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From: Jody Tucker [mailto:jody@prestwickcompanies.com]
Sent: Thursday, October 25, 2018 1:55 PM
To: Nicholson, Laura 6-9190
Cc: Ken Blankenship; Darien Lee; Sarah Nieman
Subject: Prestwick's Comments to the 2019 QAP and 2019 Manual

Hey Laura:

Attached please find a letter with our comments to the 2019 QAP and Manual. Unfortunately we will not be able to make it to the public hearing tomorrow by Sarah will be there for us.

We would welcome the opportunity to have an open discussion with you and staff to discuss our letter if you feel it will be beneficial. We rarely make comments unless we feel it is 100% necessary.  We see some major issues in this years draft that we think warrants a deeper conversation. We 100% understand what the State agency is attempting to accomplish with its policies but we also see they unintended consequences that are created based on our experience. Let us know if you want to discuss further and thank you for considering these options.

Regards,

Jody

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Prestwick companies

October 22, 2018

Laura Nicholson, Development Director
The SC State Housing Finance and Development Authority
300-C Outlet Pointe Boulevard
Columbia, SC 29210

Dear Laura:

Thank you for the opportunity to comment on this year's QAP. We offer the following comments.

1. **Services distances** – we recommend the State revert to the 2018 rules where points for services start at ½ mile. All deals in the general pool and non-profit pool will tie because scoring has become much easier with the relaxation of distances. This means all deals will be awarded through the tiebreak and there are fatal flaws within the tiebreak that I want to point out.

2. **First tiebreak, requiring deals to remain affordable for 35 years** is not feasible. An inability to properly capitalize deteriorated projects is the reason why the public housing program, and sparsely maintained 30-year-old USDA projects, have served as an immovable eyesore in so many communities. For 30 years the LIHTC program has battled the image that it is NOT "The Projects". To deprive LIHTC properties of the ability to recapitalize before they begin to fail destroys all of the work that has been done by developers, non-profits, community advocates, legislators, stakeholders and the State Housing Agency to make these communities prized by those they interact with in their hometowns across South Carolina and the nation.

   Both the bond program and the 9% tax credit program are explicitly a 15-year subsidy. The tax credit program was designed with a 15-year affordability period. The benefit for these properties burns off after the 10-year tax credit stream and owners are already carrying properties for an additional 5 years at a lower debt coverage. There are no other programs that have a compliance period longer than the affordability period.

The Omnibus Budget Reconciliation Act of 1989 created a requirement that projects that received an award of credits after 1990 would be subject to an "extended use period" of an additional 15 years after the initial 15 years, or 30 years of affordability; but the bill also recognized that in year 15 properties would be struggling with debt service coverage and would likely need additional investment. Indeed, these are the two scenarios contemplated in the law at year 15.

i. The QC process provides the flexibility necessary to maintain the economic viability of the credit program.
ii. Deals must have the ability to receive both capital investments to improve the physical plant as well as to refinance the property.
iii. Without the QC process, properties will be put at risk of physical obsolescence and increasing maturity risk for the existing debt.
iv. If the law/state policy changes such that any deal bought after 15 years will remain in the program, then every deal will get sold to financially motivated buyers who would be incentivized to strip properties down to the financial bone. Indifferent owners and a lack of capital has always led to the creation of slums.

Trapping owners in financially infeasible properties will result in low -income families trapped in deteriorating homes with no viable options. Elimination of the Qualified Contract Option until year 35 rather will produce the same slums that we have seen in other affordable housing programs or result in the corruption that we have seen in those states that have not allowed for Qualified Contract opt-outs. This is not an end result anyone involved in the LIHTC program wants to see. We support and appreciate the State's efforts to preserve affordable housing.

3. **Second Tie-break, deals with the lowest Total Development Cost less Land Cost per Heated Square Footage.** While we greatly appreciate the States efforts of cost containment in an environment where construction prices continue to rise to record levels, we feel very strongly that this will encourage developers and builders to cut corners, use lesser quality materials that don't hold up as long and create long-term issues on deals. This encourages larger units that are built the cheapest way possible. With tie break number 1, deals will have to live for 35 years before they can be recapitalized with the cheapest construction allowed. This is a recipe for failure and can be a disaster for owners long term, for residents whose units can't be kept up to normal standards late in the deals life which greatly effects our reputation of building a high quality product that is sustainable and will last. The last thing the State should want is the unintended consequences this policy will create. As the 2019 awarded deals age, there will always be newer deals coming on line and this will cause market issues and

operational issues because there is no way a 25-35yr old cheaply built property can compete with a new one. It will become the slums and have to take on a different tenant profile to stay full.

I also want to point out another fatal flaw that ties to all deals going to these tiebreaks for awards. Per the Manual, all deals must have a minimum 1.0 DCR through year 20. That means at year 21 you can have negative cash flow yet still meet the states underwriting criteria. What happens to the property in year 21 when it needs to refi the loan that has just matured and the cash flow is negative? It will go into foreclosure without some sort of cash infusion. The bank sell to the highest bidder and they will do what they want with the property. The LIHTC restrictions are now removed and the property either is rehabbed and repositioned with higher market rents or it becomes a great opportunity for a slum lord to buy and keep in the worst of conditions. No one wants either of these scenerios to happen to deals we have worked so hard to create and operate for all these years. This is bad for all parties involved and is a step back in our program.

When you think of what makes a great real estate deal, it is the best location in the best market. The 2019 Draft QAP is setup to award deals that are in any mediocre location with a perfect score that is built as cheaply as possible and promises to remain affordable for 35 years which is impossible without some form of recapitalization. These are the unintended consequence of the proposed policy.

We respectfully ask the State to consider the following Tiebreak Criteria.

1. Developments with the Highest Site Score
2. Developments with the Lowest Capture Rate
3. First Selected Application for the Project Team in the round to ensure a more equitable distribution of resources to Applicants
4. Least amount of tax credits per low income unit

4. **Developer Fees maxed at $18,000 / unit.** LIHTC are becoming more risky to develop because of higher construction costs, higher land costs, rising interest rates, rising operating costs, lower tax credit equity pricing and less soft money available to fill financial gaps. Because of the all of the unknowns in a deal, we have a lot more risk. The fees we can earn offset this risk. The majority of deals today are using some deferred developer fees to pay for a portion of the project costs. Reducing the amount of total fee, reduces the amount we can earn and puts a major strain on us as developers. I ran an analysis of the proposed 2019 fee calculation versus the 2018 fees we earned on our 2018 award and it is approximately a 17.5% reduction in fee earned. This is a large revenue hit to all development companies. The developer fee provides us added

protection with the substantial guarantees we give to our banks and equity providers. We respectfully request the State revert to the 2018 QAP developer fee calculation.

5. **Identity of Interest Contractors Profit and Overhead limited to 6%.** Prestwick Development and Prestwick Construction are independently operated and completely separate companies from each other. If we build for ourselves or if we build for a 3rd party customer, we take the same financial risk, incur the same overhead costs and have the same company operating costs. We do not understand why we should be penalized and forced to make a lesser fee to provide the same construction services to our in house development company. We disagree with this policy and respectfully request the State revert to the 2018 QAP contractor overhead and profit calculation of 8%.

6. **Syndication Information.** The added language is confusing and we would like the state to clarify the language and intent. The main question is what is the State trying to accomplish with the following language? ***"The tax credit award cannot exceed the syndicator's projected 10-year total capital contribution in the letter of intent at initial application and placed in service application"***

Thank you for allowing us to make these comments. If you would like to discuss any of these with us, we would welcome the conversation.

Regards,

Jody Tucker, CEO
Prestwick Companies