December 5, 2013

Acting Administrator Richard Davis  
Rural Housing Service  
United States Department of Agriculture  
Room 5104, Mailstop 0701  
1400 Independence Avenue, S.W.  
Washington, DC 20250

RE: Unnumbered Letter Guidance for Multi-Family Transactions, dated September 30, 2013 (Released on USDA’s website on or about November 1st) (the “Underwriting Guidance”)

Dear Mr. Davis:

We are writing to request that you withdraw the above-referenced Underwriting Guidance until in-depth discussions can be held with industry stakeholders on the changes contained in the Unnumbered Letter. As issued, many of these changes will create impediments to working with Rural Development’s (“RD”) multifamily rental housing programs. The Underwriting Guidance creates material barriers, sets unrealistic standards and separates RD from many common sense approaches used in the preservation of affordable housing by entities across the country. Further, we question the authority of RD to implement such material policy changes without going through the proper procedures meant to safeguard the public from unreasonable policies. As noted in RD Instruction 2006-A, Unnumbered Letters are meant for minor communications and are not part of the directives system. RD Instruction 2030-C, particularly Exhibit B to 2030-C, provides that Unnumbered Letters may not be used to establish, change or modify directives. As such, using Unnumbered Letters to make policy changes is procedurally and substantively improper, and violates RD Instructions, the Administrative Procedure Act and potentially other authorities.

The undersigned organizations represent the interests of owners, operators, funding partners, managers, non-profit and for-profit small businesses, local and state government agencies, banks and financial institutions who are RD’s business partners in the delivery of decent, safe and sanitary housing. The undersigned organizations also represent the residents these business partners serve. Our collective goal is to preserve the affordable housing opportunities provided by the Section 515 portfolio, which is a critically important resource for families living in rural areas.

The Underwriting Guidance is the wrong approach to preserving housing and protecting families and the elderly. The Underwriting Guidance continues many policies that are contained in RD’s regulations and handbooks, and industry stakeholders have urged re-examination of these policies for some time. Many existing policies and practices impede project operations and project improvement. For example, processing each transfer through a separate local office, lacking in experience and training on specific tasks and already overburdened with inspection
monitoring and audit review requirements, makes little sense. RD must consolidate processing and functions on a regional basis with specialists trained in specific, complex tasks such as transfer review.

However, more disturbing are the new policies and practices contained in the Underwriting Guidance. Many of these policies have been applied on an ad hoc basis, on and off, for about the last two years. This is the first time these policies have been consolidated in one place, and the new Underwriting Guidance thus represents a major, and very negative, departure from longstanding successful practices. Specifically:

* The Underwriting Guidance provides that owners must obtain a Comprehensive Needs Assessment ("CNA"), and that reserves should be sized to 100 percent of the CNA. Amounts each year must equal the minimum projection for each year of the projections. Stakeholders have previously advised RD that CNAs are projections, only, not hard standards, and RD is mis-using this projection too.

* Perhaps most troubling, RD effectively abrogates its transfer regulations at 7 CFR 3560.406, and its responsibility to reasonably permit transfers. The Underwriting Guidance prohibits transfers unless the owner obtains a CNA and funds the full CNA. The new Underwriting Guidance imposes this requirement even if the current reserves are fully funded and the owner has performed all of its obligations and funded all reserves under the existing RD Loan Agreement. Clearly, RD is imposing new burdens on the owner – essentially new fees in the nature of a tax – which is not currently a contractual obligation of the owners. This effectively takes from the owner the ability to operate and transfer its asset in any sort of reasonable manner.

* The Underwriting Guidance eliminates equity pay out for a seller or return to owner ("RTO") increase for a purchaser if any new direct Agency funds are used in the transfer. As RD is well aware, many transactions are supported by third party funds, such as equity raised through the Low Income Housing Tax Credit ("LIHTC") program. The partners that enter the purchasing entity rely on distributions to pay certain of their operating costs, as well as to fund a portion of the developer fee that the transaction cannot support at closing. That developer fee, including the deferred portion, is often a material basis for raising LIHTCs. That is to say, the developer fee goes into basis and LIHTCs are generated from that basis, which are then used to help attract new partners and private capital.

* The new RTO is now set based on the general partner's contributions, not the owners’ contributions, as LIHTC proceeds are excluded. This specifically contradicts existing RD guidance and ignores the equity investor’s contribution. At the same time, limited partnerships and other entities, created to bring in and use private capital “may” be denied an RTO where the general partner is a non-profit corporation trying to advance affordable housing. This appears to violate 7 CFR 3560.68(a), which provides no such
Acting Administrator Richard Davis
December 5, 2013
Page 3

distinction for eligible limited partnerships. RD is ignoring the basic tax-incentivized structure and punishing investors who work with non-profit general partners.

* The Underwriting Guidance continues RD’s recent practices of regulating sales prices, interfering with transactions between parties. The Underwriting Guidance now sets sales price at the lesser of the value reached by an independent third party appraiser or the amount of debt that RD will allow based on the rents RD has permitted. As RD knows from prior stakeholder letters and meetings, RD’s use of appraisals has already created barriers to permitting new debt and investment. This new barrier greatly increases the problem.

* The Underwriting Guidance contains unclear language about the nature and treatment of the Reserve Account. The Reserve Account is there for the benefit of the project and residents but is contributed by owners from pre-tax dollars and is the owner’s asset.

* The Underwriting Guidance also contains a restatement of some of the guidance for the Multifamily Preservation and Revitalization (“MPR”) demonstration program. Over the past several years RD has both tried to terminate this program and has promoted this program. The Underwriting Guidance does not address the impediments to the program. Specifically, MPR suffers from slow implementation of the debt deferral even after approval, which can easily take many months. Also, MPR creates an event that may be subject to federal taxation and RD has failed to clarify its treatment with its sister federal agency at the IRS.

* The underwriting guidance requires RD staff to use a “Hyperion” report to evaluate the quality and acceptability of transfer underwriting, but provides no means for any party to the transaction other than RD to access its contents. If this reporting capacity will be used to approve or disapprove transfer transactions, RD should make it easily available to those who will be subjected to RD’s determinations as well RD’s funding partners who depend on transparent feasibility decisions from RD.

* The new underwriting guidance requires project loan accounts to transfer from DIAS to PASS even though 7 CFR 3560.406 (j)(3) excludes monthly payment DIAS loans from that requirement. Many potential purchasers value a DIAS loan for its rapid pay down of principle and this new requirement would discourage some transfers from occurring.

* The new underwriting guidance does not establish when its advice becomes effective and draws into question what standards would apply to transactions already submitted to RD for consideration. While we maintain this guidance is so flawed it should be withdrawn immediately, any new guidance should establish which transactions would be considered “grandfathered” under new guidance.

Our organizations want to work together with you on developing solutions that keep the financial integrity of the properties intact and also provide the necessary assistance to the residents who live in these properties. We request a meeting with you and your staff at the
earliest opportunity to review the issues as outlined above and any previously discussed. In the meantime, we believe the Underwriting Guidance should be withdrawn.

Please contact Colleen Fisher, Executive Director for the Council for Affordable and Rural Housing at (703) 837-9001 (cfisher@carh.org) to arrange any meeting or additional discussion.

Sincerely,

Council for Affordable and Rural Housing
Housing Assistance Council
Institute for Real Estate Management
Institute for Responsible Housing Preservation
National Affordable Housing Management Association
National Apartment Association
National Association of Home Builders
National Housing Law Project
National Leased Housing Association
National Multi Housing Council
Rural Housing Preservation Associates
Volunteers of America

cc: Acting Under Secretary Doug O'Brien, USDA, Rural Development
    Room 205-W, Mailstop 0107
    1400 Independence Avenue, S.W.
    Washington, DC 20250

Mr. Bryan Hooper
Deputy Administrator Multifamily Housing
USDA Rural Development, Room 5013
1400 Independence Avenue SW
Washington, DC 20250-0701