



August 23, 2023

Marni Holloway

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

Dear Ms. Holloway:

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

Maximum Developer Fees, Developer Overhead, and Consultant Fees (QAP pg. 11)

We appreciate that SC Housing updated the 2023 QAP relating to the maximum developer fee for 9% LIHTC transactions. This was an appreciated improvement. However, we suggest that the developer fee policy is still too low. We currently work in more than twenty states, and in most of these jurisdictions the 9% LIHTC developer fee is set at 15% of TDC, which we think is a more appropriate fee structure in the current inflationary and high-cost environment.

Furthermore, we are deeply concerned about the proposed language to disallow developer fees on acquisition costs. We think it sets a bad precedent and could be highly problematic for preservation transactions, particularly if this language is applied to projects financed with tax-exempt bonds. The policy does not recognize the overhead expended nor the uncompensated work conducted during pre-development including time and cost related to due diligence, underwriting, negotiating with sellers, etc. Allowing developer fee on acquisition basis helps compensates for this activity.

There are potential unintended negative consequences of this proposed policy that should also be considered – namely that it could be a disincentive to preserving at-risk preservation assets. The affordable housing assets most likely to file for a qualified contract and/or depart the program at the end of the extended use period tend to be well-maintained communities that are in markets where they have a significant rent advantage over market assets. These communities tend to trade at low cap-rates and have lower capital needs compared to other communities. As a result, acquisition costs tend to be higher while rehab scope of work tends to be lower. Eliminating developer fee on acquisition basis creates a misalignment in incentives that will encourage more owners of Year 15-30 assets to sell to market rate buyers or opt-out at the end of their compliance period. We do not think this is in the best interest of the program.



Deferred Developer Fee (QAP, pg. 11-12)

It is critical that deferred developer fees are sized appropriately. The deferred developer fee policy, as written in the draft QAP, is generally appropriate; however, we suggest a minor tweak to allow additional flexibility, which we feel is appropriate in today's uncertain financing environment – which is to add language to allow the deferral of more than 50% of the developer fee on a waiver basis at the discretion of SC Housing staff.

Developer Fee Tax Exempt Bonds (Appendix C2 pg. 3-4)

We appreciate that SC Housing is proposing to raise the per unit developer fee cap from \$25k to \$30k per unit for projects financed using tax exempt bonds. That being said (and building on our earlier comment regarding developer fees for 9% LIHTC deals), we believe that the developer fee for bond deals in South Carolina is still too low and as a result, the state is missing an opportunity to finance more affordable housing. Many of South Carolina's neighboring states have higher developer fees for bond deals. To help address the rising cost and interest rate environment, we recommend that SC Housing build on the logic it has established within the current QAP we recommend that SC Housing allow bond deals to be eligible for up to a 20 percent developer fee.

Like smaller scale 9 percent developments, the risk and financing profile of these transactions warrant a different treatment. Developers take on more risk on large bond deals because of the extended pre-development period and the high proportion of foreclosable debt, for which the developer is responsible. The developer fee compensates developers for these risks. The additional eligible basis generated by the increased fee will also generate more tax credit equity which will help offset reduced debt proceeds brought on by rising interest rates and help plug gaps brought on by rising construction costs. Unlike 9 percent transactions, the additional eligible basis generated by the increased fee will not deplete the overall supply of 4 percent credits, which as described above are “as of right” and uncapped. Increasing the fee could have the additional benefit of reducing developers State LIHTC requests, stretching scarce state resources further.

Maximizing developer fees, within the constraints of the tax law, regulation, and reasonable underwriting, is a proven and successful method of generating additional LIHTC eligible basis, and in turn, equity proceeds which help fill project gaps and/or reduce the need to obtain state tax credits. It is a proven strategy that has been deployed of late by many of SC Housing's peer HFAs in the region including Arizona, Kentucky, Oklahoma, Ohio, North Dakota, and Tennessee, all of which have developer fees for bond transactions ranging between 18 and 25 percent. If SC Housing finds it desirable, it could also require developers to defer any fee above the current ceiling. We would be happy to provide case studies of active transactions we are underwriting in South Carolina to illustrate the impact of this policy on project gaps if that is helpful to the Authority's decision making.

Even if SC Housing does not choose to raise developer fees above 15%, we strongly urge the Authority to reconsider its \$5 million developer fee cap. Constraining the eligible basis associated with the cap on fees creates additional project gaps, requiring more projects to request state tax credits. An





alternative SC Housing could consider would be to have a hard dollar cap on developer fee for projects requesting state tax credits but no cap for projects that do not request state tax credits. If SC Housing desires, it could also require all developer fee over the current \$5 million cap and/or \$30,000 per unit be deferred. Adopting a combination of these recommendations should reduce the demand for state LIHTC, allowing the authority to subsidize additional properties throughout the state.

Rent Increases (Appendix E, Pg. 6)

We have deep empathy for our residents and the potential hardship that rent increases can place on families with limited means; however, we do not think that SC Housing's proposed change to cap rent increases at 5% per year is in the best interest of the program. In today's inflationary environment, our operating costs, including insurance, payroll, utilities, etc., have been increasing at unsustainable rates. When operating costs exceed revenue affordable properties are at risk of not maintaining required DSC covenants and/or deferring maintenance, neither of which benefits the property or the residents. We also note that HUD already sets caps on potential rent increases at LIHTC properties (this year the cap is 5.9%) through its income limits calculation methodology so we think this policy is duplicative. We also observe that this policy does not align with NCSHA's new proposed recommended practices relating to Tenant protections. We suggest that SC Housing revert to their previous policy and allow rent increases above 5% at SC Housing's discretion. If SC Housing is unwilling to revert to its previous policy, we suggest raising the cap to 10%. Alternatively, we suggest that in the long-term, tenants and properties would be better served by notice requirements of rent increases (as recommended by NCSHA) rather than hard caps.

Additionally, we request SC Housing amend its policy further to provide an exception for units covered by Project Based Rental Assistance or Project Based Vouchers since LIHTC rent increases will not actually impact the out-of-pocket rent paid by residents but would potentially benefit the operations of the affordable community.

Mandatory Site Requirements (QAP, Pg. 9)

We support the proposed deletion of J(2)(e). We concur that if the market study demonstrates sufficient demand, adding additional units to a market that has recently had a tax credit allocation should not be disqualified. We also support the additional proposed language in J(3) relating to the ability for SC Housing to issue waivers based on the presence of market-rate residential in the area for projects that would otherwise be disqualified based on their proximity to certain negative land uses. SC Housing may wish to provide more detail as to what threshold would have to be met for waivers to be issued.

Replacement Reserve Requirements (QAP pg. 11-12)

We request SC Housing to update its replacement reserve requirements to align with NCSHA's new Recommended Practice. \$300 per unit annually is an appropriate replacement reserve for family/general occupancy properties. New construction properties serving the elderly tend to have less wear and tear and as such it is generally accepted that a \$250 per unit annually is an appropriate minimum replacement reserve requirement.



Operating Reserve Requirements (QAP pg. 11-12, 14)

We request SC Housing reconsider the sizing of the minimum operating reserves. We feel that the six month minimum for operating reserves, that is inclusive of all projected operating expenses and must-pay debt service along with the addition of the replacement reserve, is excessive. On a large bond deal, this can add in excess of \$1 million of non-basis eligible costs, decreasing leverage and requiring additional need for state gap filling resources. Just the addition of insurance in the methodology can add in excess of \$600 per unit to the reserve requirement in today's market. We recommend SC Housing revert to its previous replacement reserve policy and annual operating expenses methodology.

Additionally, we urge SC Housing to reconsider its requirement that the operating reserve remain with the property post the investor exit. By the time an investor exits a partnership typically in years 11-16 there are typically growing capital needs from wear and tear. We believe it is in the best interest of the property and residents to allow the property to be able access the operating reserve at this stage of the lifecycle to support the needs of the property and residents. Ideally, owners will have flexible access to draw down this reserve. Alternatively, SC Housing could allow the partnership to transfer to the operating reserve to the replacement reserve account.

Additionally, for projects with HUD Project-Based Rental Assistance (PBRA), we recommend SC Housing add language in the QAP that explicitly allows developers to offset the SC Housing minimum by the amount of HUD-controlled operating reserves. These reserves fulfil the same basic function and purpose.

Utility Allowance Methodologies (QAP, Pg. 4)

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

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

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

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





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

Awards Limitations (Appendix C1, pg. 2)

We support the increase in the 9% award limitations. Given the rising cost environment, this is appropriate. We also support the proposed amendment to allow up to two new construction awards per county in the 9% program so long as the market study supports demand for both developments. Additionally, we recommend increasing the award limitation for bond deals from 2 to 3 awards.

Size Requirements (Appendix C1, pg. 7)

We support the proposed change to increase the maximum project size for projects funded with 9% LIHTCs. Developers achieve greater economies of scale with larger projects sizes and as a result makes more efficient use of scarce resources.

Site and Site Lighting (Appendix B, Pg.12)

We propose a reduction in the horizontal distance from the foundation walls that grade must have positive continuous slope from 10' to 5'. A horizontal run of 10' often impedes the ability to locate buildings properly among the other spatial constraints that sites have. Positive drainage for 5' would still maintain the desired outcome of shedding surface water away from the building foundations, while providing increased flexibility to the property as a whole.

Electrical (Appendix B, pg. 23)

We support the proposed change in the Design Standards that only require elderly units to be pre-wired for telephone. Increasingly, residents of family properties no longer require, or desire, wired telephones, preferring mobile options. For those that do prefer a "land line" VOIP options provide a more cost-effective option for the consumer while saving the developer the expense of wiring units.

Conclusion

LAC appreciates the opportunity to provide feedback to SC Housing as it continues to develop its 2024 QAP. We would welcome the opportunity to discuss them with you further at your leisure and/or answer any questions you may have regarding our feedback. I can be reached directly at 860-287-1635 or tamdur@lincolnavcap.com.

Regards,

Thom Amdur

Senior Vice President, Policy & Impact





About Lincoln Avenue Capital

Lincoln Avenue Capital is one of the nation's fastest-growing developers, investors, and operators of affordable and workforce housing, providing high-quality, sustainable homes for lower- and moderate-income individuals, seniors, and families nationwide. LAC is a mission-driven organization that serves residents across 23 states, with a portfolio of 120 properties comprising 22,000+ units.

cc: Julie Davis
Hank Moore
Leanne Johnson



Appendix: Incentivizing Sustainable LIHTC Housing Through Utility Allowance Modernization

The recent passage of the Inflation Reduction Act (IRA) creates a unique opportunity to leverage new and expanded federal resources to reduce the utility burden at affordable housing properties financed with Low-Income Housing Tax Credits. The opportunity to fully leverage solar and renewable energy tax credits at LIHTC properties also has the *potential* to help developers and housing finance agencies fill project funding gaps created by rising construction costs, inflationary factors, and rising interest rates. Utility allowance (UA) policies, as administered by many state housing finance agencies, can be a *significant barrier* to the integration of solar and renewable energy investments in the LIHTC portfolio. The purpose of this memo is to increase awareness of housing finance authorities (HFA) about adopting, establishing, and offering utility allowance options aligned with energy-efficiency and renewable energy investments in new construction and rehabilitation of affordable rental housing. It provides a brief overview of current UA regulations, UA policy implementation barriers affecting renewable energy deployment in affordable housing, and sustainable policy recommendations.

Utility Allowances: An Overview

Most federal housing programs cap ‘housing costs’ at 30% of a household’s adjust monthly income. ‘Housing costs’ are defined as the combination of rent and utilities. The amount a household is expected to pay for utilities is called the “utility allowance” (UA). Covered utilities include tenant paid electricity, natural gas, propane, fuel oil, wood or coal, water and sewage service, and garbage collection. The rent a LIHTC property owner can receive is the difference between the programmatic rent and the estimated utility costs (i.e., the UA). A LIHTC property UAs can range from small to large depending on the number of utilities, end-uses covered, climate, utility rates, dwelling unit size, house-hold size, unit design, etc.

The Internal Revenue Service (IRS) has issued a series of regulations that provide guidance on allowable methodologies in which a PHA, HFA, Utility or Developer may use to estimate the UA. These include:

1. The local PHA sets the Housing Choice Voucher (HCV or Section 8) utility allowances.
2. The local utility company provides an estimate.
3. A LIHTC HFA estimate.
4. HUD’s Utility Schedule Model.
5. An engineering/consumption model approved by the state’s HFA.

There are several practical issues and shortcomings with the first four methodologies which have been well documented by affordable housing advocates² that generally center around the accuracy of the allowances and the inability to incorporate efficiency investments into prospective underwriting. The

² Enterprise Green Communities, *Utility Allowance Options for Investments in Energy Efficiency: Resource Guide*; National Consumer Law Center, *Up the Chimney: How HUD’s Inaction Costs Taxpayers Millions and Drives up Utility Bills for Low Income Families*; National Housing & Rehabilitation Association, *Incentivizing Affordable Housing Retrofits Through Utility Allowance Modernization*





fifth option, an Engineering/Consumption Model approved by the state's HFA, offers unique benefits to developers and residents which we will outline below; however, many HFAs do not permit the use of this methodology at this time.

The Benefits of the Engineering/Consumption Utility Allowance Methodology

Traditional utility allowance schedules (i.e., methodologies 1-4) do not differentiate between energy-efficient and typical units or buildings with substantial investments in renewable energy. This can create so called "split-incentives" -- circumstances in which the flow of investments and benefits are not properly rationed among the parties to a transaction, impairing investment decisions. Utility allowances that reflect *prospective* investments in renewable energy and energy efficiency allow owners to overcome split-incentives. This contributes to the financial viability of existing and new projects and also results in a more comfortable and better performing unit for residents.

The recent passage of the Inflation Reduction Act (IRA) explicitly encourages the use of renewable and energy efficiency tax credits in LIHTC properties by eliminating the requirement to reduce the LIHTC eligible basis by the amount of investment tax credit or 45L tax credits, and by making additional tax credits available for qualified low-income buildings and communities. The biggest barrier to large scale deployment of these investments in LIHTC properties is no longer the scale of the subsidy but rather the impact of utility allowances on project underwriting.

As owners and developers, we now seek to maximize renewable energy and efficiency investments at the design stage to mitigate the risk of utility rate fluctuations, reduce our carbon footprint and provide a more resilient property for our residents. When we can model future utility utilization using an engineered UA during the design and underwriting stage, we are able to plan and finance additional features to further reduce or even eliminate tenant paid utilities. If these savings can be captured in the form of prospectively reduced utility allowances, we are able to increase our net collectible rent and leverage additional debt proceeds for additional scope of work *or* in some scenarios, actually fill project financing gaps.³ It should also be noted that the impact on the resident's actual housing burden is unchanged.

Recommendations

Many state housing finance agencies have already deployed engineered utility allowances to drive increased investments in sustainability to significant effect, including California, Colorado, Georgia, New Mexico, and Utah. We recommend that all states proactively adopt policies that allow for the utilization of energy efficient engineered utility allowance models.

Option 1 (Preferred): States can issue guidance that permits a third-party energy and water and sewage consumption and analysis model, prepared for by a licensed engineer or qualified professional (such as a HERS rater). We suggest that the policies developed by either Georgia Department of Community

³ To help illustrate the positive effect of utilizing an engineered utility allowance model on net debt proceeds we have attached a case study of a recent transaction LAC is currently develop in Colorado Springs, CO.





Affairs⁴ or Colorado Housing Finance Authority⁵ are reasonable templates that other HFAs may wish to model policies after.

Option 2: A state agency could develop their own model such as the California Utility Allowance Calculator (CUAC), which was developed by California’s Public Utility Commission.

Case Study: New Construction 4% LIHTC Bond Transaction

The following case study illustrates the difference between UAs a new construction 4% LIHTC transaction in LAC’s portfolio. It shows difference between the local PHA UA and the modeled UA and the additional debt leverage generated by utilizing the modeled UA.

PHA Utility Allowances	Tenant Paid	1	2	3	4
Heating - Gas	Yes	27	31	36	40
Heating - Electric	No	26	36	46	55
Cooking - Gas	Yes	2	4	5	6
Cooking - Electric	No	5	8	10	13
Other Electric	Yes	20	28	36	44
Cooling	Yes	2	3	4	5
Water Heating - Gas	Yes	6	10	13	15
Water Heating - Electric	No	14	18	22	26
Water	No	47	56	65	76
Sewer	No	29	34	39	44
Trash	No	21	21	21	21
Electric Charge	Yes	16	16	16	16
Gas Charge	Yes	12	12	12	12
Total UA Per Month		85	104	122	138

⁴ See Approved DCA Utility Allowance Methodologies, 4. Energy Consumption or Engineered Model (ECM), (26 CFR 1.42-10(b)(4)€) https://www.dca.ga.gov/sites/default/files/2020dcaumethodchnngprocess_1.pdf

⁵ See CHFA’s Utility Allowance Policy for Housing Tax Credit and Multifamily Loan Developments, https://www.chfainfo.com/getattachment/e5532e61-c096-4d3d-a186-a60f4fb90f80/CHFA_Utility_Allowance_Policy.pdf



Modeled UA's	Gas	Electric	Total
1 Bedroom	30	39	69
2 Bedroom	32	44	76
3 Bedroom	36	48	84
4 Bedroom	37	53	90

Debt Proceeds Analysis - PHA UA's	
NOI	\$ 2,412,888
DSCR	1.15 x
NOI Available	\$ 2,098,163
Debt Constant	5.95 %
Debt Available	\$ 35,263,248

Debt Proceeds Analysis - Modeled UA's	
NOI	\$ 2,498,032
DSCR	1.15 x
NOI Available	\$ 2,172,202
Debt Constant	5.95 %
Debt Available	\$ 36,507,593
<i>Additional Debt with Modeled UA's</i>	\$ 1,244,345

