August 26, 2019

VHDA Multifamily Loan Program Updates

REACH *Virginia* and Lending Policy Announcement

VHDA's REACH *Virginia* program provides below-market rate financing as well as grants towards our mission of addressing affordable housing needs in Virginia. VHDA funds this program by allocating a portion of its Net Revenues to the program annually. The REACH *Virginia* program was first funded in fiscal year 2006 with an allocation of 15% of a three-year average of Net Revenue, or $15,862,412 of subsidy. The allocation percentage was subsequently increased as follows:

2015 - 20% of a five-year average of Net Revenue, or $16,434,862 of subsidy
2017 - 40% of a five-year average of Net Revenue, or $44,843,239 of subsidy
2018 - 50% of a five-year average of Net Revenue, or $64,780,404 of subsidy

In fiscal year 2020, VHDA again increased funding to the REACH *Virginia* program by allocating 60% of the five-year average of Net Revenue to the program, equating to over $93 million of subsidy.

The Rental Housing Division is provided a share of funding from the REACH *Virginia* program. These funds help incentivize the development of affordable rental housing by providing attractive interest rates on VHDA loans financing LIHTC developments, as well as other rental housing programs. The Rental Housing REACH *Virginia* allocation policy seeks to ensure that resources are effectively deployed, equitably available and do not over-subsidize any development. We also seek to provide flexibility with the use of these funds where that is warranted.

You may recall that in September 2017 VHDA announced significant policy changes that lowered interest rates and fees, among other changes. At that time, we purposefully left the existing REACH *Virginia* allocation policy intact, which in practice allowed for generous use of such funding. Since that time, VHDA's anticipated use of REACH *Virginia* funding has broadened, placing more demand on this resource.

VHDA is now implementing additional policy changes pertaining to REACH *Virginia* funding utilization and allocation limits on such funding. Other changes to VHDA Loan Policy are also contained herein. All policy changes which follow are effective immediately, unless otherwise noted below.

Given our goal to deploy REACH *Virginia* funding in a manner that is equitable and does not over-subsidize a development, the following REACH *Virginia* subsidized loan allocation limits will be put into effect:

1. Taxable funding with 9% LIHTC - up to 20% of the total long-term VHDA loan may be REACH *Virginia* subsidized loan funds.
2. Tax-Exempt funding with 4% LIHTC:
    a. Where the owner elects a LIHTC occupancy restriction of 100% at 60% of AMI - up to 20% of the total long-term VHDA loan may be REACH *Virginia* subsidized loan funds, but in no instance more than $7 million.
    b. If the owner is willing to further restrict all or a portion of those LIHTC units to 40% or 50% of AMI, then additional REACH *Virginia* subsidized loan funds

necessary to achieve a targeted DSCR may be provided. This amount will be determined by VHDA in its sole discretion.

3. Any LIHTC development in a locality identified in VHDA's Low Income Housing Tax Credit Manual as part of the Balance of State Pool will be eligible for REACH *Virginia* funding in an amount up to 50% of the total long-term VHDA loan.
4. Local Match REACH *Virginia* Funding: VHDA will continue to offer deeply subsidized funding in amounts equal to locality provided funding up to $2 million. Note that this funding will be included in the total REACH *Virginia* loan that will be subject to the stated allocation limits.

Please note that VHDA reserves the right to further limit REACH *Virginia* funding during underwriting, typically by targeting a DSCR of approximately 1.15.

This allocation policy is **not** applicable to any development using VHDA financing that was awarded funding in the 2019 9% LIHTC application round. **Those applicants in the 2020 9% LIHTC application round seeking VHDA financing will be subject to the new policy.**

Finally, earlier this year VHDA began charging a fee on the REACH *Virginia* subsidized funding portion of any permanent, forward-delivery loan where the delivery period exceeds 18 months. This fee will continue to be assessed going forward.

Public Housing

Beginning with fiscal year 2020, approximately 17% of VHDA's annual REACH *Virginia* allocation will be dedicated to supporting the transformation of public housing communities resulting in either new replacement units or newly renovated units. Such units will be generated as a result of one or more of the following HUD public housing transformation options:

1. Section 18 Demolition/Disposition
2. Rental Assistance Demonstration
3. Streamlined Voluntary Conversions for Projects of Small Public Housing Agencies (totaling 250 units or less)
4. Mixed-Finance Structure

It should be noted that the first three options will move the public housing units to the Section 8 platform while the fourth option has the units remaining on the Section 9 platform. The use of VHDA resources including REACH *Virginia* will be considered on a case-by-case basis based on the financing needs of the proposed transformation as well as the transformational nature of the proposed deal and the leveraging of other resources. Such deals will be encouraged to consider as an option the use of tax-exempt bonds with 4% LIHTC, both administered by VHDA, whenever feasible when REACH *Virginia* resources are requested.

Other Lending Policy Announcements

Locality Imposed Use Restrictions Surviving Foreclosure

Increasingly, we are seeing localities imposing income and rent restrictions through zoning, site plan, financial contribution or other means; and such use restrictions remain in place after foreclosure. Arguably this increases VHDA lending risk by lowering the value of a property due to restricted NOI, thereby negatively impacting our ability to recover costs in the event of foreclosure and disposition as a first lienholder. The magnitude of this impact varies significantly based on how deeply targeted the units are, as well the percentage of total units which are subject to such restrictions.

In response to these circumstances, VHDA will commit to the following with respect to the locality imposed income set-asides:

The locality's income set-asides may survive a foreclosure and be binding upon a successor in interest; however, **if VHDA as first lienholder is the successful bidder at foreclosure and becomes the successor in interest**, the locality's set-aside must terminate other than:

i. 20% of the units in the development may remain at 60% of AMI following such a foreclosure; and

ii. VHDA may permit additional units at 60% of AMI to survive such a foreclosure, provided that VHDA projects that the development will achieve a targeted DSCR of at least 1.25 while subject to such additional set-aside. This determination of additional units at 60% AMI will be made by VHDA in its sole discretion.

LIHTC Equity Pay-In Requirements

VHDA has a "loan in balance" policy that requires all non-VHDA funding sources to be paid in before any VHDA funds. The rationale is that in the event of foreclosure during construction, 1) there remains a sufficient amount of undisbursed loan funds available to finish construction of the project, should that be an option, and 2) potential losses are minimized upon property disposal.

With respect to LIHTC developments, current market conditions dictate that LIHTC equity be phased in, typically requiring construction costs to be paid from other funding sources. Sometimes the owner takes a bridge loan from the LIHTC equity investor in lieu of LIHTC equity. At other times, the owner will obtain a loan from a third party to bridge the LIHTC equity. Regardless of whether the LIHTC is bridged or directly funded, VHDA now often agrees to pay in loan funds ahead of a portion of the LIHTC equity, which deviates from our "loan in balance" policy. We view this as an increase in risk, and charge an "out of balance" fee as compensation. The fee calculation takes into account the degree to which, as well as the duration, that the loan is out of balance. The "out-of-balance" fee is intended to provide an economic incentive for the owner to negotiate a more aggressive LIHTC investor pay-in schedule, thereby reducing the fee amount. While we are comfortable with a structured pay-in schedule, we are requiring a minimum equity pay-in schedule, as described below.

Please note that VHDA considers Required Equity to be those funds that pay for "approved" costs. Approved costs are those costs incurred between closing of the construction loan and closeout of construction. Examples of costs not included in our budget are developer fees earned as a result of reaching minimum debt service coverage and operating reserves funded by the investor at conversion to the permanent loan. Not all costs included in the VHDA budget are approved costs and are therefore not counted when meeting the Required Equity pay-in at closing. For example, a partial payment toward developer's fee or interest reserves associated with another lender's debt may be included in the VHDA budget, but its payment cannot count toward meeting the required equity pay-in. The loan to cost calculation will also exclude these costs otherwise found in the VHDA budget.

The following represents the Required Equity pay-in schedule:

1. 25% of LIHTC investor equity in at loan closing;
    a. net of any developer fee payment or other cost not included in the LTC calculation
    b. must be funded by LIHTC investor in either bridge or equity form; no 3rd party
2. 50% of all equity in by 50% construction completion
3. 100% of all equity in by end of construction

Security on Short-Term Tax-Exempt Bonds

VHDA is sometimes asked to issue short term tax-exempt bonds for several reasons, primarily to meet the 50% Test for LIHTC. Increasingly we have been asked to sell short-term bonds to bridge LIHTC, historic tax credit or other forms of equity as well. For much of this time, VHDA has been indifferent to this request because the bonds were fully secured by a letter of credit (LOC). More recently, the dollar amount of the requests has become very large; in some instances, over $15 million. It is not always feasible for borrowers to obtain LOCs of that size. VHDA is attempting to manage the risk that the funds expected to be available to retire the short-term bonds do not materialize. We would then be forced to use our own funds for that purpose. Accordingly, VHDA's policy regarding issuance of short-term tax-exempt bonds is as follows:

Tax-exempt gap loans are to be used to meet the LIHTC 50% Test only. VHDA has determined a cushion of up to 53% is acceptable for use of tax-exempt bond allocation.

In no event shall the LOC be in the amount less than 30% of the gap loan amount. In exchange for the additional risk of not receiving the full 100% LOC, VHDA will collect prior to the "Bond Issue Inclusion" date, a non-refundable fee equal to 2% of the amount of the gap loan that is not secured.

VHDA's normal fee schedule will apply to the aggregate loan amount reflecting both the gap loan and permanent loan amounts.

The gap funding will be disbursed first and in full before the long-term VHDA funding begins disbursing, with the exception of certain nominal amounts for administrative purposes.

Extensions of the gap loan maturity date outlined below are subject to VHDA first determining that an Event of Default under the Mortgage Loan does not then exist and that owner is making satisfactory progress toward completion of the Development and meeting all conditions for receipt of equity funds to repay the gap loan.

- If the gap loan has been fully disbursed, then VHDA may grant an extension of the maturity date of up to three months without any additional fees. Beyond that, VHDA may extend for a fee of at least 0.25% per month, for each of the next three months, and a fee of at least 0.50% per month for each additional month, thereafter. However, requests for extensions that encroach on the four-month period immediately prior to bond maturity will be considered on a case-by-case basis. All extensions will be conditioned upon a corresponding extension of the LOC securing the gap loan.

- If the gap loan has not been fully disbursed, then fees will be calculated and assessed on a case-by-case basis.

Underwriting of HAP Rents

Many of the developments VHDA finances have project based rental assistance provided by HUD. This takes the form of either Project Based Vouchers or Project Based Rental Assistance pursuant to a Housing Assistance Payment Contract (HAP). Under these contracts, HUD makes monthly payments to property owners which constitute all or most of the rent collected on behalf of each household. HUD makes its own determination as to the Fair Market Rents to be paid. VHDA often finds that the rents paid by HUD exceed our own estimates of what rents could realistically be charged in the market, absent any HUD assistance. In many cases the rent differential is very significant. HUD programs, including these, are funded by the federal government, and rely on annual appropriations from Congress. HUD also may have rights under the HAP contract to freeze annual HAP rent adjustments, as well as make mid-term adjustments. While it is unlikely that Congress would direct HUD to suddenly discontinue all or most of these payments, such an event would be catastrophic to property owners, and ultimately VHDA would be forced to foreclose on the property.

To mitigate the risk of significant financial loss, VHDA has historically taken a conservative approach to determining loan size in these circumstances. The loan amount is based on the least of HAP rents, maximum LIHTC rents or unrestricted market rents; thus in the event of foreclosure it is less likely that the property is carrying too much debt. Until recently, most other state HFAs and tax credit investors took a similar conservative approach. We have been told by developers that this is no longer the case. Informal inquiries made by staff appear to corroborate this. Increasingly, we are receiving loan applications which assume that HAP rents will be underwritten and therefore support a larger loan than typical VHDA underwriting.

Going forward, VHDA will take a more moderate position in underwriting rent overhang, as reflected in the following policy change:

- For any development being constructed or renovated in connection with a public housing transformation initiative, VHDA will underwrite the full rental assistance payment in determining loan size.
- Likewise, for any development receiving rental assistance from Rural Development, VHDA will underwrite the full rental assistance payment in determining loan size.
- For any development which has rental assistance that is not associated with public housing or Rural Development, VHDA may, on a case-by-case basis, underwrite all or a portion of the rent overhang in determining loan size. This determination will take into account the amount of the overhang and VHDA's assessment of current market conditions. This determination will be made by VHDA in its sole discretion.

Use of Tax-Exempt Bond Proceeds

In order to best leverage the private activity bond volume cap allocated to VHDA in the Code of Virginia, VHDA will now **require** developments receiving tax-exempt bond financing issued by VHDA to utilize 4% LIHTC, to the maximum amount determined by VHDA in the issuance of its Section 42(m) letter.

This new VHDA requirement is also consistent with the Virginia Department of Housing and Community Development's guidelines for applications for private activity bond allocation from Virginia's local housing authority pool, which require a certification that the project will utilize 4% credits or other federal, state or local program with similar rent restrictions.