GREYSTONE

November 14, 2017

United States Department of Agriculture
Office of Budget and Program Analysis
Jamie L. Whitten Building
Room 101-A
1400 Independence Avenue S.W.
Washington, DC 20250

Re: Identifying Regulatory Reform Initiatives
Second Batch

Pursuant to Executive Order 1377 – Enforcing the Regulatory Reform Agenda published on July 17, 2017, Greystone Affordable Development ("Greystone") hereby submits a number of recommendations on how the Department of Agriculture can provide better customer service and remove unintended barriers to participation in your programs while still accomplishing your mission. Our comments are primarily focused on Rural Housing Service regulations that are in need of reform and modernization, of streamlining to improve efficiencies, of reforming in order to reduce unnecessary costs that often exceed benefits, and of expanding or repeal where serious inconsistency with other housing programs prohibit the maximization of the Agency's mission.

Greystone Affordable Development continues as the nation's leader in preservation of affordable rental housing in rural markets. Over the past several years, we have facilitated the acquisition and rehabilitation of over 10,000 housing units (256 properties) across 10 different states. Such preservation efforts of aged and at-risk USDA Section 515 housing has primarily been successfully completed utilizing LIHTCs in large state-wide portfolio tax exempt bond transactions. We have witnessed first-hand the challenges with many of the existing outdated and ineffective regulations that were originally adopted during a completely different era at USDA. Below are several suggestions that would help modernize the programs and help make them more attractive to the private sectors needed to help preserve the over 14,000 aged properties now at risk of becoming obsolete or leaving the program.

USDA provides a variety of financing methods for affordable multi-family rental housing for low-income, elderly, or disabled individuals in eligible rural areas. We believe there are many areas of opportunity for USDA to improve its procedures and regulations imposed on a developer/applicant seeking to secure financing. In general, the application process tends to be unnecessarily cumbersome, lengthy, and inconsistent from state to state. Please consider our specific requests for the overall improvement of 515, MPR, and 538 program application requirements.

SECTION I – PROCEDURAL REGULATIONS

A. Transfer Application Submission

Current language in HB-3-3560 states that all transfer applications will be reviewed by the Servicing Office within 14 business days of receipt for completeness and the full evaluation of the complete application is to be completed within 45 business days for one property and 75 business days for portfolios.

In order to improve efficiencies and reduce administrative burden on all parties, USDA should expand its online tracking system to allow the applicant to submit transfer applications via an online portal. In our experience, each state has a different requirement in terms of whether they will accept digital or paper applications (or in some cases, both). The requirement for paper submissions is outdated and imposes unnecessary additional costs on the applicant. An online application portal, to be used universally across all states, would ease the burden on applicants, as they would no longer have to purchase costly supplies, coordinate original signatures on documents, assemble large binders/8-position folders, and ship boxes and boxes to either the State office or multiple Area office locations (depending on the State's review process). An online application submission portal would also ease the reviewing burden on USDA since the information would be submitted directly into the system by the applicant and would negate the need for the Loan Servicer to input information into the MFH Transfer Tracking System. Such portal would also allow Headquarters to more accurately monitor the timely processing of Transfer Applications at the state level, which continues to be a major challenge in many states.

In terms of the review process, Headquarters should be responsible for handling the review and approval of all portfolio transfer applications. If this is not a viable option due to limited human resources at the National level, then more clarity and consistency in the definition of a "complete" application is greatly needed. In our experience, we have received inconsistent comments in various states in terms of what specific documentation is required and when to be received in order to consider an application "complete". As such, an undue burden is placed on the developer to modify their application processes for the same USDA programs in order to fit the individual desires of each state.

USDA should consider amending the timeline for full evaluation of a transfer application. For a portfolio transaction, the current regulation is that the full evaluation should be complete within 75 business days – nearly four (4) months! Other third party participants rely on many of the same reports and documents as included in the Transfer Applications to USDA, which many of those reports and documents are time sensitive material. With 4 months allocated to just USDA review and approval, many reports and documents expire prior to transfer closing and require unnecessary updates and costs to the developer.

In our experience, USDA is actually able to review applications much faster than this (if so motivated and driven) and the expectation should be set accordingly. In our opinion, 45 days for a portfolio transaction is a much more reasonable expectation for applicants when planning their development timeline.

B. Transfer Application Documents

In general, there is much repetition regarding information USDA requires the applicant to submit. For example, in the case where there are identity of interest relationships within the development group, such IOI relationships must be addressed within the following required documents:

- Executive Summary
- Required Written Statements
- MFH Transfer and Assumption Application Supplement (Attachment 7-B-2)
- IOI Disclosure Forms (RD 3560-30 and RD 3560-31)

USDA should closely review and reconsider each document required as part of the transfer application, with a goal of eliminating all unnecessary or repeating information. The ideal application would consist of one (1) application form which lists all questions the applicant must answer, plus the required supporting documentation (i.e. Purchase and Sale Agreement, Preliminary Title Report, Capital Needs Assessment, Appraisal, Management Plan, etc.) to be submitted in conjunction with the PAT underwriting template. This amendment to the requirements would not only greatly reduce the applicant's burden of completing a full transfer application, it would also greatly reduce the burden on USDA's reviewers.

In terms of the USDA forms that are required for transfer (required as part of the initial application, closing, and loan closeout processes), USDA should make available instructions online for all forms. At this time, instructions are available for only select forms, leaving instructions subject to the various interpretations of the state or area offices who may or may not have experience with such forms.

Since Greystone has completed hundreds of transfers in the recent years, we are willing and able to assist the Agency with this administrative review process. In addition, we can provide valuable input into the duplication of forms required by other funding sources which may further eliminate USDA redundancy.

C. MPR Program – Awarding Process

The current MPR NOSA allows the Director to fund applications with lower scores if within a state with 4 or less funded applications over a higher scoring applicant within a state that has had 5 or more funded applications, even if the lower scoring applicant was received at a later date and time. USDA should base MPR awards within a given State strictly on scoring as the priority, regardless of the number of other funded applications in said state. Otherwise, applicants in lower participating states are given an unfair advantage regardless of scoring results.

Furthermore, there is no current means for transparency in how applicants are selected for funding or what MPR tools are selected. Therefore, an applicant cannot adequately gauge their position in the queue or the potential timing for funding which is necessary before other funding sources can commit to a preservation transaction. During the awarding period, USDA publishes online a listing of the number of applicants awarded by State; however, the information made public should be expanded to include the applicant name (or portfolio name, if applicable), score, and funding amount (deferral, new 515, bullet loans, etc.). This modification from the current process would create more transparency in how the funding dollars are allocated, as well as a means of estimating remaining funding available.

D. 538 NOSA Response Submission

As stated in the current NOSA - “Although a complete application is not required in response to this Notice, eligible lenders may submit a complete application concurrently with this response.”

The purpose of the NOSA response is primarily for initial scoring and place holder. In circumstances where an applicant is indeed able to submit a complete 538 Application concurrently with the NOSA Response, USDA should eliminate the need for the separate NOSA response. We believe that in such circumstance, a completed NOSA Response Application Form (with scoring) plus the full application (as prescribed by USDA HB-1-3565, Attachment 4-A, “Section 538 GRRHP Application Checklist”) should suffice. This would reduce the burden on both the applicant and USDA reviewer due to fewer documents required. USDA should continue to allow the submission of the NOSA Response ahead of the full application in circumstances where the applicant is not able to submit all documentation at once.

E. 538 Program Application Submission

In conjunction with its review and approval of a Transfer Application process (see above), USDA should utilize an online application portal for submission and tracking of the review and approval of 538 applications. In addition, in those cases where the 538 loan is being requested in conjunction with a transfer of an existing 515 project, significant duplication of forms and documents are required. Allowing online access of such forms utilized by both the MF staff and the 538 staff would eliminate duplicate and burdensome requirements to the applicant/borrower.

F. Unnumbered Letters

USDA should consistently solicit input from stakeholders before implementing any new procedure or process by incorporating a comment period, where applicable. This would allow individuals and entities the opportunity to influence regulations and could also prevent USDA from implementing unnecessary or conflicting new regulations in Unnumbered Letters.

SECTION II – INTERGOVERNMENTAL AGREEMENTS

According to HB-3-3560, Chapter 2, Section 2.6, the Agency gives preference to applications for new loans that leverage other funds, thereby reducing the amount of Section 515 loan funds needed to develop or rehab a project. Examples of funds that count as leveraged funds include borrower resources beyond the minimum required amount, equity generated by the sale of low-income housing tax credits, a second loan from another lender, or a grant from a State or Local public agency or other source.

Having worked with multiple USDA State offices on transactions involving additional leveraged funds (mainly LIHTCs and other senior debt), it has been our experience that it can be difficult to determine which agency should underwrite "first". Many state agencies actually refuse to allow an applicant to submit applications for LIHTCs until USDA has issued their conditional commitment for transfer approval since they control the rents and expenses. If USDA gives preference to applications that leverage other funds, USDA should work to mitigate this issue and where possible defer to the other governmental agency or senior lender for underwriting priorities.

Additionally, under the current regulations it is difficult for borrowers to subordinate USDA debt to debt of other agencies. While it is possible to do so, the process is timely and inconsistent depending on the sources of debt. USDA should pursue a more streamlined process for allowing the subordination by creating a Memorandum of Understanding stating that USDA will subordinate its debt, under certain terms and conditions, when other agency funding is included as a source in the deal.

SECTION III – INCENTIVIZING THE PRIVATE SECTOR

USDA has a mission to improve the economy and quality of life in rural America. The USDA 515 and 538 programs provide a unique opportunity for the public and private sectors to work together, to join forces and funding for the good of American communities. However, USDA currently maintains outdated and restrictive underwriting parameters that counteract its mission by disincentivizing the private sector to participate in the programs. The biggest fundamental problem is that there is no economic incentive to own and preserve affordable housing. Following are a few suggestions that would help alleviate some of the challenges.

A. Eliminating the Zero-Based Budget

USDA continues to manage properties on a zero-based budget, in which the managing agent determines the upcoming annual operating expenses and then backs into the rent needed based on the calculation. This process has historically been enforced as a way to maintain lower rents for both the unsubsidized tenant as well as minimize annual impact to the Section 521 Rental Assistance budget. However, because this does not allow any growth in NOI or cash flow, there is no increase in value (based on the income approach). As such, investors and owners who would otherwise have an interest in affordable housing preservation are deterred from investing in Section 515 projects due to the lack of opportunity for increasing the value of their assets. Furthermore, this inconsistency with the market often results in equity pricing cuts from those capital partners that are willing to invest.

A modification to the regulation that allows for less restriction (or none at all) on the RTO would result in more interest in the USDA program by owners and equity investors alike.

B. USDA Section 521 Rental Assistance Contract Terms

Currently, RA contracts are issued with one-year terms, requiring owners to either renew contracts or re-apply for the subsidy year after year with no guarantee of the subsidy remaining in place. Investors in the capital market hold a preference for projects protected under existing long-term contracts due to the risk associated with renewing contracts and the common viewpoint that the government will honor the existing contracts. To mitigate the subsidy risk, investors often require owners to deposit large cash reserves which, when coupled with the lower tax credit price the investor is willing to pay, has a negative impact and could even cause an otherwise feasible project to be deemed infeasible. In an environment where affordable housing programs are already facing increasing barriers to securing financing, the modification of contract terms to 20 years (or similar term to match the new investment), still subject to *annual* appropriations, would have a positive impact on the program by removing a major hurdle in attracting private capital.

C. Easing the Burden of Owner Subsidy Requirements

The tenant subsidy requirement protects tenants from having to pay for rent charges in excess of 30% of their income; however, it places an immense burden on owners who must establish and maintain tenant subsidy escrows ("Private Rental Assistance"). With their budgets already operating as lean as possible, owners are often forced to fund this escrow out of their own accounts, thus creating another cause for lack of participation in the USDA program. We recommend that USDA consider allowing the tenant subsidy to be funded from excess funds in the general operating account, a regulation change that would maintain the tenant protection while benefitting and incentivizing the owner to continue to develop and preserve affordable housing.

D. Income Averaging

States often give preference to developments serving the lowest-income populations (30% to less than 60% AMI); however, it can often be difficult to make such developments financially feasible. This can be even more challenging in rural markets with very low median incomes. USDA currently prohibits tiered rents (i.e. targeted rents based on varied income levels), which precludes many projects from successfully scoring for competitive LIHTCs. Pending legislation in both the House and Senate include language authorizing income averaging in LIHTC projects. If this bill is enacted, USDA will need to make changes to their restrictions in order for the Owners to implement such provisions.

Greystone recommends that USDA consider allowing either tiered rents or "income averaging," which would allow the 60 percent of AMI ceiling to apply to the *average* of all apartments in a property rather than to every individual apartment. The rental income generated by the higher rents (up to the maximum of 80 percent AMI) could offset the lower rents generated from the very low income households (30 percent AMI), allowing developments to maintain financial feasibility while providing a deeper level of affordability and broader marketability.

E. 538 Option III – Increase Loan-to-Cost limit to 70%

The continuous guarantee, "Option 3" under 7 CFR Section 3565.52(c), allows an applicant to apply to a USDA-approved private sector lender for a loan for the development of affordable rural housing. USDA guarantees the private sector loan up to 90% of the value of the loan. This partnership of both government agency and private sector funding provides a unique opportunity to financing these types of projects and is extremely critical to affordable housing preservation.

Loan-to-Cost ("LTC") limits in other similar affordable housing finance programs typically range from 80% to 90%. By USDA further restricting the LTC ratio to only 50% for Option III - Continuous Guarantees unnecessarily limits the amount of funding allowable under this program and adversely impacts the ability for long term preservation. Therefore, Greystone recommends that USDA revise its policy to apply the 70% Ginnie Mae approved LTC ratio consistently allowed on all other Section 538 loan types. At the 70% rate, USDA is still below the market average of 80% - 90%, further mitigating perceived construction risk.

F. Decouple Section 521 from Section 515 for maturing mortgages

The Rural Housing Preservation Act of 2016 (the "Act), which was proposed to Congress in April 2016, proposes that USDA extend rural housing vouchers to any low-income household residing in a property financed with a loan specifically for housing and related facilities for low-income persons and families which has been prepaid, or which has matured, after September

30, 2005. Greystone recommends that USDA enact the Act, which would decouple Section 521 RA from Section 515 mortgages. The risk with the current regulation is that when the Section 515 mortgage matures, the project loses its much needed rental assistance. Potentially, this could create vacancy issues where tenants can no longer afford their rents, which puts a strain on both tenants trying to make ends meet and project owners who are losing an income stream. Decoupling the rental assistance agreements from the mortgages would benefit the tenants and owners by continuing such rental assistance even after the mortgage has fully matured.

G. Rural Energy Incentive Programs

USDA currently maintains a variety of funding programs designed to incentivize energy efficiency in rural agricultural developments, most notably the Rural Energy for America Programs. These programs provide funding in the form of a loan and/or grant for the purchase, installation, and construction of energy efficient improvements on qualified developments. Unfortunately, USDA does not consider rural multifamily affordable housing "qualified" to receive such funding, despite the obvious focus in the industry on utilizing energy-efficient building materials. Greystone recommends that USDA consider expanding the list of qualified developments to include affordable housing so that the rehabilitation or new construction developments can take advantage of the funding and utilize it towards the cost of purchasing and installing often-required energy efficient materials.

SECTION IV – UNDERWRITING PARAMETERS

USDA currently requires several restrictive underwriting thresholds that, while originally designed to reduce Agency risk when USDA was the only debt provider on affordable housing rental projects, are inconsistent with the private industry in today's fiscal environment. As such, these thresholds artificially limit the amount of private funds (debt and equity) that can be secured for the preservation of existing 515 projects. Updating several restrictive provisions to better align with current private sector lenders and investors would allow more preservation transactions to be completed.

A. Eligible vs. Ineligible Costs

USDA's 538 and 515 programs maintain differing standards as to what costs are eligible under the respective programs. Currently, the 538 program is more favorable to developers and owners and therefore, USDA should consider modifying the 515 regulations to mirror those of the 538 program (as are laid out in HB-1-3565, Chapter 3, Section 3.23). The most notable of the differences is the ineligible status of developer's fee and acquisition costs under the 515 program.

B. Artificially Inflated Underwritten Vacancy

Per HB 3560, USDA calculates underwritten vacancy as the historical average of collected rents for the most recent three years, plus two percent (2%) for bad debt. Alternatively, private lenders and investors use a combination of historical performance and the project's current budget to determine the underwritten vacancy factor, and then include an additional annual inflation factor of two to three percent (2-3%) to hedge against risks associated with future unforeseen vacancy issues. The HB specifically states, "If the budgeted allowance is less than historical average plus 2 percent, it will be considered a failure to meet the required threshold *unless extenuating circumstances can be supported and documented to RD's satisfaction*." However, it is our experience that regardless of what historical documentation can be presented to disprove the need for the additional 2%, RHS does not allow for a reduction in the vacancy allowance calculation.

Greystone recommends that USDA eliminate the artificial inflation of historical vacancy. By inflating the initial vacancy by *another* two percent (2%), the effect is an underwriting model that is so conservative that it can render a project infeasible that would have otherwise been financially stable based on its own actual historical vacancy levels. Typically, when a project is using USDA funding, private lenders and investors defer to the more restrictive USDA underwriting rather than using their own standard calculations. Eliminating the artificial inflation of historical vacancy would allow for more accurate and realistic underwriting parameters and better align USDA underwriting with current private and quasi-government lenders.

C. Inflated ADRR

USDA currently maintains the position that the reserve account should be adequately funded in accordance with CNA requirements to meet estimated reserve-eligible needs over a twenty (20)-year analysis period; however, Greystone recommends that USDA defer to the often less-strict lender or housing finance agency requirements annual deposit to replacement reserves (ADRR). This will decrease the amount of funds required from annual cash flow, and in turn decrease rent needed to support the ADRR. In order to ensure that there are enough reserves available to maintain the capital needs of the project for the life of the loan, USDA could consider requiring an updated CNA every 10 years to ensure sufficient funding.

D. Senior Debt Term

Although it is not a regulatory or statutory requirement per the HB-3560, it has been our experience that USDA requires any senior debt issued to be co-terminus with their sub-debt (30 year). If the senior debt were allowed to mature ahead of the subordinate debt, then a more advantageous interest rate could be secured, thus reducing the amount of rent needed to support the owner's debt service payments. For this reason, Greystone recommends that USDA reconsider its senior debt term requirements. Our suggested minimum term would be 16 or 18 years, which is the typical timing of the LIHTC partner exiting the project ownership.

This shorter term is considered favorable in the marketplace and would secure a lower interest rate, thus increasing the leveraging of the senior debt.

Another positive effect of having a reduced term on senior debt is that it would attract funding from private lenders, where they would conventionally be averse to tying up capital in small loans over a 30-year period. This would allow USDA to stretch its resources further while still maintaining the goal of affordable housing preservation.

SECTION V – CONSTRUCTION DOCUMENTATION REVIEW & PHYSICAL INSPECTIONS

As a key industry player in the preservation of affordable housing across the nation and the primary firm spearheading large-scale, multi-project portfolio transactions, Greystone has witnessed significant challenges and inconsistency within USDA's construction documentation review and physical inspection process. Although there are directives for the process listed within the HB's and ULs, the instructions are often vague and outdated for such current financial structures and rehab processes. Furthermore, there tend to be significant inconsistencies in the interpretations of said regulations among different state offices. Additionally, when it comes to large-scale portfolios, the individual state offices do not typically have the capacity to review the extensive construction documentation or perform timely and on-going physical inspections; therefore, the process can be extremely lengthy, causing significant delays in closing out the projects and meeting other critical timing milestones of private sector participates (debt and equity providers).

A. National Architectural Team

Similar to the recent and very successful implementation of a National Underwriting Team for portfolio transactions, USDA should develop a dedicated team within its National resources to oversee the rehab process for those same transactions. This National Architectural Team would have the capacity to handle the high-volume endeavor of document review and physical inspections that results from a portfolio deals without adversely impacting the other responsibilities of the state level staff that often serve multiple USDA programs. This would not only provide better predictability for the developer, it would also ease the burden on USDA RHS State offices, provide consistency across the nation, ensure the Agency's assets are protected and simply allow more preservation to be completed.

Single site construction or rehabilitation would continue to run through the state staff only; however, the National Architectural team would be available for consult to ensure continued consistency is maintained.

A common obstacle for developers is the lack of quality contractors who are experienced in performing work on affordable housing. Where their true skill is performing the manual labor, these contractors are loaded down with the seemingly endless paperwork needed for documenting hard costs. A modernized and systematic construction approach, applicable in all states, would highly benefit contractors by not forcing them to "re-learn" a new process in every state in which they conduct business. Furthermore, USDA should consistently adopt the

AIA suite of documents as their required forms for submittal throughout the construction process. AIA forms represent the industry standard, while many of the current required USDA forms are outdated and a duplication.

B. Estimated Useful Life (EUL)

The current guidance from USDA allows for an alternate EUL from the standard EUL provided adequate explanation is provided in the CNA tool. While Greystone certainly supports this provision, we have experienced numerous cases when the State reviewer has not allowed a differing EUL. We recommend that USDA clarify that in all cases, the actual product specification and warranty provided by the manufacturer should supersede the Standard EUL listed within the established tables.

C. Change Order Process

Unless new USDA 515 funds are being used for the construction/rehab of a project, the Architect of record on the project should be the entity responsible for approving change orders and should attest to the fact that the change orders have been completed in accordance with 7 CFR 1924.10. Removing USDA's responsibility from change order approvals when no USDA funding is being utilized would greatly reduce USDA's burden and would create more efficiency within the process as a whole. Although USDA may take the stand that their security interest in the property is affected by change orders, the lender and equity provider directly funding the rehab should be the approving parties as applicable. Furthermore, the final cost certification completed by an independent CPA and required project provides ample evidence that all project dollars (hard costs included) have been spent on allowable costs. This would not apply to projects where new 515 or other program funds are being utilized to fund a rehab or construction.

If USDA is unwilling to yield its role in change order approvals, then Greystone recommends improving the process. In general, the parameters for approving change orders are extremely vague. The lack of specific regulation in terms of submission requirements for requests and also what change order costs are allowable causes great inefficiencies for developers attempting to conduct business in multiple states, as the state offices are left to interpret the regulation as they see fit. Greystone recommends implementing uniform guidance in terms of what costs are approvable as well as what process for submitting requests is required in order to obtain a timely approval.

Thank you for your time and consideration, and for the opportunity to provide recommendations to improve efficiencies within your programs. We look forward to seeing policy changes that will allow owners/developers to use USDA funding more effectively for the purpose of producing and preserving affordable housing. We value our partnership with USDA and look forward to continuing to work with you to preserve the much needed but aging affordable housing across rural America. Please do not hesitate to reach out to me for clarification regarding any of the above recommendations.

Sincerely,

Greystone Affordable Development

Tanya Eastwood

Tanya Eastwood
President