2019 Clarifications

Received by January 4, 2019:

Question 12:

Under Building Efficiency there is no mention of Rehabilitation projects. Does that mean that Rehab projects must meet all the same requirements as new construction, even minimum residential floor area?

ADOH Response:

No, Minimum and Maximum Residential Floor Area does not apply to Rehabilitation Projects, so long as the floor plan of the Unit is not being changed. If the existing floor plan of a Unit is changed, that Unit must meet the Minimum and Maximum Residential Floor Areas stipulated in Section 2.7(D) of the 2019 QAP. However, all Projects, including Rehabilitation Projects, are required to meet the efficiency ratios stipulated in the Section 2.7(D) of the 2019 QAP in order to receive points associated with the Building Efficiency scoring category.

Question 13:

It looks like the department removed the prohibition from a developer selling appreciated property to a tax credit partnership and continuing to be the developer or consultant in the deal. Can you confirm my understanding?

ADOH Response:

The answer to your question depends upon whether the appreciated property includes buildings, which are currently, or have been used for affordable housing in the past. Please refer to 2019 QAP Section 7.1(C)(4)(a)(i)(1) beginning on page 109, which describes the implications of several scenarios, along with the definition of Principal beginning on page 15 of the 2019 QAP.

Question 14:

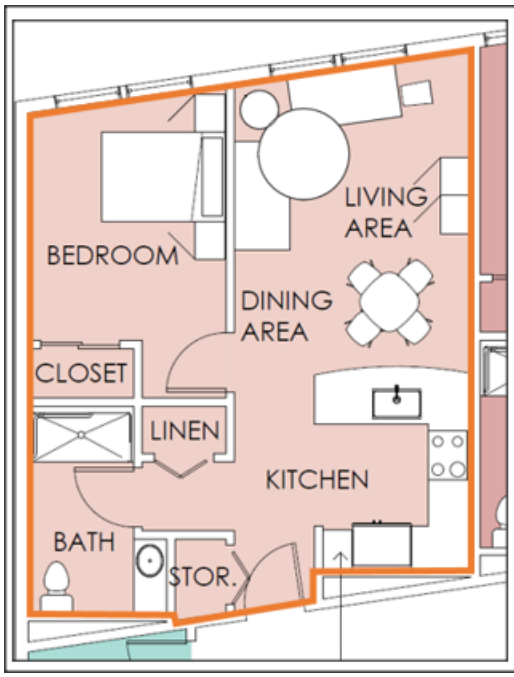
I am filling out the new form 12-1 and it has a line "Inside Walls: Do not include walls to interior closets)". What square footage are you looking for?

ADOH Response:

*The answer to your specific question is below under **Inside Walls**. For clarity and context, this response provides a more comprehensive answer regarding the expectations for Form 12-1.*

Form 12-1 breaks down all of the area described in the Total Project Square Footage definition on page 22 of the 2019 QAP. It requests:

1) ***Residential Floor Area*** *broken down between the interior space and exterior Balcony, Porch or Deck. The interior of the unit is measured based upon the definition of Residential Floor Area ("RFA") on page 18 of the 2019 QAP.*



In the example to the left, all of the area within the darker orange line is included in the Residential Floor Area.

Any Balcony, Porch or Deck that is private open space associated with a Unit is limited to 100 square feet of usable space for purposes of the Building Efficiency scoring category and Eligible Basis. Any walls associated with the Balcony, Porch or Deck that are not metal railings would be included in ***Inside Walls*** *below. Space in excess of this limitation must be included under the* ***Other*** *category below, and explained on a separate sheet. The footprint for the stairs on <u>each</u> floor of a Unit with more than one level are included in the calculation of the Residential Floor Area.*

2) ***Common Areas, Circulation, Building Services****, which describes the interior paint-to-paint measurement of these spaces. Elevators and stairs are included here. Similar to the RFA, there is no requirement to measure interior closets in these areas separately, but the entire closet and its accompanying walls in the room would be included in this measurement. The Total Project Square Footage is the total of all the horizontal floor areas (as viewed on a floor plan) of all floors of a building contained within their building perimeters. Thus, the footprint for all stairs and elevator on <u>each</u> floor that are not located inside a Residential Unit are include in the circulation space of the building.*
3) ***Structured Parking Garage****, which describes the new square footage of this structured space from interior finished surface to finished surface.*

4) ***Other*** *includes space such as areas with restricted headroom (i.e., attics), HVAC shafts, pipes, flues, and other vertical penetrations that are not described elsewhere, plus any Balcony, Porch or Deck space in excess of 100 square feet that is associated with any Unit.*
5) ***Inside Walls*** *includes all vertical walls inside the building perimeter that are not specifically excluded from another measurement described herein, such the walls that within the perimeter of a Unit described in the definition of RFA. All walls are measured from finished surface to finished surface. It includes the demising walls between Units, the walls enclosing the building perimeter measured from the interior finished surface to the exterior of the building envelope, code-required enclosing walls between Units and the adjacent Common Area, Circulation and/or Building Services space, and between the Common Areas, Circulation and/or Building Services areas, and any other walls that are not specified herein that are included in the Total Building Square Footage.*

Question 15:

Will a developer receive developer experience points if past projects do not include rental and/or LIHTC experience. Previous development experience includes homeownership of like size and federally funded (NSP/CDBG/HOME) developments.

ADOH Response:

Yes, if the housing was limited to low-income households. Section 2.7(A) provides points for "experience in the development of LIHTC or Federally Subsidized low income housing projects". Thus, the projects claimed for points must be housing for low-income households and include as a funding source either LIHTC or source(s) described in the definition of Federal Subsidy on page 9 of the QAP.

Received by December 21, 2018:

Question 1:

Trying to understand how income averaging scoring is proposed to work. To score maximum 35 points I believe this is saying average income of the low income units has to be at 50% or less to score. That said I don't understand item 2 on page 126 of draft 2 redline that states the average income of the Units shall be limited to 58% as a safe harbor. I.e., would the average need to be 50% or less to score?"

ADOH Response:

The 50% average income relates specifically to scoring. Applicants competing in the 9% competitive round are subject to Section 2.7(G) to calculate their score, which requires no more than 50% average income, among other requirements, in order to earn the 35 points on non-Tribal Set-Aside Applications. The 58% limitation in Section 7.1(F)(2) is an ADOH compliance ceiling for all Tax

Credit Projects electing the Average Income minimum set-aside on Form 8609, including non-competitive 4% Tax Credit Projects.

Question 2:

If a non-basis amenity such as storage is included on the site plan at submittal, but then the Developer subsequently opts not to build the storage, will the Developer be required to build it?

ADOH Response:

Yes, Developers are expected to deliver what is promised in the Application. 2019 QAP Section 5.5 states that "Development Team members with Controlling Interest in the Project must deliver a Project as described in the Application for Tax Credits unless ADOH approves a Material Change request in writing." Section 7.1(D)(1)(d) further states: "In order to maintain the eligibility for ADOH Gap Financing after a determination is made under Section 7.1(D)(1)(f) below, the Applicant must deliver the Project as described in the Application for Tax Credits."

Question 3:

2019 QAP Section 7.1(C)(3)(i) states that "All soft financing, including seller carryback loans and related party loans shall fall below ADOH Gap Financing and Local Government financing in priority of payment." Can you please clarify the definition of related party loan?

ADOH Response:

A related party loan is one that is extended to the borrowing entity by an Affiliate of a member of the Development Team. See definitions of Affiliate on page 4 and Development Team on page 8 of the 2019 QAP.

Question 4:

In reviewing the latest draft of the 2019 QAP, the limitation of one (1) approved project per Developer/Co-Developer/Development Team poses some interesting challenges for partnerships/joint-ventures with other, quality non-profit organizations that would like to work on LIHTC projects.

I'm wondering if a group that meets the Developer Experience requirements of Section 2.7.A. of the 2019 QAP but still chooses to work with an experienced development group like ours as a Consultant (per the draft 2019 QAP – a ""Consultant" means an advisor to the Development Team or to any member of the Development Team.") not for the Developer Experience points, but rather for our ability to advise on practical LIHTC issues and practices, would be viewed by the Department as truly a Consultant and not a member of the Development Team? Any consulting fees would be based on actual advisement time at reasonable rates directly by the non-profit group themselves and not the Owner or Applicant.

Of course the premise of this question is that we plan to submit our own 9% LIHTC application but we don't want to jeopardize that application by assisting another non-profit group as a Consultant.

ADOH Response:

> *Section 2.2 of the 2019 QAP limits the Maximum Reservation to "one* ***(1) Project in any Application Round for any Developer****." This means that a neither a Developer, nor any of its Affiliates may participate in a Project as a Consultant and earn a fee for doing so. Section 7.1(C)(4)(f) states that the Developer Fee includes "all consultant fees to perform development work including but not limited to preparation of applications, and representation of the Applicant to obtain entitlements, coordinate utilities, inspect construction, purchase furniture and fixtures."*

Question 5:

If a developer is aiding a project other than their own strictly on a consulting basis, having no part of the ownership or developer fee, would this consulting relationship constitute a violation of the rule?

ADOH Response:

> *Section 2.2 of the 2019 QAP limits the Maximum Reservation to "one (1) Project in any Application Round for any Developer." This means that a neither a Developer, nor any of its Affiliates may participate in a Project as a Consultant and earn a fee for doing so. Section 7.1(C)(4)(f) states that the Developer Fee includes "all consultant fees to perform development work including but not limited to preparation of applications, and representation of the Applicant to obtain entitlements, coordinate utilities, inspect construction, purchase furniture and fixtures."*

Question 6:

We are writing to request a clarification in Section 7. Underwriting, D. ADOH Gap Financing and Layering Analysis.

In Section D(1.)(c.)(i.), it states that "Payment shall be the greater of: (1) an annual simple interest hard payment to be determined by the ADOH during underwriting and/or (2) Surplus Cash.

How does the ADOH calculate the annual simple interest hard payment, and if the Project's cash flow cannot support that hard payment, what is the alternative (if any) payment structure, the ADOH will allow?

ADOH Response:

> *Pursuant to 2019 QAP Section 7.1(D)(1)(c)(i) the minimum annual payment is determined by ADOH during underwriting. It is generally determined by multiplying the loan amount by the Annual Long-term Applicable Federal Rate ("AFR") (published through a Revenue Ruling by the Internal Revenue Service on a monthly basis) that is in effect at the time of the assessment, and then*

is finalized based upon the AFR as of the date of the closing. If the minimum annual payment is greater than the Surplus Cash Flow, then the minimum annual payment will be due. If the Surplus Cash Flow is greater than the minimum annual payment, then the Surplus Cash Flow will be due. Any modification to the amount of the minimum annual payment is determined on a case-by-case basis, in ADOH's sole discretion. See definition of Surplus Cash Flow on page 21 of the 2019 QAP.

Question 7:

Under the proposed Arizona Department of Housing 2019 Qualified Allocation Plan ("QAP"), 2.5 points will be allocated for sites that are located within one mile of an Urgent Care Clinic or Hospital (Service Enriched Location). I have identified a site that is located near a Hospital that is currently under construction. However, the Hospital will not be completed before the Application Deadline of April 1, 2019. Does the Hospital facility need to be open to qualify as a Service Enriched Amenity?

ADOH Response:

Yes. Section 2.9(K) states that the "information for each Facility claimed must be complete in order to receive the points for that Facility" The distance is calculated by measuring the distance from the Facility to the property line of the proposed Project, which requires that the Facility be in place at the time the distance is measured. Applicants must demonstrate that the Facility is in place via supporting documentation. For example, Section 2.9(K)(2)(e)(i) states that the "Applicant must provide evidence that twenty-four (24) hour emergency, cardiac services, major surgery and overnight care ***are*** *provided", meaning that they must currently be available.*

Question 8:

If I am considering a 4% project that will not be placed in service until (at the earliest) 2020, would ADOH permit underwriting using current rent limits inflated by 2% per year? For example, 2018 gross rent for a 60% 2-bedroom unit in Pima County is $819. With the 2% annual income growth used by ADOH for underwriting, that would increase to $852 in 2020. (If you believe Novogradac, AMI growth will be more robust than that.) For purposes of sizing the debt and the 15-year pro forma, could I use that projection as my base rent?

ADOH Response:

No. ADOH underwrites Projects at the rent level that is published as of the date the underwriting is performed at each stage of the Application. ADOH makes a final determination of the amount of Tax Credits for a Project, using the rents in effect at the time of the 8609 submittal.

Question 9:

The site for our proposed affordable apartment community is owned by an unrelated third-party group ("Property Owner") which is not prepared to sell the property to us outright, but is willing to ground

lease the project site to the project development partnership ("Project Partnership") subject to a significant upfront payment in lieu of annual rental payments during the +30 year ground lease period.

Based on our readings of Sections 7.1.C.2.a and 7.1.C.4.a.ii of the 2019 QAP our Project Partnership would not be able to include in this upfront lease payment its ADOH LIHTC application project development budget. Is this correct?

In anticipation that we would not be allowed to include this project cost as part of our development budget for tax credit application purposes, we have proposed to the Property Owner a two-step ground lease structure which would result in the Property Owner receiving its requested upfront lease payment, our being able to finance/pay this required upfront lease payment without any funding from the Project Partnership, and the Project Partnership being able to exclude the inclusion of this payment in its ADOH LIHTC application development budget.

The first step would be a ground lease agreement to be entered into by and between the Property Owner ("Lessor") and the nonprofit parent entity of the Project Partnership's nonprofit managing general partner ("Lessee/Sub-Lessor") (the "Master Ground Lease"). Under the terms of this Master Ground Lease the Lessee/Sub-Lessor would be wholly and solely responsible for making the upfront lease payment to the Lessor.

The second step would include the Lessee/Sub-Lessor entering into a sub-ground lease agreement with the Project Partnership ("Sub-Lessee") (the "Sub-Ground Lease"). Under the terms of this Sub-Ground Lease, there will be no obligation/requirement for the Sub-Lessee to repay any portion of the Lessee/Sub-Lessor's upfront lease payment to the Lessor. The Sub-Ground Lease will only require the Sub-Lessee to pay the Lessee/Sub-Lessor a de minimis rental payment of approximately $100 per year.

The payment made under the Master Ground Lease will not be included as part of the Project Partnership's ADOH LIHTC application development budget.

Hopefully, this two-step ground lease structure will be acceptable to ADOH as it seems as though it will enable the Project Partnership to address both the Property Owner's demand for a ground lease w/ upfront lease payment structure and ADOH's disallowance of the inclusion of any such payment in the project development budget.

ADOH Response:

You are correct that the Project Partnership would not be able to include an upfront lease payment in the Development Budget.

The answer to your two-step ground lease question would depend upon the source of funding for the up-front payment. If the Developer (or an Affiliate) raises funds, either through grant applications or loans, for which the purpose of the grant or loan is related to the Project, then that source would be considered a source to the Project and would need to be included in the Sources on Tab 7 (Section 18) of Form 3. Thus, those funds could not be used to pay an up-front lease payment.

If the Developer (or an Affiliate) elects to use a portion of the Developer Fee earned for the Project, or the Developer's cash on hand, that will not be reimbursed by a grant or loan for which the purpose of the grant or loan is related to the Project, then this structure might be acceptable – depending upon the supporting information and the balance of the Application.

Question 10:

With respect to the following language, "ADOH will expect the Applicant to maximize its lending sources by paying at least the maximum mortgage payment supportable by Project net operating income as described hereafter. The amount of the primary loan shall be fully amortized for no less than twenty-five (25) years, with a loan term of no less than the Compliance Period, written at a competitive market rate of interest and the annual debt service coverage ratio ("DSCR") shall be no less than one point two zero (1.20) for each year of operation during the Compliance Period and no more than one point one five (1.15) on the earlier of: the date the Extended Use Period expires or the year the loan matures. (The DSCR is the quotient obtained by dividing the annual net operating income by total annual debt service payments for the primary mortgage.)", what is the Department's position when a Project in year 16 is operating at a 1.20 DSCR, but then trends downward to a 1.15 DSCR in later years? What does the Department advise the developer to do to reduce the DSCR to meet the language as stated in the QAP? In an attempt to mitigate this issue, we have already maximized our primary debt service with the anticipated interest rate and sizing to a 1.20 as required in the QAP.

ADOH Response:

Section 7.1(C)(3)(b) outlines the parameters that the Department uses to determine whether an Applicant has maximized its lending sources. The term of the loan would impact whether the DSCR falls below 1.15 in later years.

Question 11:

I am registered for the 2019 workshop on January 23. If I'm not listed on the LIHTC application, does another member of the development team need to attend as well?

ADOH Response:

The person who attends the Application Workshop on behalf of the Applicant should be the Developer contact listed on the Form 3 as the Primary or Secondary Contact, the Co-Developer listed on the Form 3, or the Consultant listed on the Form 3 who will be preparing the Application on behalf of the Developer. Please see the following portions of the 2019 QAP: 1) Section 2.5(B), which states that the "Developer, Co-Developer, or Consultant must submit a certificate of attendance from the 2019 LIHTC Application Workshop." 2) The definition of Consultant on page 7 which "means an advisor to the Development Team or to any member of the Development Team." and 3) The definition of

Development Team on page 8 which "means the entities and professionals assembled to develop and manage the Project, typically including the Applicant, Owner, Developer(s), Co-Developer(s) and general partner or any other related entities in which the Developer or Co-Developer has an identity of interest or a Controlling Interest."