



5 POINT HOUSING POLICY PLAN FOR SAVINGS TO THE STATE

*INCREASING EFFICIENCY IN THE OPERATION OF NEW YORK STATE'S
HOUSING PROGRAMS*

Introduction

The New York State Association for Affordable Housing (NYSFAH) is the statewide trade association for New York's affordable housing industry. Our 300 members include for-profit and nonprofit developers, lenders, investors, syndicators, attorneys, architects and others active in the financing, construction, and operation of affordable housing. Together, NYSAFAH's members are responsible for virtually all of the housing built in New York State with federal, state, or local subsidies. NYSAFAH is focused on ensuring that limited public subsidies are used efficiently, advocating for policies and program reforms that leverage state dollars with private and federal government funding.

As Governor Cuomo's Urban Agenda noted, New York should take full advantage of all available state and federal housing resources, and spur private sector investment to produce and preserve affordable housing. Particularly during this time of financial constraint, the state must make certain the value of scarce public resources is maximized, and its programs are operating as efficiently as possible.

New York State has a proud legacy of promoting affordable housing, and has benefitted from the many innovative and committed contributions of talented public servants leading or working in the state's housing agencies. With the recent integration of numerous state housing agencies into the single New York State Homes and Community Renewal (HCR), comes the opportunity for unprecedented efficiencies and fully leveraged resources. NYSAFAH seeks to work in close partnership with the state's housing leadership in continued support of optimizing program performance. It is to this end NYSAFAH offers the following Five Point Housing Policy Plan for Savings to the State, which suggests reforms to increase efficiency in the operations of New York's housing programs.

Coordinating oversight with other agencies and entities to minimize duplicative staffing and contradictory standards

HCR could save significant resources by identifying where other city or federal agencies, or banking institutions are conducting oversight activities comparable to HCR's, coordinating with those entities to eliminate duplication. Streamlining oversight processes, such as construction monitoring and design review will result in savings from both reduced staffing demands and shorter delays in construction financing closing and permanent loan conversion.

HTF Financing and Coordination with Banks

Currently, HCR's construction monitoring activity and related costs for New York State's Housing Trust Fund (HTF) financed projects could be significantly reduced by relying on the oversight of private financial institutions as New York City's Housing Development Corporation (HDC) and Department of Housing Preservation (HPD) do. HDC and HPD relegate the construction approval process to the bank, relying on bank engineers, which saves processing time and subsidy. HPD's review is limited only to façade design and schematic floor plans, while the bank:

- Reviews all construction documents
- Conducts the cost and plan review
- Conducts the appraisal
- Holds and services the bank loan and HPD/HDC loans
- Dispenses HPD/HDC loan funds

Finally, the bank certifies to HPD that the project was built substantially in accordance with the plans; any material changes during construction must be approved by HPD. If HCR believes a project requires more monitoring than a bank usually provides, the agency could request additional scope in the bank engineer's oversight.

Currently, developers may be reluctant to obtain HTF construction financing because of duplicative oversight practices, and delays in processing payment, in addition to higher interest rates; adopting the type of coordination that has proven successful at HPD could lead more developers to obtain construction financing through HTF, resulting in savings related to origination fees and interest.

HCR Coordination with USDA RD

In upstate New York, the state could conserve resources by better coordinating with USDA Rural Development (RD). The Leveraged Loan Program for example, was created as a collaboration between HCR and RD. Initially, it was agreed RD would conduct property inspections; in recent years, HCR began conducting the same inspections – in essence, projects now have double the inspections, with at times different standards.

Duplicative Design Guidelines

Streamlining and coordinating oversight and standards related to design guidelines bear particular potential for savings. HCR's Design Handbook has grown into a document reflecting not just state and federal legal standards, but also preferred practice; the state could benefit from analyzing design requirements truly essential to safety and those duplicative or less necessary given limited available resources. For instance, with the Leveraged Loan Program, the federal government requires hand rails to be placed on the back or front of shower stalls; the state requires them placed on either side – consequently, developers must place them on the side and front or back, installing two different plumbing units to service both.

Maximizing Housing Trust Fund Resources

Decreasing the HTF Replacement Reserve Requirements

The purpose of HTF replacement reserves is to protect a project's financial viability in the event of unforeseen emergency. Currently for HTF projects, HCR requires a minimum annual reserve payment of \$800/dwelling unit (du) for family projects and \$400/du for senior projects. Prior to 2009, the reserve requirement was .5% of the Total Development Cost (TDC), which was exceeding \$1,000/du per year for most projects.

Though improved, current HTF reserve requirements significantly exceed the industry standard, and conventional multi-family underwriting typically stipulates a \$250 to \$300/du per year reserve requirement. Added to which, HCR has higher than conventional bank requirements for design, construction quality, life cycle cost analysis goals and material durability, reducing the risk on reserves.

A reduction in reserve requirements to the industry standard of \$250/du per year for senior projects and \$350/du per year for family projects could save the state significantly: HCR awarded HTF/HOME loans to approximately 1,100 units in 2010; the replacement reserve reduction would enable the state to save \$6,000/du per year, or \$6,600,000 annually across the program. This funding could be capitalized to reduce state subsidy needs, or be used to produce more affordable housing.

Following is a case study of Van Rensselaer Village, an 81 unit Mitchell Lama project undergoing rehabilitation in Watervliet, New York, financed by a Low Income Housing Credit (LIHC) and HTF loan of \$3,800,000:

- Current replacement reserve requirement: \$64,800
- Reduced reserve requirement at \$350/du per year: \$28,350
- Additional hard debt capitalized by the delta: \$500,000
- Added hard debt could reduce the HTF loan amount dollar for dollar, or could be leveraged to produce an additional 10 dwelling units of affordable housing, an effective 12% increase in productivity from the same New York State dollars.

Maximizing Housing Trust Fund Resources (cont.)

HCR's Housing Finance Agency (HFA) aligns their replacement reserve requirement more closely with the industry standard, at \$250/du per year for both family and senior units. Erie Harbor, a 131 unit family affordable housing project in Rochester, closed with HFA in November 2010. The project includes tax exempt bond financing and HFA subsidy funds. As per the HCR underwriting requirements for HFA projects, the replacement reserve is \$250/du per year, versus \$800/du per year for the same project if it included HTF subsidy:

- Current replacement reserve requirement of \$250/du per year: \$32,750
- Replacement reserve requirement if HTF requirement of \$800/du per year: \$104,800
- Loss in hard debt leverage by this increased requirement: \$875,000
- With the increased replacement reserve requirement, the project would have required \$875,000 more in subsidy funds to make the project feasible.

Offer Prepayment of 30-Year Loans

HCR could also consider allowing project owners to pay off 30 year 1% HTF loans earlier, based upon a reduced Net Present Value determined amount. The state would benefit financially from receiving loan proceeds earlier, save costs related to mortgage oversight, and could recycle the funds back into affordable housing production. As an example, if the project has a \$1,000,000 HTF loan outstanding, the state receives \$10,000 per year in interest; estimating it costs \$25,000 per year to oversee the project, that would result in \$15,000 per year in savings if the loan is paid off in addition to recouping the funds back into the state treasury. As long as the project is covered by a non-HTF 30+ year affordable regulatory agreement, there is no risk of the project reverting to market rate.

Waiving the Per Unit LIHC Cap while Maintaining the Project Cap

HCR could achieve significant savings by allowing the \$22,000/du cap for LIHC projects to be exceeded for each LIHC unit so long as it is not exceeded for the total number of units in a project—this would reduce subsidy needs while facilitating the development of units serving households between 60% and 90% of Area Median Income (AMI). The current policy discourages developers from including units between 60% and 90% of AMI in 9% LIHC projects, an income mix that would meet demand. As an example:

- A 47 unit project funded in New York City received a LIHC allocation of \$1,034,000 (\$22,000/du) and an HTF award of \$2,180,000 for a project with 100% of the units targeting households below 60% of AMI.
- If the project had proposed 10 units at rents of 80% AMI, it would have only been eligible for a LIHC allocation of \$814,000 – a loss of \$2.024 million in LIHC equity assuming a \$0.92 raise. While the higher 80% AMI rents would support about \$56,000/du in additional debt, it would not be sufficient enough to make up for the loss of equity, which is more than \$200,000/du.
- However, if the project were able to have 10 units at 80% AMI rents without reducing the LIHC award, the project would be able to support an additional \$560,000 in bank debt assuming a 6% interest rate and a 1.15 debt-to-coverage ratio, which would enable HCR to reduce its HTF award by \$560,000.
- While the LIHC allocation per LIHC unit would equal approximately \$28,000/du, the LIHC allocation per overall unit below 90% AMI would still be \$22,000. In this example, the project has sufficient basis to be eligible for the approximately \$28,000/ LIHC du.
- As an alternative to reducing the HTF allocation, HCR could lower the LIHC allocation by approximately \$61,000 which would reduce the LIHC allocation to approximately \$26,300/LIHC du and \$20,700/du overall.

The same number of units would be created with a broader income mix, with less government subsidy, and more private financing leveraged.

Allowing Private Placements of Tax-Exempt Private Activity Bonds Issued for Multifamily Housing Revenue Bonds

Private placements can save valuable time and cost between the point when a transaction has been underwritten by the issuer and the start of construction. With a direct sale, the state could save approximately 1% from the cost of issuance, and 2% to 3% in negative arbitrage costs, in addition to potential interest rate savings.

Many financial institutions are able to purchase privately placed tax-exempt municipal bonds in order to finance specific projects. Private placements are used frequently throughout the country, particularly with regard to the purchase of tax-exempt private activity bonds used to finance new construction, or the acquisition and rehabilitation of affordable multifamily housing projects. This option has taken on even greater importance given the contraction of the credit enhancement market, including the virtual cessation of new business by Fannie Mae, once among the largest participants in the market, and the reluctance of banks to employ long-term letters of credit to secure publicly issued bonds. While the private placement market has also contracted over the past few years, it provides an additional option for issuers and developers to finance affordable rental housing.

The financing of affordable rental housing using tax-exempt bonds has turned what has historically been relatively simple construction to permanent loan real estate financings, something developers and financial institutions have been doing for decades, into highly complex transactions. While there is no doubt that the benefits of the use of private activity bonds, especially when combined with LIHC, more than outweigh the disadvantages, a private placement simplifies the transaction by eliminating certain parties and costs that are part of the rated, publicly offered alternative. A private placement brings a multifamily housing financing back closer to the model of a developer working with a financial institution, albeit with the additional requirements and guidance of the issuer and the federal tax code.

Allowing Private Placements of Tax-Exempt Private Activity Bonds Issued for Multifamily Housing Revenue Bonds (cont.)

Besides expanding the market, the most substantial benefit of a private placement is the cost savings, reducing the inevitable gap between sources and uses inherent in an affordable rental project. This can result in reduced public subsidies, or increased sources to be used for project purposes. Private placements eliminate the need for a bond rating, a bond underwriter and related costs. Additionally, depending on the situation, placements may be structured as “draw-down” bonds, where funds are advanced on an as needed basis more typical of a traditional construction loan, allowing the project to largely avoid the substantial negative arbitrage cost of a publicly offered transaction during most interest rate environments. These cost reductions most benefit small projects, where fixed financing costs, such as rating agency and legal fees, have a substantial impact—in this case, the difference between a private and public transaction can be the difference between a project getting financed, particularly with regard to infill and rural projects.

Some issuers have had concerns about the secondary market sale of private placements to investors that lack the sophistication to assess their risks. Such fears can be allayed by requiring that the bonds not be sold in small denominations, and by limiting the class of eligible investors who can purchase them to Qualified Institutional Buyers under Rule 144A and Accredited Investors under Regulation D of the Securities Act of 1933.

In summary, the use of private placements puts another tool in the hands of issuers seeking to expand the alternatives available to finance affordable housing, while driving down issuance costs to the benefit of the project.

Expediting the 8609 Process

To access LIHC equity, a developer must submit to the IRS form 8609 obtained from HCR, which certifies the developer has completed several significant milestones in development and the project continues to be financially sound. The timing of this LIHC capital is especially critical for projects utilizing it to pay down the construction loan, to convert to a permanent loan.

HCR's current 8609 guidelines require closing on all permanent financing; though there can be project-specific flexibility on this point, the HCR 8609 process can be initiated so late in the development process to temporarily prevent a project from moving forward, and the timeframe for process completion can vary significantly – from 6 weeks to 90 days or even, in some cases up to a year. Consequently, delays in the 8609 process can cost an affordable developer tens or hundreds of thousands, effectively in state subsidy dollars, that could otherwise be used more efficiently in affordable housing production.

Currently, HFA initiates the 8609 process at construction completion, and generally completes it in a consistent timeframe. HCR could save significant state subsidy by adopting HFA's 8609 process, and by conducting various processes, such as underwriting, legal and regulatory review, simultaneously.

Conclusion

NYSFAH stands ready to partner with and assist New York State's housing leadership in implementing any of these, or other, efforts to save state resources and improve efficiency in the operation of New York State's housing programs. We would welcome continued dialogue and the opportunity to expand further on these suggestions.

NYSFAH is furthermore, particularly interested in partnering with the state in advocacy for additional federal resources, or any legislative or regulatory changes that would advance New York's affordable housing agenda.

Thank you for the opportunity to present these suggestions on behalf of New York's private affordable housing industry.