutory criteria for a Single Purpose Private Nonprofit Organization or Single-Purpose Nonprofit Organization, as applicable, that should be sufficient to assure that the mixed-finance owner is eligible.

Mixed-finance Loan Terms (24 CFR 891.808)

24 CFR 891.808 provides that HUD will provide a capital advance fund reservation to the sponsor which transfers the fund reservation to the Nonprofit Organization which is the general partner of the for-profit limited partner. Then the regulation states that HUD provides the capital advance funds to the Nonprofit Organization which makes a non-amortizing loan to the mixed-finance owner to be repaid within 40 years at the 202 or 811 interest rate in effect on the date of the closing of the capital advance. HUD's recognition of the need to meet certain LIHTC requirements with respect to the use of the section 202/811 capital advance in mixed-finance project is welcome. However, we think that the regulation may be overly specific in its direction with respect to the loan terms and that this may cause some conflict with LIHTC requirements. For instance, having the general partner make a loan to the partnership could cause some serious problems under the LIHTC program with respect to requirements that loans to the owner must be non-recourse in nature. We think that the regulation just needs to provide that the capital advance funds may be made available to the mixed-finance owner in the form of a loan without stating specifically the entity that will be the lender.

The regulation also goes on to say that the capital advance funds may be provided as a loan in the case of a mixed-finance project using nine percent tax credits and as a pass-through to

the limited partnership in the case of mixed-finance project using tax-exempt bonds and four percent tax credits. It is accurate that the capital advance funds will necessarily need to be a loan in a nine percent LIHTC deal, but there also may be a need to have the capital advance funds as a loan in a bond financed deal with four percent tax credits in order to assure that the loan will be included in the LIHTC eligible basis.

The regulation currently states that the funds will be lent "at the interest rate in effect on the date of the closing of the capital advance". We understand currently that section 202/811 capital advances from HUD to the nonprofit owner bear no interest, so the reference to the interest rate in effect at closing is unclear. In nine percent tax credit transactions, the funds must be lent to the owner of the project at the applicable federal rate ("AFR"). In addition, in order to satisfy tax credit investors that it is reasonable to expect that the loans on the project reasonably can be expected to be paid over time, the financing may need to be structured so that some of the capital advance funds are lent to the project at the AFR and some of the funds are lent to the project at a lower or zero interest rate. We do not think that the HUD regulation needs to specifically establish an interest rate, but should state that the funds may be lent to the project at interest rates necessary to meet LIHTC requirements.

In sum, we believe that the regulation has to provide sufficient flexibility with respect to the loan terms to allow the parties to structure the financing in a way that makes the most sense for the transaction. HUD will have the opportunity approve or disapprove the proposed financing structure in its review of the mixed-finance proposal and the evidentiary submission.

Developer's Fee (24 CFR 891.815)

24 CFR 891.815 provides that the developer fee may not exceed nine percent of the total project replacement cost and that a maximum of eight percent may be paid from the capital advance. It would appear that this provision is intended to establish both an overall cap on the developer fee and a cap on the amount of the developer fee that may be paid from the capital advance. We think that the rule needs to provide some flexibility with respect to the developer fee. Under the public housing mixed-finance Cost Control and Safe Harbor Standards ("Safe Harbor Standards") a safe harbor developer fee is set at nine percent of the project costs subject to a maximum developer fee of twelve percent of the project costs with a justification for a higher fee. Justification for higher fees include a number of factors, including the size of the developer guarantees, developer's role in obtaining additional financing, including tax credits, for the project, the size and complexity of the project, etc. The Safe Harbor Standards also provide that if the State Housing Finance Agency, which is providing the LIHTCs to the project, allows a fee higher than twelve percent, HUD may approve the higher fee upon a significant justification demonstrating the increased risk to the developer. We believe that the section 202/811 rule needs to provide similar flexibility, especially in light of the fact that generally these projects will be small projects that will require a good degree of risk and expense on the part of the developer in comparison to the size of the project.

In addition, we note that the regulation at 891.815 lists a number of eligible uses and ineligible uses for the developer fee and that many of these uses are based on provision in Housing Notice 96-102 which provided for an eight percent developer fee for the project in lieu

of a two percent project contingency allowance, consultant fees, and organizational expenses. One of the eligible uses is for the developer's overhead and profit, but limits the fee for overhead and profit to just six percent of the total construction cost. Generally, the purpose of a developer's fee is to provide overhead and profit to the developer and this additional limitation on the amount of the developer fee that may be used for this purpose is unreasonable, particularly in light of the risks and costs that the developers will be incurring in this process. The eligible uses and ineligible uses listed in the regulation made sense in the context of replacing the contingency allowance, consultant fees and organizational expenses in underwriting a project that was receiving only section 202/811 capital advances for the development of the project. Many times a developer is required to use part of the developer fee to meet various expenses of development such as cost overruns. However, in LIHTC transactions where there are other sources of funding, including for the developer fee, and oversight of such fees by a State Housing Finance Agency, the limitations set out in the regulation are too restrictive. We think that HUD should establish a maximum developer fee that can be paid from the section 202/811 capital advance to be used for developer overhead and profit, but also provide for some flexibility and deference to State Housing Finance Agencies in LIHTC transactions with respect to the amount of the developer fee and the uses to which such fees can be put when paid from other sources such as LIHTC equity. The State Housing Finance Agencies have very broad experience in overseeing LIHTC projects and assuring that costs and fees are reasonable.

Firm Commitment Application (24 CFR 891.818) As a general matter, we do not think that the regulation is the best place for a long list of submission requirements that may need to change over time. We think that such a list would make more sense in more informal HUD guidance such as a handbook and a notice. Some specific comments on submission requirements are noted below.

24 CFR 891.818(a)(2). The regulation provides that when the application for firm commitment is submitted, the mixed-finance owner and the Nonprofit Organization must submit the organizational documents of both the mixed-finance owner and the Nonprofit Organization. In LIHTC transactions the investor limited partner is generally responsible for and is highly involved in the negotiation of the ownership organizational documents of the mixed-finance owner. Since an investor limited partner will probably not be selected until after there is a firm commitment of the section 202/811 capital advance, it probably would make more sense to have the mixed-finance owner organizational documents submitted as part of the mixed-finance evidentiary package.

24 CFR 891.818(a)(4). This provision requires a balance sheet of the mixed-finance owner showing that it is adequately capitalized. HUD needs to provide some guidance on how it will determine whether the mixed-finance owner is adequately capitalized.

24 CFR 891.818(a)(6). See comments above with respect to the Developer Fee.

24 CFR 891.818(a)(8). This provision requires "evidence" that certain fair housing and accessibility standards will be met, but does not indicate what the evidence should be. The regulation should state the form that such evidence should take.

Mixed-Finance Proposal (24 CFR 891.819)

24 CFR 891.819(b) Financing. This provision states that the owner is required to submit as part of the proposal "all documents relating to the financing of the proposal" including loan agreements, notes, mortgages, etc. Experience in the public housing mixed-finance program has shown that the submission of these documents at the proposal stage is not really practical. HUD should be provided with sufficient information in the proposal to make a determination that the mixed-finance proposal is feasible. However, the actual documentation of the financing should be part of the evidentiary package submission and not part of the proposal submission as is the current practice in public housing mixed-finance transactions.

24 CFR 891.819(n) Certifications and Assurance. As indicated above, it is unlikely that at the proposal stage, the mixed-finance owner will be formed and there is no need for a certification that the mixed-finance owner has authority under State and local law to develop the housing. There may be a need for a certification from the Nonprofit Organization that it has the authority to participate in the mixed-finance owner entity, but this is an unnecessary certification with respect to the mixed-finance owner itself.

HUD Review and Approval. (24 CFR 891.823)

24 CFR 891.823(b)(1) – we do not see a reason for HUD to make a determination that the mixed-finance owner has the legal capacity to enter into all necessary contracts and agreements to complete the development. While HUD may need to determine that the Nonprofit Organization has the legal capacity to participate in the transaction, we do not understand why HUD would need to make a determination with respect to the legal capacity of the mixed-finance owner. In the public housing mixed-finance program, HUD requires a PHA to demonstrate legal capacity, but HUD does not require that the legal capacity of the mixed-finance owner to develop the project be demonstrated. There are numerous checks in the closing process, including owner counsel opinions that should provide sufficient comfort to HUD that the mixed-finance owner has the legal capacity to enter into the transaction documents.

24 CFR 891.823(b)(6) and (7) – the submission of financing documents with the appropriate restrictive covenants and evidence that necessary Federal, State and local approvals have been obtained should be part of the evidentiary review process and not the proposal process.

Evidentiary Materials. (24 CFR 891.825)

24 CFR 891.825(a)(1)(ii) – this provision addresses requirements with respect to conflicts of interest and identity of interest involving the sponsor, the nonprofit organization, and the mixed-finance owner and that the mixed-finance owner is not controlled or under the direction of persons or firms seeking to derive profit or gain from the mixed-finance owner. This provision appears to be at odds with the basic purpose of the mixed-finance rule which is to bring experienced for-profit entities into the section 202/811 program and to expand the affordable housing choices of the elderly and persons with disabilities. This broad prohibition on

profit or gain by the participants in the program, and in particular those participants who are putting at risk their money through investment in the project and the provision of guarantees, is not a realistic position for HUD to take. This prohibition relates back to when the owner participation in the section 202/811 programs was limited to nonprofit entities. HUD will have sufficient opportunity to review the financing proposals and the evidentiary documents to assure itself that the financing structure, including fees, is reasonable.

24 CFR 891.825(a)(12) – we do not think that HUD should require the legal opinion to attest that the counsel has "examined the availability of the participating parties' financing, the amounts and sources of financing committed to the mixed-finance project by the participating parties, and the such financing has been irrevocably committed for use in carrying out the project". Legal opinions do and should address the proper legal formation and execution of documents and the legal enforceability of such documents in accordance with their terms. However, it is unreasonable to expect an opinion from attorneys that funds are "irrevocably committed" to the project.

Replacement Reserves (24 CFR 891.855) – we agree that owner should be allowed to establish a replacement reserve for the section 202/811 units as will be the case with other units in the project. However, the uses of the replacement reserve cannot be limited to expenditures on such units. There are many costs that will need to be incurred on a pro rata basis, e.g., roof replacements.

Operating Reserve (24 CFR 891.860) – this provision should be clarified that the three-month operating reserve requirement is a minimum and that if the parties agree to establish a larger operating reserve out of tax credit equity or other sources they are free to do so.

We thank you for your consideration of these comments.

Sincerely,

Denise B. Muha

Denise B. Muha
Executive Director