



2006 Real Estate Analysis Rules and Guidelines

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§1.31 General Provisions

(a) **Purpose.** The Rules in this subchapter apply to the underwriting, market analysis, appraisal, environmental site assessment, property condition assessment, and reserve for replacement standards employed by the Texas Department of Housing and Community Affairs (the "Department" or "TDHCA"). This chapter provides rules for the underwriting review of an affordable housing development's financial feasibility and economic viability. In addition, this chapter guides the underwriting staff in making recommendations to the Executive Award and Review Advisory Committee ("the Committee"), Executive Director, and TDHCA Governing Board ("the Board") to help ensure procedural consistency in the award determination process. Due to the unique characteristics of each development the interpretation of the rules and guidelines described in this subchapter is subject to the discretion of the Department and final determination by the Board.

(b) **Alternative Dispute Resolution Policy.** In accordance with §2306.082, Texas Government Code, it is the Department's policy to encourage the use of appropriate alternative dispute resolution procedures ("ADR") under the Governmental Dispute Resolution Act, Chapter 2009, Texas Government Code, to assist in resolving disputes under the Department's jurisdiction. As described in Chapter 154, Civil Practices and Remedies Code, ADR procedures include mediation. Except as prohibited by the Department's ex parte communications policy, the Department encourages informal communications between Department staff and applicants, and other interested persons, to exchange information and informally resolve disputes. The Department also has administrative appeals processes to fairly and expeditiously resolve disputes. If at anytime an applicant or other person would like to engage the Department in an ADR procedure, the person may send a proposal to the Department's Dispute Resolution Coordinator. For additional information on the Department's ADR Policy, see the Department's General Administrative Rule on ADR at §1.17 of this title.

(c) **Definitions.** Many of the terms used in this subchapter are defined in the Department's Housing Tax Credit Program Qualified Allocation Plan and Rules, known as the "QAP", as proposed. Those terms that are not defined in the QAP or which may have another meaning when used in subchapter B of this title, shall have the meanings set forth in this subsection unless the context clearly indicates otherwise.

(1) **Affordable Housing**--Housing that has been funded through one or more of the Department's programs or other local, state or federal programs or has at least one unit that is restricted in the rent that can be charged either by a Land Use Restriction Agreement or other form of Deed Restriction.

(2) **Bank Trustee**--A bank authorized to do business in this state, with the power to act as trustee.

(3) **Cash Flow**--The funds available from operations after all expenses and debt service required to be paid has been considered.

(4) **Credit Underwriting Analysis Report**--Sometimes referred to as the "Report." A decision making tool used by the Department and Board, described more fully in §1.32 of this subchapter.

(5) **Comparable Unit**--A Unit, when compared to the subject Unit, similar in overall condition, unit amenities, utility structure, and common amenities, and

(A) for purposes of calculating the inclusive capture rate targets the same population and is likely to draw from the same demand pool;

(B) for purposes of estimating the subsidized Unit rent targets the same population and is similar in net rentable square footage and number of bedrooms; or

(C) for purposes of estimating the subject Unit market rent does not have any income or rent restrictions and is similar in net rentable square footage and number of bedrooms.

(6) **Contract Rent**--Maximum Rent Limits based upon current and executed rental assistance contract(s), typically with a federal, state or local governmental agency.

(7) **DCR**--Debt Coverage Ratio. Sometimes referred to as the "Debt Coverage" or "Debt Service Coverage." A measure of the number of times loan principal and interest are covered by Net Operating Income.

(8) **Development**--Sometimes referred to as the "Subject Development." Multi-unit residential housing that meets the affordability requirements for and requests or has received funds from one or more of the Department's sources of funds.

(9) **EGI**--Effective Gross Income. The sum total of all sources of anticipated or actual income for a rental Development less vacancy and collection loss, leasing concessions, and rental income from employee-occupied units that is not anticipated to be charged or collected.

(10) **ESA**--Environmental Site Assessment. An environmental report that conforms with the Standard Practice for Environmental Site Assessments: Phase I Assessment Process (ASTM Standard Designation: E 1527) and conducted in accordance with the Department's Environmental Site Assessment Rules and Guidelines in §1.35 of this subchapter as it relates to a specific Development.

(11) **First Lien Lender**--A lender whose lien has first priority.

(12) **Gross Program Rent**--Sometimes called the "Program Rents." Maximum Rent Limits based upon the tables promulgated by the Department's division responsible for compliance by program and by county or Metropolitan Statistical Area ("MSA") or Primary Metropolitan Statistical Area ("PMSA").

(13) **Market Analysis**--Sometimes referred to as "Market Study." An evaluation of the economic conditions of supply, demand and rental rates or pricing conducted in accordance with the Department's Market Analysis Rules and Guidelines in §1.33 of this subchapter as it relates to a specific Development.

(14) **Market Rent**--The unrestricted rent concluded by the Market Analyst for a particular unit type and size after adjustments are made to rents charged by owners of Comparable Units.

(15) **NOI**--Net Operating Income. The income remaining after all operating expenses, including replacement reserves and taxes have been paid.

(16) **Primary Market**--Sometimes referred to as "Primary Market Area" or "Submarket" or "PMA". The area defined by the Qualified Market Analyst as described in §1.33(d)(9) from which a proposed or existing Development is most likely to draw the majority of its prospective tenants or homebuyers.

(17) **PCA**--Property Condition Assessment. Sometimes referred to as "Physical Needs Assessment," "Project Capital Needs Assessments," "Property Condition Report," or "Property Work Write-Up." An evaluation of the physical condition of the existing property and evaluation of the cost of rehabilitation conducted in accordance with the Department's Property Condition Assessment Rules and Guidelines in §1.36 of this subchapter as it relates to a specific Development.

(18) **Rent Over-Burdened Households**--Non-elderly households paying more than 35% of gross income towards total housing expenses (unit rent plus utilities) and elderly households paying more than 40% of gross income towards total housing expenses.

(19) **Reserve Account**--An individual account:

(A) Created to fund any necessary repairs for a multifamily rental housing development; and

(B) Maintained by a First Lien Lender or Bank Trustee.

(20) **Secondary Market**--Sometimes referred to as "Secondary Market Area". The area defined by the Qualified Market Analyst as described in §1.33(d)(8).

(21) **Supportive Housing**--Sometimes referred to as "Transitional Housing." Rental housing intended solely for occupancy by individuals or households transitioning from homelessness or abusive situations to permanent housing and typically consisting primarily of efficiency units.

(22) **Sustaining Occupancy**--The occupancy level at which rental income plus secondary income is equal to all operating expenses and mandatory debt service requirements for a Development.

(23) **TDHCA Operating Expense Database**--Sometimes referred to as "TDHCA Database." A consolidation of recent actual operating expense information collected through the Department's Annual Owner Financial Certification process and published on the Department's web site.

(24) **Underwriter**--The author(s), as evidenced by signature, of the Credit Underwriting Analysis Report.

(25) **Unstabilized Development**-- A Development with Comparable Units that has been approved for funding by the TDHCA Board or is currently under construction or has not maintained a 90% occupancy level for at least 12 consecutive months following construction completion.

(26) **Utility Allowance**--The estimate of tenant-paid utilities, based either on the most current HUD Form 52667, "Section 8, Existing Housing Allowance for Tenant-Furnished Utilities and Other Services," provided by the local entity responsible for administering the HUD Section 8 program with most direct jurisdiction over the majority of the buildings existing or a documented estimate from the utility provider proposed in the Application. Documentation from the local utility provider to support an alternative calculation can be used to justify alternative Utility Allowance conclusions but must be specific to the Subject Development and consistent with the building plans provided.

(27) **Work Out Development**--A financially distressed Development seeking a change in the terms of Department funding or program restrictions based upon market changes.

§1.32 Underwriting Rules and Guidelines

(a) **General Provisions.** The Department, through the division responsible for underwriting, produces or causes to be produced a Credit Underwriting Analysis Report (the "Report") for every Development recommended for funding through the Department. The primary function of the Report is to provide the Committee, Executive Director, the Board, Applicants, and the public a comprehensive analytical report and recommendations necessary to make well informed decisions in the allocation or award of the State's limited resources. The Report in no way guarantees or purports to warrant the actual performance, feasibility, or viability of the Development by the Department.

(b) **Report Contents.** The Report provides an organized and consistent synopsis and reconciliation of the application information submitted by the Applicant. At a minimum, the Report includes:

- (1) Identification of the Applicant and any Principals of the Applicant;
- (2) Identification of the funding type and amount requested by the Applicant;
- (3) The Underwriter's funding recommendations and any conditions of such recommendations;
- (4) Review and analysis of the Applicant's operating proforma;
- (5) Analysis of the Development's debt service capacity;
- (6) Review and analysis of the Applicant's development budget;
- (7) Evaluation of the commitment for additional sources of financing for the Development;
- (8) Identification of related interests among the members of the Development Team, Third Party service providers and/or the seller of the property;
- (9) Analysis of the Applicant's and Principals' financial statements and creditworthiness;
- (10) Review of the proposed Development plan and evaluation of the proposed improvements;
- (11) Review of the Applicant's evidence of site control and any potential title issues that may affect site control;
- (12) Identification of the site which includes review of the independent site inspection report;
- (13) Review of the Phase I Environmental Site Assessment in conformance with the Department's Environmental Site Assessment Rules and Guidelines in §1.35 of this subchapter or soils and hazardous material reports as required;
- (14) Review of market data and Market Study information and any valuation information available for the property in conformance with the Department's Market Analysis Rules and Guidelines in §1.33 of this subchapter;
- (15) Review of the appraisal, if required, for conformance with the Department's Appraisal Rules and Guidelines in §1.34 of this subchapter; and,
- (16) Review of the Property Condition Assessment, if required, for conformance with the Department's Property Condition Assessment Rules and Guidelines in §1.36 of this subchapter.

(c) **Recommendations in the Report.** The conclusion of the Report includes a recommended award of funds or allocation of Tax Credits based on the lesser amount calculated by the program limit method (if applicable), gap/DCR method, or the amount requested by the Applicant as further described in paragraphs (1) through (3) of this subsection.

(1) **Program Limit Method.** For Developments requesting Housing Tax Credits, this method is based upon calculation of Eligible Basis after applying all cost verification measures and program limits as described in this section. The Applicable Percentage used is as defined in the QAP. For Developments requesting funding through a Department program other than Housing Tax Credits, this method is based upon calculation of the funding limit based on current program rules at the time of underwriting.

(2) **Gap/DCR Method.** This method evaluates the amount of funds needed to fill the gap created by total development cost less total non-Department-sourced funds or Tax Credits. In making this determination, the Underwriter resizes any anticipated deferred developer fee down to zero before reducing the amount of Department funds or Tax Credits. In the case of Housing Tax Credits, the syndication proceeds needed to fill the gap in permanent funds are divided by the syndication rate to determine the amount of Tax Credits. In making this determination, the Department adjusts the permanent loan amount and/or any Department-sourced loans, as necessary, such that it conforms to the DCR standards described in this section.

(3) **The Amount Requested.** The amount of funds that is requested by the Applicant as reflected in the application documentation.

(d) **Operating Feasibility.** The operating financial feasibility of Developments funded by the Department is tested by adding total income sources and subtracting vacancy and collection losses and operating expenses to determine Net Operating Income. This Net Operating Income is divided by the annual debt service to determine the Debt Coverage Ratio. The Underwriter characterizes a Development as infeasible from an operational standpoint when the Debt Coverage Ratio does not meet the minimum standard set forth in paragraph (4)(D) of this subsection. The Underwriter may choose to make adjustments to the financing structure, such as lowering the debt and increasing the deferred developer fee that could result in a re-characterization of the Development as feasible based upon specific conditions set forth in the Report.

(1) **Income.** The Underwriter evaluates the reasonableness of the Applicant's income estimate by determining the appropriate rental rate per unit based on contract, program and market factors. Miscellaneous income and vacancy and collection loss limits as set forth in subparagraphs (B) and (C) of this paragraph, respectively, are applied unless well-documented support is provided.

(A) **Rental Income.** The Program Rent less Utility Allowances or Market Rent or Contract Rent is utilized by the Underwriter in calculating the rental income for comparison to the Applicant's estimate in the application. Where multiple programs are funding the same units, Contract Rents are used, if applicable. If Contract Rents do not apply, the lowest Program Rents less Utility Allowance ("net Program Rent") or Market Rents, as determined by the Market Analysis that are lower than the net Program Rents, are utilized.

(i) **Market Rents.** The Underwriter reviews the Attribute Adjustment Matrix of Comparable Units by unit size provided by the Market Analyst and determines if the adjustments and conclusions made are reasoned and well documented. The Underwriter uses the Market Analyst's conclusion of adjusted Market Rent by unit, as long as the proposed Market Rent is reasonably justified and does not exceed the highest existing unadjusted market comparable rent. Random checks of the validity of the Market Rents may include direct contact with the comparable properties. The Market Analyst's Attribute Adjustment Matrix should include, at a minimum, adjustments for location, size, amenities, and concessions as more fully described in §1.33 of this subchapter.

(ii) **Program Rents less Utility Allowance.** The Underwriter reviews the Applicant's proposed rent schedule and determines if it is consistent with the representations made in the remainder of the application. The Underwriter uses the Program Rents as promulgated by the Department's division responsible for compliance for the year that is most current at the time the underwriting begins. When underwriting for a simultaneously funded competitive round, all of the applications are underwritten with the rents promulgated for the same year. Program Rents are reduced by the Utility Allowance. The Utility Allowance figures used are determined based upon what is identified in the application by the Applicant as being a utility cost paid by the tenant and upon other consistent documentation provided in the application.

(I) Units must be individually metered for all utility costs to be paid by the tenant.

(II) Gas utilities are verified on the building plans and elsewhere in the application when applicable.

(III) Trash allowances paid by the tenant are rare and only considered when the building plans allow for individual exterior receptacles.

(IV) Refrigerator and range allowances are not considered part of the tenant-paid utilities unless the tenant is expected to provide their own appliances, and no eligible appliance costs are included in the development cost breakdown.

(iii) **Contract Rents.** The Underwriter reviews submitted rental assistance contracts to determine the Contract Rents currently applicable to the Development. Documentation supporting the likelihood of continued rental assistance is also reviewed. The underwriting analysis will take into consideration the Applicant's intent to request a Contract Rent increase. At the discretion of the Underwriter, the Applicant proposed rents may be used in the underwriting analysis with the recommendations of the Report conditioned upon receipt of final approval of such increase.

(B) **Miscellaneous Income.** All ancillary fees and miscellaneous secondary income, including but not limited to late fees, storage fees, laundry income, interest on deposits, carport rent, washer and dryer rent, telecommunications fees, and other miscellaneous income, are anticipated to be included in a \$5 to \$15 per unit per month range. Exceptions may be made at the discretion of the Underwriter for garage income, pass-through utility payments, pass-through water, sewer and trash payments, cable fees, congregate care/assisted living/elderly facilities, and child care facilities.

(i) Exceptions must be justified by operating history of existing comparable properties.

(ii) The Applicant must show that the tenant will not be required to pay the additional fee or charge as a condition of renting an apartment unit and must show that the tenant has a reasonable alternative.

(iii) The Applicant's operating expense schedule should reflect an offsetting cost associated with income derived from pass-through utility payments, pass-through water, sewer and trash payments, and cable fees.

(iv) Collection rates of exceptional fee items will generally be heavily discounted.

(v) If the total secondary income is over the maximum per unit per month limit, any cost associated with the construction, acquisition, or development of the hard assets needed to produce an additional fee may also need to be reduced from Eligible Basis for Tax Credit Developments as they may, in that case, be considered to be a commercial cost rather than an incidental to the housing cost of the Development.

(C) **Vacancy and Collection Loss.** The Underwriter uses a vacancy rate of 7.5% (5% vacancy plus 2.5% for collection loss) unless the Market Analysis reflects a higher or lower established vacancy rate for the area. Elderly and 100% project-based rental subsidy Developments and other well documented cases may be underwritten at a combined 5% at the discretion of the Underwriter if the historical performance reflected in the Market Analysis is consistently higher than a 95% occupancy rate.

(D) **Effective Gross Income.** The Underwriter independently calculates EGI. If the EGI figure provided by the Applicant is within 5% of the EGI figure calculated by the Underwriter, the Applicant's figure is characterized as reasonable in the Report; however, for purposes of calculating DCR the Underwriter will maintain and use its independent calculation unless the Applicant's proforma meets the requirements of paragraph (3) of this subsection.

(2) **Expenses.** The Underwriter evaluates the reasonableness of the Applicant's expense estimate by line item comparisons based upon the specifics of each transaction, including the type of Development, the size of the units, and the Applicant's expectations as reflected in their proforma. Historical stabilized certified or audited financial statements of the Development or Third Party quotes specific to the Development will reflect the strongest data points to predict future performance. The Department's database of property in the same location or region as the proposed Development also provides heavily relied upon data points. Data from the Institute of Real Estate Management's (IREM) most recent Conventional Apartments-Income/Expense Analysis book for the proposed Development's property type and specific location or region may be referenced. In some cases local or project-specific data such as Public Housing Authority ("PHA") Utility Allowances and property tax rates are also given significant weight in determining the appropriate line item expense estimate. Finally, well documented information provided in the Market Analysis, the application, and other sources may be considered.

(A) **General and Administrative Expense.** General and Administrative Expense includes all accounting fees, legal fees, advertising and marketing expenses, office operation, supplies, and equipment expenses. The underwriting tolerance level for this line item is 20%.

(B) **Management Fee.** Management Fee is paid to the property management company to oversee the effective operation of the property and is most often based upon a percentage of Effective Gross Income as documented in the management agreement contract. Typically, 5% of the Effective Gross Income is used, though

higher percentages for rural transactions that are consistent with the TDHCA Database can be concluded. Percentages as low as 3% may be utilized if documented by a Third Party management contract agreement with an acceptable management company. The Underwriter will require documentation for any percentage difference from the 5% of the Effective Gross Income standard.

(C) **Payroll and Payroll Expense.** Payroll and Payroll Expense includes all direct staff payroll, insurance benefits, and payroll taxes including payroll expenses for repairs and maintenance typical of a conventional development. It does not, however, include direct security payroll or additional supportive services payroll. The underwriting tolerance level for this line item is 10%.

(D) **Repairs and Maintenance Expense.** Repairs and Maintenance Expense includes all repairs and maintenance contracts and supplies. It should not include extraordinary capitalized expenses that would result from major renovations. Direct payroll for repairs and maintenance activities are included in payroll expense. The underwriting tolerance level for this line item is 20%.

(E) **Utilities Expense (Gas & Electric).** Utilities Expense includes all gas and electric energy expenses paid by the owner. It includes any pass-through energy expense that is reflected in the EGI. The underwriting tolerance level for this line item is 30%.

(F) **Water, Sewer and Trash Expense.** Water, Sewer and Trash Expense includes all water, sewer and trash expenses paid by the owner. It would also include any pass-through water, sewer and trash expense that is reflected in the EGI. The underwriting tolerance level for this line item is 30%.

(G) **Insurance Expense.** Insurance Expense includes any insurance for the buildings, contents, and liability but not health or workman's compensation insurance. The underwriting tolerance level for this line item is 30%.

(H) **Property Tax.** Property Tax includes all real and personal property taxes but not payroll taxes. The underwriting tolerance level for this line item is 10%.

(i) The per unit assessed value will be calculated based on the capitalization rate published on the county taxing authority's website. If the county taxing authority does not publish a capitalization rate on the internet, a capitalization rate of 10% will be used or comparable assessed values may be used in evaluating this line item expense.

(ii) Property tax exemptions or proposed payment in lieu of tax agreement (PILOT) must be documented as being reasonably achievable if they are to be considered by the Underwriter. At the discretion of the Underwriter, a property tax exemption that meets known federal, state and local laws may be applied based on the tax-exempt status of the Development Owner and its Affiliates.

(I) **Reserves.** Reserves include annual reserve for replacements of future capitalizable expenses as well as any ongoing additional operating reserve requirements. The Underwriter includes minimum reserves of \$200 per unit for new construction and \$300 per unit for all other Developments. The Underwriter may require an amount above \$300 for Developments other than new construction based on information provided in the PCA. Higher levels of reserves also may be used if they are documented in the financing commitment letters.

(J) **Other Expenses.** The Underwriter will include other reasonable and documented expenses, not including depreciation, interest expense, lender or syndicator's asset management fees, or other ongoing partnership fees. Lender or syndicator's asset management fees or other ongoing partnership fees also are not considered in the Department's calculation of debt coverage. The most common other expenses are described in more detail in clauses (i) through (iv) of this subparagraph.

(i) **Supportive Services Expense.** Supportive Services Expense includes the documented cost to the owner of any non-traditional tenant benefit such as payroll for instruction or activities personnel. The Underwriter will not evaluate any selection points for this item. The Underwriter's verification will be limited to assuring any anticipated costs are included. For all transactions supportive services expenses are considered in calculating the Debt Coverage Ratio.

(ii) **Security Expense.** Security Expense includes contract or direct payroll expense for policing the premises of the Development. The Applicant's amount is typically accepted as provided. The Underwriter will require documentation of the need for security expenses that exceed 50% of the anticipated payroll expense estimate discussed in subparagraph (C) of this paragraph.

(iii) **Compliance Fees.** Compliance fees include only compliance fees charged by TDHCA. The Department's charge for a specific program may vary over time; however, the Underwriter uses the current charge per unit per year at the time of underwriting. For all transactions compliance fees are considered in calculating the Debt Coverage Ratio.

(iv) **Cable Television Expense.** Cable Television Expense includes fees charged directly to the owner of the Development to provide cable services to all units. The expense will be considered only if a contract for such services with terms is provided and income derived from cable television fees is included in the projected EGI. Cost of providing cable television in only the community building should be included in General and Administrative Expense as described in subparagraph (A) of this paragraph.

(K) The Department will communicate with and allow for clarification by the Applicant when the overall expense estimate is over 5% greater or less than the Underwriter's estimate. In such a case, the Underwriter will inform the Applicant of the line items that exceed the tolerance levels indicated in this paragraph, but may request additional documentation supporting some, none or all expense line items. If an acceptable rationale for the difference is not provided, the discrepancy is documented in the Report and the justification provided by the Applicant and the countervailing evidence supporting the Underwriter's determination is noted. If the Applicant's total expense estimate is within 5% of the final total expense figure calculated by the Underwriter, the Applicant's figure is characterized as reasonable in the Report; however, for purposes of calculating DCR the Underwriter will maintain and use its independent calculation unless the Applicant's proforma meets the requirements of paragraph (3) of this subsection.

(3) **Net Operating Income.** NOI is the difference between the EGI and total operating expenses. If the NOI figure provided by the Applicant is within 5% of the NOI figure calculated by the Underwriter, the Applicant's figure is characterized as reasonable in the Report; however, for purposes of calculating the DCR the Underwriter will maintain and use his independent calculation of NOI unless the Applicant's EGI, total expenses, and NOI are each within 5% of the Underwriter's estimates.

(4) **Debt Coverage Ratio.** Debt Coverage Ratio is calculated by dividing Net Operating Income by the sum of loan principal and interest for all permanent sources of funds. Loan principal and interest, or "Debt Service," is calculated based on the terms indicated in the submitted commitments for financing. Terms generally include the amount of initial principal, the interest rate, amortization period, and repayment period. Unusual financing structures and their effect on Debt Service will also be taken into consideration.

(A) **Interest Rate.** The interest rate used should be the rate documented in the commitment letter.

(i) Commitments indicating a variable rate must provide a detailed breakdown of the component rates comprising the all-in rate. The commitment must also state the lender's underwriting interest rate, or the Applicant must submit a separate statement executed by the lender with an estimate of the interest rate as of the date of the statement.

(ii) The maximum rate allowed for a competitive application cycle is evaluated by the Director of the Department's division responsible for Credit Underwriting Analysis Reports and posted to the Department's web site prior to the close of the application acceptance period. Historically this maximum acceptable rate has been at or below the average rate for 30-year U.S. Treasury Bonds plus 400 basis points.

(B) **Amortization Period.** The Department generally requires an amortization of not less than 30 years and not more than 50 years or an adjustment to the amortization structure is evaluated and recommended. In non-Tax Credit transactions a lesser amortization period may be used if the Department's funds are fully amortized over the same period.

(C) **Repayment Period.** For purposes of projecting the DCR over a 30-year period for Developments with permanent financing structures with balloon payments in less than 30 years, the Underwriter will carry forward Debt Service calculated based on a full amortization and the interest rate stated in the commitment.

(D) **Acceptable Debt Coverage Ratio Range.** The initial acceptable DCR range for all priority or foreclosable lien financing plus the Department's proposed financing falls between a minimum of 1.10 to a maximum of 1.30. HOPE VI and USDA Rural Development transactions may underwrite to a DCR less than 1.10 based upon documentation of acceptance from the lender.

(i) For Developments other than HOPE VI and USDA Rural Development transactions, if the DCR is less than the minimum, the recommendations of the Report are conditioned upon a reduced debt service and the Underwriter will make adjustments to the assumed financing structure in the order presented in subclauses (I) through (III) of this clause.

(I) A reduction of the interest rate or an increase in the amortization period for TDHCA funded loans;

(II) A reclassification of TDHCA funded loans to reflect grants, if permitted by program rules;

(III) A reduction in the permanent loan amount for non-TDHCA funded loans based upon the rates and terms in the permanent loan commitment letter as long as they are within the ranges in subparagraphs (A) and (B) of this paragraph.

(ii) If the DCR is greater than the maximum, the recommendations of the Report are conditioned upon an increase in the debt service and the Underwriter will make adjustments to the assumed financing structure in the order presented in subclauses (I) through (III) of this clause.

(I) A reclassification of TDHCA funded grants to reflect loans, if permitted by program rules;

(II) An increase in the interest rate or a decrease in the amortization period for TDHCA funded loans;

(III) An increase in the permanent loan amount for non-TDHCA funded loans based upon the rates and terms in the permanent loan commitment letter as long as they are within the ranges in subparagraphs (A) and (B) of this paragraph.

(iii) For Housing Tax Credit Developments, a reduction in the recommended Tax Credit allocation may be made based on the gap/DCR method described in subsection (c)(2) of this section.

(iv) Although adjustments in Debt Service may become a condition of the Report, future changes in income, expenses, and financing terms could allow for an acceptable DCR.

(5) **Long Term Feasibility.** The Underwriter will evaluate the long term feasibility of the Development by creating a 30-year operating proforma.

(A) A 3% annual growth factor is utilized for income and a 4% annual growth factor is utilized for expenses.

(B) The base year projection utilized is the Underwriter's EGI, expenses, and NOI unless the Applicant's EGI, total expenses, and NOI are each within 5% of the Underwriter's estimates.

(C) The DCR should remain above a 1.10 and a continued positive Cash Flow should be projected for the initial 30-year period in order for the Development to be characterized as feasible for the long term. DCR will be calculated based on the guidelines stated in subsection (d)(4) of this section.

(D) Any Development with a 30-year proforma, used in the underwriting analysis, reflecting cumulative Cash Flow over the first fifteen years as insufficient to repay the projected amount of deferred developer fee, amortized in irregular payments at 0% interest, is characterized as infeasible. An infeasible Development will not be recommended for funding unless the Underwriter can determine a plausible alternative feasible financing structure and conditions the recommendation(s) in the Report accordingly.

(e) **Development Costs.** The Development's need for permanent funds and, when applicable, the Development's Eligible Basis is based upon the projected total development costs. The Department's estimate of the total development cost will be based on the Applicant's project cost schedule to the extent that it can be verified to a reasonable degree of certainty with documentation from the Applicant and tools available to the Underwriter. For new construction Developments, the Underwriter's total cost estimate will be used unless the Applicant's total development cost is within 5% of the Underwriter's estimate. In the case of a rehabilitation Development, the Underwriter may use a lower tolerance level due to the reliance upon the PCA. If the Applicant's total development cost is utilized and the Applicant's line item costs are inconsistent with documentation provided in the Application or program rules, the Underwriter may make adjustments to the Applicant's total cost estimate.

(1) **Acquisition Costs.** The proposed acquisition price is verified with the fully executed site control document(s) for the entire proposed site.

(A) **Excess Land Acquisition.** Where more land is being acquired than will be utilized for the site and the remaining acreage is not being utilized as permanent green space, the value ascribed to the proposed Development will be prorated from the total cost reflected in the site control document(s). An appraisal or tax assessment value may be tools that are used in making this determination; however, the Underwriter will not utilize a prorated value greater than the total amount in the site control document(s).

(B) **Identity of Interest Acquisitions.**

(i) The acquisition will be considered an identity of interest transaction when an Affiliate of, a Related Party to, or any owner at any level of the Development Team

(I) is the current owner in whole or in part of the proposed property, or

(II) was the owner in whole or in part of the proposed property during any period within the 36 months prior to the first day of the Application Acceptance Period.

(ii) In all identity of interest transactions the Applicant is required to provide the additional documentation identified in §50.9(h)(7)(A) of this title to support the transfer price to be used in the underwriting analysis.

(iii) In no instance will the acquisition cost utilized by the Underwriter exceed

(I) the original acquisition cost listed in the submitted settlement statement or, if a settlement statement is not available, the original asset value listed in the most current audited financial statement for the identity of interest owner, or

(II) the "as-is" value conclusion in the submitted appraisal.

(C) Acquisition of Buildings for Tax Credit Properties. In order to make a determination of the appropriate building acquisition value, the Applicant will provide and the Underwriter will utilize an appraisal that meets the Department's Appraisal Rules and Guidelines as described in §1.34 of this subchapter. The value of the improvements are the result of the difference between the as-is appraised value less the land value. The Underwriter may alternatively prorate the actual or identity of interest sales price based upon a lower calculated improvement value over the as-is value provided in the appraisal, so long as the resulting land value utilized by the Underwriter is not less than the land value indicated in the appraisal or tax assessment.

(2) Off-Site Costs. Off-Site costs are costs of development up to the site itself such as the cost of roads, water, sewer and other utilities to provide the site with access. All off-site costs must be well documented and certified by a Third Party engineer on the required application form.

(3) Site Work Costs. Project site work costs exceeding \$7,500 per Unit must be well documented and certified by a Third Party engineer on the required application form. In addition, for Applicants seeking Tax Credits, documentation in keeping with §50.9(i)(6)(G) of this title will be utilized in calculating eligible basis.

(4) Direct Construction Costs. Direct construction costs are the costs of materials and labor required for the building or rehabilitation of a Development.

(A) New Construction. The Underwriter will use the Marshall and Swift Residential Cost Handbook and historical final cost certifications of all previous housing tax credit allocations to estimate the direct construction cost for a new construction Development. If the Applicant's estimate is more than 5% greater or less than the Underwriter's estimate, the Underwriter will attempt to reconcile this concern and ultimately identify this as a cost concern in the Report.

(i) The "Average Quality" multiple, townhouse, or single family costs, as appropriate, from the Marshall and Swift Residential Cost Handbook, based upon the details provided in the application and particularly site and building plans and elevations will be used to estimate direct construction costs. If the Development contains amenities not included in the Average Quality standard, the Department will take into account the costs of the amenities as designed in the Development.

(ii) If the difference in the Applicant's direct cost estimate and the direct construction cost estimate detailed in clause (i) of this subparagraph is more than 5%, the Underwriter shall also evaluate the direct construction cost of the Development based on acceptable cost parameters as adjusted for inflation and as established by historical final cost certifications of all previous housing tax credit allocations for:

(I) the county in which the Development is to be located, or

(II) if cost certifications are unavailable under subclause (I) of this clause, the uniform state service region in which the Development is to be located.

(B) Rehabilitation Costs. In the case where the Applicant has provided a PCA which is inconsistent with the Applicant's figures as proposed in the development cost schedule, the Underwriter may request a supplement executed by the PCA provider supporting the Applicant's estimate and detailing the difference in costs. If said supplement is not provided or the Underwriter determines that the reasons for the initial difference in costs are not well-documented, the Underwriter utilizes the initial PCA estimations in lieu of the Applicant's estimates.

(5) Hard Cost Contingency. All contingencies identified in the Applicant project cost schedule will be added to Hard Cost Contingency with the total limited to the guidelines detailed in this paragraph. Hard Cost Contingency is limited to a maximum of 5% of direct costs plus site work for new construction Developments and 10% of direct costs plus site work for rehabilitation Developments. For tax credit Developments, the percentage is applied to the sum of the eligible direct construction costs plus eligible site work costs in calculating the eligible contingency cost. The Applicant's figure is used by the Underwriter if the figure is less than 5%.

(6) Contractor Fee Limits. Contractor fees are limited to 6% for general requirements, 2% for contractor overhead, and 6% for contractor profit. The percentages are applied to the sum of the direct construction costs plus site work costs. For tax credit Developments, the percentages are applied to the sum of the eligible direct construction costs plus eligible site work costs in calculating the eligible contractor fees. Minor reallocations to make these fees fit within these limits may be made at the discretion of the Underwriter. For Developments also receiving financing from TX-USDA-RHS, the combination of builder's general requirements, builder's overhead, and builder's profit should not exceed the lower of TDHCA or TX-USDA-RHS requirements.

(7) **Developer Fee Limits.** For Tax Credit Developments, the development cost associated with developer fees and Development Consultant (also known as Housing Consultant) fees included in Eligible Basis cannot exceed 15% of the project's Total Eligible Basis less developer fees, as defined in the QAP. Developer fee claimed must be proportionate to the work for which it is earned. In the case of an identity of interest transaction requesting acquisition Tax Credits, no developer fee attributable to acquisition of the Development will be included in Eligible Basis. For non-Tax Credit Developments, the percentage remains the same but is based upon total development costs less the sum of the fee itself, land costs, the costs of permanent financing, excessive construction period financing described in subsection (f)(8) of this section, reserves, and any other identity of interest acquisition cost.

(8) **Financing Costs.** Eligible construction period financing is limited to not more than one year's fully drawn construction loan funds at the construction loan interest rate indicated in the commitment. Any excess over this amount is removed to ineligible cost and will not be considered in the determination of developer fee.

(9) **Reserves.** The Department will utilize the terms proposed by the syndicator or lender as described in the commitment letter(s) or the amount described in the Applicant's project cost schedule if it is within the range of two to six months of stabilized operating expenses less management fees plus debt service.

(10) **Other Soft Costs.** For Tax Credit Developments all other soft costs are divided into eligible and ineligible costs. Eligible costs are defined by Internal Revenue Code but generally are costs that can be capitalized in the basis of the Development for tax purposes. Ineligible costs are those that tend to fund future operating activities. The Underwriter will evaluate and accept the allocation of these soft costs in accordance with the Department's prevailing interpretation of the Internal Revenue Code. If the Underwriter questions the eligibility of any soft costs, the Applicant is given an opportunity to clarify and address the concern prior to removal from Eligible Basis.

(f) **Developer Capacity.** The Underwriter will evaluate the capacity of the Person(s) accountable for the role of the Developer to determine their ability to secure financing and successfully complete the Development. The Department will review financial statements, and personal credit reports for those individuals anticipated to guarantee the completion of the Development.

(1) **Credit Reports.** The Underwriter will characterize the Development as "high risk" if the Applicant, General Partner, Developer, anticipated Guarantor or Principals thereof have a credit score which reflects a 40% or higher potential default rate.

(2) **Financial Statements of Principals.** The Applicant, Developer, any principals of the Applicant, General Partner, and Developer and any Person who will be required to guarantee the Development will be required to provide a signed and dated financial statement and authorization to release credit information in accordance with the Department's program rules.

(A) **Individuals.** The Underwriter will evaluate and discuss financial statements for individuals in a confidential portion of the Report. The Development may be characterized as "high risk" if the Developer, anticipated Guarantor or Principals thereof is determined to have limited net worth or significant lack of liquidity.

(B) **Partnerships and Corporations.** The Underwriter will evaluate and discuss financial statements for partnerships and corporations in the Report. The Development may be characterized as "high risk" if the Developer, anticipated Guarantor or Principals thereof is determined to have limited net worth or significant lack of liquidity.

(C) If the Development is characterized as a high risk for either lack of previous experience as determined by the TDHCA division responsible for compliance or a higher potential default rate is identified as described in paragraph (1) or (2) of this subsection, the Report must condition any potential award upon the identification and inclusion of additional Development partners who can meet the Department's guidelines.

(g) **Other Underwriting Considerations.** The Underwriter will evaluate numerous additional elements as described in subsection (b) of this section and those that require further elaboration are identified in this subsection.

(1) **Floodplains.** The Underwriter evaluates the site plan, floodplain map, survey and other information provided to determine if any of the buildings, drives, or parking areas reside within the 100-year floodplain. If such a determination is made by the Underwriter, the Report will include a condition that:

(A) The Applicant must pursue and receive a Letter of Map Amendment (LOMA) or Letter of Map Revision (LOMR-F); or

(B) The Applicant must identify the cost of flood insurance for the buildings and for the tenant's contents for buildings within the 100-year floodplain; or

(C) The Development must be designed to comply with the QAP, as proposed.

(2) **Inclusive Capture Rate.** The Underwriter will not recommend the approval of funds to new Developments requesting funds if the anticipated inclusive capture rate, as defined in §1.33 of this title, exceeds 25% for the Primary Market unless:

(A) The Developments is classified as a Rural Development according to the QAP, as proposed, in which case an inclusive capture rate of 100% is acceptable; or

(B) The Development is strictly targeted to the elderly or special needs populations, in which case an inclusive capture rate of 100% is acceptable; or

(C) The Development is comprised of Affordable Housing which replaces previously existing substandard Affordable Housing within the same Primary Market Area on a Unit for Unit basis, and which gives the displaced tenants of the previously existing Affordable Housing a leasing preference, in which case an inclusive capture rate is not applicable.

(3) The Underwriter will identify in the report any Developments funded or known and anticipated to be eligible for funding within one linear mile of the subject.

(4) **Supportive Housing.** The unique development and operating characteristics of Supportive Housing Developments may require special consideration in the following areas:

(A) **Operating Income.** The extremely-low-income tenant population typically targeted by a Supportive Housing Development may include deep-skewing of rents to well below the 50% AMI level or other maximum rent limits established by the Department. The Underwriter should utilize the Applicant's proposed rents in the Report as long as such rents are at or below the maximum rent limit proposed for the units and equal to any project based rental subsidy rent to be utilized for the Development.

(B) **Operating Expenses.** A Supportive Housing Development may have significantly higher expenses for payroll, security, resident support services, or other items than typical Affordable Housing Developments. The Underwriter will rely heavily upon the historical operating expenses of other Supportive Housing Developments provided by the Applicant or otherwise available to the Underwriter.

(C) **DCR and Long Term Feasibility.** Supportive Housing Developments may be exempted from the DCR requirements of subsection (d)(4)(D) of this section if the Development is anticipated to operate without conventional debt. Applicants must provide evidence of sufficient financial resources to offset any projected 30-year cumulative negative cash flows. Such evidence will be evaluated by the Underwriter on a case-by-case basis to satisfy the Department's long term feasibility requirements and may take the form of one or a combination of the following: executed subsidy commitment(s), set-aside of Applicant's financial resources, to be substantiated by an audited financial statement evidencing sufficient resources, and/or proof of annual fundraising success sufficient to fill anticipated operating losses. If either a set aside of financial resources or annual fundraising are used to evidence the long term feasibility of a Supportive Housing Development, a resolution from the Applicant's governing board must be provided confirming their irrevocable commitment to the provision of these funds and activities.

(D) **Development Costs.** For Supportive Housing that is styled as efficiencies, the Underwriter may use "Average Quality" dormitory costs from the Marshall & Swift Valuation Service, with adjustments for amenities and/or quality as evidenced in the application, as a base cost in evaluating the reasonableness of the Applicant's direct construction cost estimate for new construction Developments.

(h) **Work Out Development.** Developments that are underwritten subsequent to Board approval in order to refinance or gain relief from restrictions may be considered infeasible based on the guidelines in this section, but may be characterized as "the best available option" or "acceptable available option" depending on the circumstances and subject to the discretion of the Underwriter as long as the option analyzed and recommended is more likely to achieve a better financial outcome for the property and the Department than the status quo.

§1.33 Market Analysis Rules and Guidelines

(a) **General Provision.** A Market Analysis prepared for the Department must evaluate the need for decent, safe, and sanitary housing at rental rates or sales prices that eligible tenants can afford. The analysis must

determine the feasibility of the subject Property rental rates or sales price and state conclusions as to the impact of the Property with respect to the determined housing needs.

(b) **Self-Contained.** A Market Analysis prepared for the Department must allow the reader to understand the market data presented, the analysis of the data, and the conclusions derived from such data. All data presented should reflect the most current information available and the report must provide a parenthetical (in-text) citation or footnote describing the data source. The analysis must clearly lead the reader to the same or similar conclusions reached by the Market Analyst. All steps leading to a calculated figure must be presented in the body of the report.

(c) **Market Analyst Qualifications.** A Market Analysis submitted to the Department must be prepared and certified by an approved Qualified Market Analyst (§2306.67055). The Department will maintain an approved Market Analyst list based on the guidelines set forth in paragraphs (1) through (3) of this subsection.

(1) If not listed as approved by the Department, Market Analysts must submit subparagraphs (A) through (F) of this paragraph at least thirty days prior to the first day of the Application Acceptance Period for which the Market Analyst must be approved. To maintain status as an approved Qualified Market Analyst, updates to the items described in subparagraphs (A) through (C) of this paragraph must be submitted annually on the first Monday in February for review by the Department.

(A) Documentation of good standing in the State of Texas.

(B) A current organization chart or list reflecting all members of the firm who may author or sign the Market Analysis.

(C) Resumes for all members of the firm or subcontractors who may author or sign the Market Analysis.

(D) General information regarding the firm's experience including references, the number of previous similar assignments and time frames in which previous assignments were completed.

(E) Certification from an authorized representative of the firm that the services to be provided will conform to the Department's Market Analysis Rules and Guidelines, as described in this section, in effect for the application round in which each Market Analysis is submitted.

(F) A sample Market Analysis that conforms to the Department's Market Analysis Rules and Guidelines, as described in this section, in effect for the year in which the sample Market Analysis is submitted.

(2) During the underwriting process each Market Analysis will be reviewed and any discrepancies with the rules and guidelines set forth in this section may be identified and require timely correction. Subsequent to the completion of the application round and as time permits, staff or a review appraiser will re-review a sample set of submitted market analyses to ensure that the Department's Market Analysis Rules and Guidelines are met. If it is found that a Market Analyst has not conformed to the Department's Market Analysis Rules and Guidelines, as certified to, the Market Analyst will be notified of the discrepancies in the Market Analysis and will be removed from the approved Qualified Market Analyst list.

(A) In and of itself, removal from the list of approved Market Analysts will not invalidate a Market Analysis commissioned prior to the removal date and at least 90 days prior to the first day of the applicable Application Acceptance Period.

(B) To be reinstated as an approved Qualified Market Analyst, the Market Analyst must amend the previous report to remove all discrepancies or submit a new sample Market Analysis that conforms to the Department's Market Analysis Rules and Guidelines, as described in this section, in effect for the year in which the updated or new sample Market Analysis is submitted.

(3) The list of approved Qualified Market Analysts is posted on the Department's web site and updated within 72 hours of a change in the status of a Market Analyst.

(d) **Market Analysis Contents.** A Market Analysis for a rental Development prepared for the Department must be organized in a format that follows a logical progression and must include, at minimum, items addressed in paragraphs (1) through (13) of this subsection.

(1) **Title Page.** Include Property address or location, effective date of analysis, date report completed, name and address of person authorizing report, and name and address of Market Analyst.

(2) **Letter of Transmittal.** The date of the letter must be the date the report was completed. Include Property address or location, description of Property, statement as to purpose and scope of analysis, reference to accompanying Market Analysis report with effective date of analysis and summary of conclusions, date of Property inspection, name of persons inspecting subject Property, and signatures of all Market Analysts authorized to work on the assignment.

(3) **Table of Contents.** Number the exhibits included with the report for easy reference.

(4) **Summary Form.** Complete and include the most current TDHCA Primary Market Area Analysis Summary form. An electronic version of the form and instructions are available on the Department's website at <http://www.tdhca.state.tx.us/rea/>.

(5) **Assumptions and Limiting Conditions.** Include a description of all assumptions, both general and specific, made by the Market Analyst concerning the Property.

(6) **Identification of the Property.** Provide a statement to acquaint the reader with the Development. Such information includes street address, tax assessor's parcel number(s), and Development characteristics.

(7) **Statement of Ownership.** Disclose the current owners of record and provide a three year history of ownership for the subject Property.

(8) **Secondary Market Area.** All of the Market Analyst's conclusions specific to the subject Development must be based on only one Secondary Market Area definition. The entire PMA, as described in paragraph (9) of this subsection, must be contained within the Secondary Market boundaries. Secondary Market Demand will be considered for only Qualified Elderly Developments or Developments targeting special needs populations. The Market Analyst must adhere to the methodology described in this paragraph when determining the market area (§2306.67055).

(A) The Secondary Market Area will be defined by the Market Analyst with boundaries based on (in descending order of TDHCA preference)

- (i) major roads,
- (ii) political boundaries, and
- (iii) natural boundaries.
- (iv) A radius is prohibited as a boundary definition.

(B) The Market Analyst's definition of the Secondary Market Area must be supported with a detailed description of the methodology used to determine the boundaries. If applicable, the Market Analyst must place special emphasis on data used to determine an irregular shape for the Secondary Market.

(C) A scaled distance map indicating the Secondary Market Area boundaries that clearly identifies the location of the subject Property must be included.

(9) **Primary Market Area.** All of the Market Analyst's conclusions specific to the subject Development must be based on only one Primary Market Area definition. The Market Analyst must adhere to the methodology described in this paragraph when determining the market area (§2306.67055).

(A) The Primary Market Area will be defined by the Market Analyst with

- (i) size based on a base year population of no more than
 - (I) 100,000 people for Developments targeting the general population, and
 - (II) 250,000 people for Qualified Elderly Developments or Developments targeting special needs populations,
- (ii) boundaries based on (in descending order of TDHCA preference)
 - (I) major roads,
 - (II) political boundaries, and
 - (III) natural boundaries.
 - (IV) A radius is prohibited as a boundary definition.

(B) The Market Analyst's definition of the Primary Market Area must be supported with a detailed description of the methodology used to determine the boundaries. If applicable, the Market Analyst must place special emphasis on data used to determine an irregular shape for the PMA.

(C) A scaled distance map indicating the Primary Market Area boundaries that clearly identifies the location of the subject Property and the location of all Local Amenities must be included.

(10) **Market Information.**

(A) For each of the defined market areas, identify the number of units for each of the categories in clauses (i) through (vi) of this subparagraph; the data must be clearly labeled as relating to either the PMA or the Secondary Market, if applicable

- (i) total housing,
- (ii) rental developments,
- (iii) Affordable Housing,
- (iv) Comparable Units,
- (v) Unstabilized Comparable Units, and
- (vi) proposed Comparable Units.

(B) **Occupancy.** The occupancy rate indicated in the Market Analysis may be used to support both the overall demand conclusion for the proposed Development and the vacancy rate assumption used in underwriting the Development (§1.32(d)(1)(C)). State the overall physical occupancy rate for the proposed housing tenure (renter or owner) within the defined market areas by

- (i) number of Bedrooms,
- (ii) quality of construction (class),
- (iii) Targeted Population, and
- (iv) Comparable Units.

(C) **Absorption.** State the absorption trends by quality of construction (class) and absorption rates for Comparable Units.

(D) **Turnover.** The turnover rate should be specific to the Targeted Population. The data supporting the turnover rate must originate from documented turnover rates from at least one of the following (in descending order of TDHCA preference)

- (i) Comparable Units,
- (ii) the defined PMA,
- (iii) the defined Secondary Market, and
- (iv) a Third Party data collection agency or demographer.

(E) **Demand.** Provide a comprehensive evaluation of the need for the proposed housing within the defined market areas using the most current census and demographic data available.

(i) **Demographics.**

(I) **Population.** Provide population and household figures, supported by actual demographics, for a five-year period with the year of application as the base year.

(II) **Target.** If applicable, adjust the household projections for the Qualified Elderly or special needs population targeted by the proposed Development. State the target adjustment rate.

(III) **Household Size-Appropriate.** Adjust the household projections or target household projections, as applicable, for the appropriate household size for the proposed Development based on 1.5 persons per bedroom (round up). State the Household Size-Appropriate adjustment rate.

(IV) **Income Eligible.** Adjust the household size appropriate projections for income eligibility based on the income bands for the proposed Development with

(-a-) the lower end of each income band calculated based on the lowest gross rent proposed divided by 35% for the general population and 40% for Qualified Elderly households, and

(-b-) the upper end of each income band equal to the applicable gross median income limit for the largest appropriate household size based on 1.5 persons per bedroom (round up).

(-c-) State the Income Eligible adjustment rate.

(V) **Tenure-Appropriate.** Adjust the income-eligible household projections for tenure (renter or owner). State the Tenure-Appropriate adjustment rate.

(ii) **Demand from Turnover.** Apply the turnover rate as described in subparagraph (D) of this paragraph to the target, income-eligible, size-appropriate and tenure-appropriate households in the PMA projected at twelve months prior to the proposed placed in service date.

(iii) **Demand from Population Growth.** Calculate the target, income-eligible, size-appropriate and tenure-appropriate household growth in the PMA for the twelve month period prior to the proposed placed in service date.

(iv) **Demand from Other Sources.** The source of additional demand and the methodology used to calculate the additional demand must be clearly stated. Calculation of additional demand must factor in the adjustments described in clause (i) of this subparagraph.

(11) **Conclusions.** Include a comprehensive evaluation of the subject Property, separately addressing each housing type and specific population to be served by the Development in terms of items in subparagraphs (A) through (G) of this paragraph. All conclusions must be consistent with the data and analysis presented throughout the Market Analysis.

(A) **Unit Mix.** Provide a best possible unit mix conclusion based on the occupancy rates by bedroom type within the PMA and target, income-eligible, size-appropriate and tenure-appropriate household demand within the PMA.

(B) **Rents.** Provide a separate market rent and subsidized rent conclusion for each proposed unit type (number of bedrooms or net rentable square footage) and rent restriction category. Conclusions of market rents or subsidized rents below the maximum net program rent limit must be well documented.

(i) **Comparable Units.** Identify developments in the PMA with Comparable Units. In Primary Market Areas lacking sufficient rent comparables, it may be necessary for the Market Analyst to collect data from markets with similar characteristics and make quantifiable location adjustments. Provide a data sheet for each development consisting of

- (I) Development name,
- (II) address,
- (III) year of construction and year of rehabilitation, if applicable,
- (IV) property condition,
- (V) population target,
- (VI) unit mix specifying number of bedrooms, number of baths, net rentable square footage

and

- (-a-) monthly rent, or
- (-b-) sales price with terms, marketing period and date of sale,
- (VII) description of concessions,
- (VIII) list of unit amenities,
- (IX) utility structure,
- (X) list of common amenities, and
- (XI) for rental developments only
 - (-a-) occupancy, and
 - (-b-) turnover.

(ii) Provide a scaled distance map indicating the Primary Market Area boundaries that clearly identifies the location of the subject Property and the location of the identified developments with Comparable Units.

(iii) **Rent Adjustments.** In support of the market rent and subsidized rent conclusions, provide a separate attribute adjustment matrix for each proposed unit type (number of bedrooms or net rentable square footage) and rental restriction category.

- (I) The Department recommends use of HUD Form 92273.
- (II) A minimum of three developments must be represented on each attribute adjustment matrix.
- (III) Adjustments for concessions must be included, if applicable.
- (IV) Total adjustments in excess of 15% must be supported with additional narrative.
- (V) Total adjustments in excess of 25% suggest a weak comparable.

(C) **Effective Gross Income.** Provide rental income, secondary income, and vacancy and collection loss projections for the subject derived independent of the Applicant's estimates.

(D) **Demand.** State the total target, income-eligible, size-appropriate and tenure-appropriate household demand by summing the demand components discussed in paragraphs (10)(E)(ii) through (iv) of this subsection.

(E) **Inclusive Capture Rate.** The Market Analyst must calculate inclusive capture rates for the subject Development's proposed program Units, market rate Units, if applicable, and total Units. The Underwriter will adjust the inclusive capture rates to take into account any errors or omissions. To calculate an inclusive capture rate

(i) total

- (I) the proposed subject Units,
- (II) Comparable Units with priority, as defined in §50.9(e)(2) of this title, over the subject that have made application to TDHCA and have not been presented to the TDHCA Board for decision and
- (III) previously approved, but Unstabilized Comparable Units, and

(ii) divide by the total target, income-eligible, size-appropriate and tenure-appropriate household demand stated in subparagraph (D) of this paragraph.

(F) **Absorption.** Project an absorption period for the subject Development to achieve Sustaining Occupancy. State the absorption rate.

(G) **Market Impact.** Provide an assessment of the impact the subject Development, as completed, will have on existing program Developments in the Primary Market (§2306.67055).

(12) **Photographs.** Provide labeled color photographs of the subject Property, the neighborhood, street scenes, and comparables. An aerial photograph is desirable but not mandatory.

(13) **Appendices.** Any Third Party reports including demographics relied upon by the Market Analyst must be provided in appendix form. A list of works cited including personal communications also must be provided, and the Modern Language Association (MLA) format is suggested.

(e) The Department reserves the right to require the Market Analyst to address such other issues as may be relevant to the Department's evaluation of the need for the subject Development and the provisions of the particular program guidelines.

(f) All Applicants shall acknowledge, by virtue of filing an application, that the Department shall not be bound by any such opinion or Market Analysis, and may substitute its own analysis and underwriting conclusions for those submitted by the Market Analyst.

§1.34 Appraisal Rules and Guidelines

(a) **General Provisions.** Appraisals prepared for the Department must conform to the Uniform Standards of Professional Appraisal Practice (USPAP) as adopted by the Appraisal Standards Board of the Appraisal Foundation. Self-contained reports must describe sufficient and adequate data and analyses to support the final opinion of value. The final value(s) must be reasonable, based on the information included. Any Third Party reports relied upon by the appraiser must be verified by the appraiser as to the validity of the data and the conclusions. The report must contain sufficient data, included in the appendix when possible, and analysis to allow the reader to understand the property being appraised, the market data presented, analysis of the data, and the appraiser's value conclusion. The complexity of this requirement will vary in direct proportion with the complexity of the real estate and real estate interest being appraised. The report should lead the reader to the same or similar conclusion(s) reached by the appraiser.

(b) Upon completion of the report, an electronic copy should be transmitted to TDHCA, and an original hard copy must be submitted.

(c) **Value Estimates.**

(1) All appraisals shall contain a separate estimate of the "as vacant" market value of the underlying land, based upon current sales comparables.

(2) Appraisal assignments for new construction are required to provide an "as completed" value of the proposed structures. These reports shall provide an "as restricted with favorable financing" value as well as an "unrestricted market" value.

(3) Reports on Properties to be rehabilitated shall address the "as restricted with favorable financing" value as well as both an "as is" value and an "as completed" value.

(4) If required the appraiser must include a separate assessment of personal property, furniture, fixtures, and equipment (FF&E) and/or intangible items. This separate assessment may be required because their economic life may be shorter than the real estate improvements and may require different lending or underwriting considerations. If personal property, FF&E, or intangible items are not part of the transaction or value estimate, a statement to such effect should be included.

(d) **Date of Appraisal.** The appraisal report must be dated and signed by the appraiser who inspected the property. The date of valuation should not be more than six months prior to the date of application to the Department unless the Department's program rules indicate otherwise.

(e) **Appraiser Qualifications.** The qualifications of each appraiser are determined and approved on a case-by-case basis by the Director of Real Estate Analysis or review appraiser, based upon the quality of the report itself and the experience and educational background of the appraiser, as set forth in the Statement of Qualifications appended to the appraisal. At minimum, a qualified appraiser must be appropriately certified or licensed for the type of appraisal being performed by the Texas Appraiser Licensing and Certification Board.

(f) **Appraisal Contents.** An appraisal prepared for the Department must be organized in a format that follows a logical progression and must include, at minimum, items addressed in paragraphs (1) through (18) of this subsection.

(1) **Title Page.** Include identification as to the type of appraisal submitted (e.g., type of process--complete or limited, type of report--self-contained, summary or restricted), property address and/or location,

housing type, the Department addressed as the client or acknowledgement that THDCA is granted full authority to rely on the findings of the report, effective date of value estimate(s), date of report, name and address of person authorizing report, and name and address of appraiser(s).

(2) **Letter of Transmittal.** Include date of letter, property address and/or location, description of property type, extraordinary/special assumptions or limiting conditions that were approved by person authorizing the assignment, statement as to function of the report, statement of property interest being appraised, statement as to appraisal process (complete or limited), statement as to reporting option (self-contained, summary or restricted), reference to accompanying appraisal report, reference to all person(s) that provided significant assistance in the preparation of the report, date of report, effective date of appraisal, date of property inspection, name of person(s) inspecting the property, identification of type(s) of value(s) estimated (e.g., market value, leased fee value, as-financed value, etc.), estimate of marketing period, signatures of all appraisers authorized to work on the assignment.

(3) **Table of Contents.** Number the exhibits included with the report for easy reference.

(4) **Assumptions and Limiting Conditions.** Include a summary of all assumptions, both general and specific, made by the appraiser(s) concerning the property being appraised. Statements may be similar to those recommended by the Appraisal Institute.

(5) **Certificate of Value.** This section may be combined with the letter of transmittal and/or final value estimate. Include statements similar to those contained in Standard Rule 2-3 of USPAP.

(6) **Disclosure of Competency.** Include appraiser's qualifications, detailing education and experience, as discussed in subsection (e) of this section.

(7) **Identification of the Property.** Provide a statement to acquaint the reader with the property. Real estate being appraised must be fully identified and described by street address, tax assessor's parcel number(s), and Development characteristics. Include a full, complete, legible, and concise legal description.

(8) **Statement of Ownership of the Subject Property.** Discuss all prior sales of the subject property which occurred within the past three years. Any pending agreements of sale, options to buy, or listing of the subject property must be disclosed in the appraisal report.

(9) **Purpose and Function of the Appraisal.** Provide a brief comment stating the purpose of the appraisal and a statement citing the function of the report.

(A) **Property Rights Appraised.** Include a statement as to the property rights (e.g., fee simple interest, leased fee interest, leasehold, etc.) being considered. The appropriate interest must be defined in terms of current appraisal terminology with the source cited.

(B) **Definition of Value Premise.** One or more types of value (e.g., "as is," "as if," "prospective market value") may be required. Definitions corresponding to the appropriate value must be included with the source cited.

(10) **Scope of the Appraisal.** Address and summarize the methods and sources used in the valuation process. Describes the process of collecting, confirming, and reporting the data used in the assignment.

(11) **Regional Area Data.** Provide a general description of the geographic location and demographic data and analysis of the regional area. A map of the regional area with the subject identified is requested, but not required.

(12) **Neighborhood Data.** Provide a specific description of the subject's geographical location and specific demographic data and an analysis of the neighborhood. A summary of the neighborhood trends, future Development, and economic viability of the specific area should be addressed. A map with the neighborhood boundaries and the subject identified must be included.

(13) **Site/Improvement Description.** Discuss the site characteristics including subparagraphs (A) through (F) of this paragraph.

(A) **Physical Site Characteristics.** Describe dimensions, size (square footage, acreage, etc.), shape, topography, corner influence, frontage, access, ingress-egress, etc. associated with the site. Include a plat map and/or survey.

(B) **Floodplain.** Discuss floodplain (including flood map panel number) and include a floodplain map with the subject clearly identified.

(C) **Zoning.** Report the current zoning and description of the zoning restrictions and/or deed restrictions, where applicable, and type of Development permitted. Any probability of change in zoning should be discussed. A statement as to whether or not the improvements conform to the current zoning should be included. A statement addressing whether or not the improvements could be rebuilt if damaged or destroyed, should be included. If current zoning is not consistent with the Highest and Best Use, and zoning changes are

reasonable to expect, time and expense associated with the proposed zoning change should be considered and documented. A zoning map should be included.

(D) **Description of Improvements.** Provide a thorough description and analysis of the improvements including size (net rentable area, gross building area, etc.), number of stories, number of buildings, type/quality of construction, condition, actual age, effective age, exterior and interior amenities, items of deferred maintenance, etc. All applicable forms of depreciation should be addressed along with the remaining economic life.

(E) **Fair Housing.** It is recognized appraisers are not an expert in such matters and the impact of such deficiencies may not be quantified; however, the report should disclose any potential violations of the Fair Housing Act of 1988, Section 504 of the Rehabilitation Act of 1973, and the Americans with Disabilities Act of 1990 and/or report any accommodations (e.g., wheelchair ramps, handicap parking spaces, etc.) which have been performed to the property or may need to be performed.

(F) **Environmental Hazards.** It is recognized appraisers are not an expert in such matters and the impact of such deficiencies may not be quantified; however, the report should disclose any potential environmental hazards (e.g., discolored vegetation, oil residue, asbestos-containing materials, lead-based paint etc.) noted during the inspection.

(14) **Highest and Best Use.** Market Analysis and feasibility study is required as part of the highest and best use. The highest and best use analysis should consider paragraph (13)(A) through (F) of this subsection as well as a supply and demand analysis.

(A) The appraisal must inform the reader of any positive or negative market trends which could influence the value of the appraised property. Detailed data must be included to support the appraiser's estimate of stabilized income, absorption, and occupancy.

(B) The highest and best use section must contain a separate analysis "as if vacant" and "as improved" (or "as proposed to be improved/renovated"). All four elements in appropriate order as outlined in the Appraisal of Real Estate (legally permissible, physically possible, feasible, and maximally productive) must be sequentially considered.

(15) **Appraisal Process.** The Cost Approach, Sales Comparison Approach and Income Approach are three recognized appraisal approaches to valuing most properties. It is mandatory that all three approaches are considered in valuing the property unless specifically instructed by the Department to ignore one or more of the approaches; or unless reasonable appraisers would agree that use of an approach is not applicable. If an approach is not applicable to a particular property, then omission of such approach must be fully and adequately explained.

(A) **Cost Approach.** This approach should give a clear and concise estimate of the cost to construct the subject improvements. The type of cost (reproduction or replacement) and source(s) of the cost data should be reported.

(i) Cost comparables are desirable; however, alternative cost information may be obtained from Marshall & Swift Valuation Service or similar publications. The section, class, page, etc. should be referenced. All soft costs and entrepreneurial profit must be addressed and documented.

(ii) All applicable forms of depreciation must be discussed and analyzed. Such discussion must be consistent with the description of the improvements analysis.

(iii) The land value estimate should include a sufficient number of sales which are current, comparable, and similar to the subject in terms of highest and best use. Comparable sales information should include address, legal description, tax assessor's parcel number(s), sales price, date of sale, grantor, grantee, three year sales history, and adequate description of property transferred. The final value estimate should fall within the adjusted and unadjusted value ranges. Consideration and appropriate cash equivalent adjustments to the comparable sales price for subclauses (I) through (VII) of this clause should be made when applicable.

(I) Property rights conveyed.

(II) Financing terms.

(III) Conditions of sale.

(IV) Location.

(V) Highest and best use.

(VI) Physical characteristics (e.g., topography, size, shape, etc.).

(VII) Other characteristics (e.g., existing/proposed entitlements, special assessments, etc.).

(B) **Sales Comparison Approach.** This section should contain an adequate number of sales to provide the reader with the current market conditions concerning this property type. Sales data should be recent and

specific for the property type being appraised. The sales must be confirmed with buyer, seller, or an individual knowledgeable of the transaction.

(i) Minimum content of the sales should include address, legal description, tax assessor's parcel number(s), sale price, financing considerations, and adjustment for cash equivalency, date of sale, recordation of the instrument, parties to the transaction, three year sale history, complete description of the property and property rights conveyed, and discussion of marketing time. A scaled distance map clearly identifying the subject and the comparable sales must be included.

(ii) Several methods may be utilized in the Sale Comparison Approach. The method(s) used must be reflective of actual market activity and market participants.

(I) **Sale Price/Unit of Comparison.** The analysis of the sale comparables must identify, relate and evaluate the individual adjustments applicable for property rights, terms of sale, conditions of sale, market conditions and physical features. Sufficient narrative analysis must be included to permit the reader to understand the direction and magnitude of the individual adjustments, as well as a unit of comparison value indicator for each comparable. The appraiser(s) reasoning and thought process must be explained.

(II) **Potential Gross Income/Effective Gross Income Analysis.** If used in the report, this method of analysis must clearly indicate the income statistics for the comparables. Consistency in the method for which such economically statistical data was derived should be applied throughout the analysis. At least one other method should accompany this method of analysis.

(III) **NOI/Unit of Comparison.** If used in the report, the net income statistics for the comparables must be calculated in the same manner and disclosed as such. It should be disclosed if reserves for replacement have been included in this method of analysis. At least one other method should accompany this method of analysis.

(C) **Income Approach.** This section is to contain an analysis of both the actual historical and projected income and expense aspects of the subject property.

(i) **Market Rent Estimate/Comparable Rental Analysis.** This section of the report should include an adequate number of actual market transactions to inform the reader of current market conditions concerning rental units. The comparables must indicate current research for this specific property type. The rental comparables must be confirmed with the landlord, tenant or agent and individual data sheets must be included. The minimum content of the individual data sheets should include property address, lease terms, description of the property (e.g., unit type, unit size, unit mix, interior amenities, exterior amenities, etc.), physical characteristics of the property, and location of the comparables. Analysis of the Market Rents should be sufficiently detailed to permit the reader to understand the appraiser's logic and rationale. Adjustment for lease rights, condition of the lease, location, physical characteristics of the property, etc. must be considered.

(ii) **Comparison of Market Rent to Contract Rent.** Actual income for the subject along with the owner's current budget projections must be reported, summarized and analyzed. If such data is unavailable, a statement to this effect is required and appropriate assumptions and limiting conditions should be made. The contract rents should be compared to the market-derived rents. A determination should be made as to whether the contract rents are below, equal to, or in excess of market rates. If there is a difference, its impact on value must be qualified.

(iii) **Vacancy/Collection Loss.** Historical occupancy data and current occupancy level for the subject should be reported and compared to occupancy data from the rental comparable and overall occupancy data for the subject's Primary Market.

(iv) **Expense Analysis.** Actual expenses for the subject, along with the owner's projected budget, must be reported, summarized, and analyzed. If such data is unavailable, a statement to this effect is required and appropriate assumptions and limiting conditions should be made. Historical expenses should be compared to comparables expenses of similar property types or published survey data (e.g., IREM, BOMA, etc.). Any expense differences should be reconciled. Historical data regarding the subject's assessment and tax rates should be included. A statement as to whether or not any delinquent taxes exist should be included.

(v) **Capitalization.** Several capitalization methods may be utilized in the Income Approach. The appraiser should present the method(s) reflective of the subject market and explain the omission of any method not considered in the report.

(I) **Direct Capitalization.** The primary method of deriving an overall rate (OAR) is through market extraction. If a band of investment or mortgage equity technique is utilized, the assumptions must be fully disclosed and discussed.

(II) **Yield Capitalization (Discounted Cash Flow Analysis).** This method of analysis should include a detailed and supportive discussion of the projected holding/investment period, income and income growth projections, occupancy projections, expense and expense growth projections, reversionary value and support for the discount rate.

(16) **Reconciliation and Final Value Estimate.** This section of the report should summarize the approaches and values that were utilized in the appraisal. An explanation should be included for any approach which was not included. Such explanations should lead the reader to the same or similar conclusion of value. Although the values for each approach may not "agree", the differences in values should be analyzed and discussed. Other values or interests appraised should be clearly labeled and segregated. Such values may include FF&E, leasehold interest, excess land, etc. In addition, rent restrictions, subsidies and incentives should be explained in the appraisal report and their impact, if any, needs to be reported in conformity with the Comment section of USPAP Standards Rule 1-2(e), which states, "Separation of such items is required when they are significant to the overall value." In the appraisal of subsidized housing, value conclusions that include the intangibles arising from the programs will also have to be analyzed under a scenario without the intangibles in order to measure their influence on value.

(17) **Marketing Period.** Given property characteristics and current market conditions, the appraiser(s) should employ a reasonable marketing period. The report should detail existing market conditions and assumptions considered relevant.

(18) **Photographs.** Provide good quality color photographs of the subject property (front, rear, and side elevations, on-site amenities, interior of typical units if available). Photographs should be properly labeled. Photographs of the neighborhood, street scenes, and comparables should be included. An aerial photograph is desirable but not mandatory.

(g) **Additional Appraisal Concerns.** The appraiser(s) must recognize and be aware of the particular TDHCA program rules and guidelines and their relationship to the subject's value. Due to the various programs offered by the Department, various conditions may be placed on the subject which would impact value. Furthermore, each program may require that the appraiser apply a different set of specific definitions for the conclusions of value to be provided. Consequently, as a result of such criteria, the appraiser(s) should be aware of such conditions and definitions and clearly identify them in the report.

§1.35 Environmental Site Assessment Rules and Guidelines

(a) **General Provisions.** The Environmental Site Assessments (ESA) prepared for the Department should be conducted and reported in conformity with the standards of the American Society for Testing and Materials. The initial report should conform with the Standard Practice for Environmental Site Assessments: Phase I Assessment Process (ASTM Standard Designation: E 1527). Any subsequent reports should also conform to ASTM standards and such other recognized industry standards as a reasonable person would deem relevant in view of the Property's anticipated use for human habitation. The environmental assessment shall be conducted by a Third Party environmental professional at the expense of the Applicant, and addressed to TDHCA as a User of the report (as defined by ASTM standards). Copies of reports provided to TDHCA which were commissioned by other financial institutions should address TDHCA as a co-recipient of the report, or letters from both the provider and the recipient of the report should be submitted extending reliance on the report to TDHCA. The ESA report should also include a statement that the person or company preparing the ESA report will not materially benefit from the Development in any other way than receiving a fee for performing the Environmental Site Assessment, and that the fee is in no way contingent upon the outcome of the assessment .

(b) In addition to ASTM requirements, the report must

(1) State if a noise study is recommended for a property and identify its proximity to industrial zones, major highways, active rail lines, civil and military airfields, or other potential sources of excessive noise;

(2) Provide a copy of a current survey, if available, or other drawing of the site reflecting the boundaries and adjacent streets, all improvements on the site, and any items of concern described in the body of the environmental site assessment or identified during the physical inspection;

(3) Provide a copy of the current FEMA Flood Insurance Rate Map showing the panel number and encompassing the site with the site boundaries precisely identified and superimposed on the map.

(4) Provide a narrative determination of the flood risk for the proposed Development described in the narrative of the report includes a discussion of the impact of the 100-year floodplain on the proposed Development based upon a review of the current site plan;

(5) State if testing for asbestos containing materials (ACMs) would be required pursuant to local, state, and federal laws, or recommended due to any other consideration;

(6) State if testing for Lead Based Paint would be required pursuant to local, state, and federal laws, or recommended due to any other consideration;

(7) State if testing for lead in the drinking water would be required pursuant to local, state, and federal laws, or recommended due to any other consideration; and

(8) Assess the potential for the presence of Radon on the property, and recommend specific testing if necessary.

(c) If the report recommends further studies or establishes that environmental hazards currently exist on the Property, or are originating off-site but would nonetheless affect the Property, the Development Owner must act on such a recommendation or provide a plan for either the abatement or elimination of the hazard. Evidence of action or a plan for the abatement or elimination of the hazard must be presented upon Application submittal.

(d) For Developments which have had a Phase II Environmental Assessment performed and hazards identified, the Development Owner is required to maintain a copy of said assessment on site available for review by all persons which either occupy the Development or are applying for tenancy.

(e) For Developments in programs that allow a waiver of the Phase I ESA such as a TX-USDA-RHS funded Development the Development Owners are hereby notified that it is their responsibility to ensure that the Development is maintained in compliance with all state and federal environmental hazard requirements.

(f) Those Developments which have or are to receive first lien financing from HUD may submit HUD's environmental assessment report, provided that it conforms with the requirements of this subsection.

§1.36 Property Condition Assessment Guidelines

(a) **General Provisions.** The objective of the Property Condition Assessment (the PCA) is to provide cost estimates for repairs, replacements, or new construction which are: immediately necessary; proposed by the developer; and expected to be required throughout the term of the regulatory period. The PCA prepared for the Department should be conducted and reported in conformity with the American Society for Testing and Materials "Standard Guide for Property Condition Assessments: Baseline Property Condition Assessment Process (ASTM Standard Designation: E 2018)" except as provided for in subsections (b) and (c) of this section. The PCA must include discussion and analysis of the following:

(1) **Useful Life Estimates.** For each system and component of the property the PCA should assess the condition of the system or component, and estimate its remaining useful life, citing the basis or the source from which such estimate is derived.

(2) **Code Compliance.** The PCA should review and document any known violations of any applicable federal, state, or local codes. In developing the cost estimates specified herein, it is the responsibility of the Housing Sponsor or Applicant to ensure that the PCA adequately considers any and all applicable federal, state, and local laws and regulations which may govern any work performed to the subject property.

(3) **Program Rules.** The PCA should assess the extent to which any systems or components must be modified, repaired, or replaced in order to comply with any specific requirements of the housing program under which the Development is proposed to be financed, particular consideration being given to accessibility requirements, the Department's Housing Quality Standards, and any scoring criteria for which the Applicant may claim points.

(4) **Cost Estimates for Repair and Replacement.** It is the responsibility of the Housing Sponsor or Applicant to ensure that the PCA provider is apprised of all development activities associated with the proposed transaction and consistency of the total immediately necessary and proposed repair and replacement cost estimates with the development cost schedule submitted as an exhibit of the Application.

(A) **Immediately Necessary Repairs and Replacement.** Systems or components which are expected to have a remaining useful life of less than one year, which are found to be in violation of any applicable codes, which must be modified, repaired or replaced in order to satisfy program rules, or which are otherwise in a state

of deferred maintenance or pose health and safety hazards should be considered immediately necessary repair and replacement. The PCA must provide a separate estimate of the costs associated with the repair, replacement, or maintenance of each system or component which is identified as being an immediate need, citing the basis or the source from which such cost estimate is derived.

(B) **Proposed Repair, Replacement, or New Construction.** If the development plan calls for additional repair, replacement, or new construction above and beyond the immediate repair and replacement described in subparagraph (A) of this paragraph, such items must be identified and the nature or source of obsolescence or improvement to the operations of the Property discussed. The PCA must provide a separate estimate of the costs associated with the repair, replacement, or new construction which is identified as being above and beyond the immediate need, citing the basis or the source from which such cost estimate is derived.

(C) **Expected Repair and Replacement Over Time.** The term during which the PCA should estimate the cost of expected repair and replacement over time must equal the longest term of any land use or regulatory restrictions which are, or will be, associated with the provision of housing on the property. The PCA must estimate the periodic costs which are expected to arise for repairing or replacing each system or component or the property, based on the estimated remaining useful life of such system or component as described in paragraph (1) of this subsection adjusted for completion of repair and replacement immediately necessary and proposed as described in subparagraphs (A) and (B) of this paragraph. The PCA must include a separate table of the estimated long term costs which identifies in each line the individual component of the property being examined, and in each column the year during the term in which the costs are estimated to be incurred. The estimated costs for future years should be given in both present dollar values and anticipated future dollar values assuming a reasonable inflation factor of not less than 2.5% per annum.

(b) If a copy of such standards or a sample report have been provided for the Department's review, if such standards are widely used, and if all other criteria and requirements described in this section are satisfied, the Department will also accept copies of reports commissioned or required by the primary lender for a proposed transaction, which have been prepared in accordance with:

- (1) Fannie Mae's criteria for Physical Needs Assessments,
- (2) Federal Housing Administration's criteria for Project Capital Needs Assessments,
- (3) Freddie Mac's guidelines for Engineering and Property Condition Reports,
- (4) TX-USDA-RHS guidelines for Capital Needs Assessment, or
- (5) Standard and Poor's Property Condition Assessment Criteria: Guidelines for Conducting Property Condition Assessments, Multifamily Buildings.

(c) The Department may consider for acceptance reports prepared according to other standards which are not specifically named above in subsection (b) of this section, if a copy of such standards or a sample report have been provided for the Department's review, if such standards are widely used, and if all other criteria and requirements described in this section are satisfied.

(d) The PCA shall be conducted by a Third Party at the expense of the Applicant, and addressed to TDHCA as the client. Copies of reports provided to TDHCA which were commissioned by other financial institutions should address TDHCA as a co-recipient of the report, or letters from both the provider and the recipient of the report should be submitted extending reliance on the report to TDHCA. The PCA report should also include a statement that the person or company preparing the PCA report will not materially benefit from the Development in any other way than receiving a fee for performing the PCA. The PCA should be signed and dated by the Third Party report provider not more than six months prior to the date of the application.

§1.37 Reserve for Replacement Rules and Guidelines

(a) **General Provisions.** The Department will require Developments to provide regular maintenance to keep housing sanitary, safe and decent by maintaining a reserve for replacement in accordance with §2306.186. The reserve must be established for each unit in a Development of 25 or more rental units, regardless of the amount of rent charged for the unit. The Department shall, through cooperation of its divisions responsible for asset management and compliance, ensure compliance with this section.

(b) The First Lien Lender shall maintain the reserve account through an escrow agent acceptable to the First Lien Lender to hold reserve funds in accordance with an executed escrow agreement and the rules set forth in this section and §2306.186.

(1) Where there is a First Lien Lender other than the Department or a Bank Trustee as a result of a bond indenture or tax credit syndication, the Department shall

(A) Be a required signatory party in all escrow agreements for the maintenance of reserve funds;

(B) Be given notice of any asset management findings or reports, transfer of money in reserve accounts to fund necessary repairs, and any financial data and other information pursuant to the oversight of the Reserve Account within 30 days of any receipt or determination thereof;

(C) subordinate its rights and responsibilities under the escrow agreement, including those described in this subsection, to the First Lien Lender or Bank Trustee through a subordination agreement subject to its ability to do so under the law and normal and customary limitations for fraud and other conditions contained in the Department's standard subordination clause agreements as modified from time to time, to include subsection (c) of this section.

(2) The escrow agreement and subordination agreement, if applicable, shall further specify the time and circumstances under which the Department can exercise its rights under the escrow agreement in order to fulfill its obligations under §2306.186 and as described in this section.

(3) Where the Department is the First Lien Lender and there is no Bank Trustee as a result of a bond indenture or tax credit syndication or where there is no First Lien Lender but the allocation of funds by the Department and §2306.186 requires that the Department oversee a Reserve Account, the Owner shall provide at their sole expense for appointment of an escrow agent acceptable to the Department to act as Bank Trustee as necessary under this section. The Department shall retain the right to replace the escrow agent with another Bank Trustee or act as escrow agent at a cost plus fee payable by the Owner due to breach of the escrow agent's responsibilities or otherwise with 30 days prior notice of all parties to the escrow agreement.

(c) If the Department is not the First Lien Lender with respect to the Development, each Owner receiving Department assistance for multifamily rental housing shall submit on an annual basis within the Department's required Owner's Financial Certification packet a signed certification by the First Lien Lender including:

(1) Reserve for replacement requirements under the first lien loan agreement;

(2) Monitoring standards established by the First Lien Lender to ensure compliance with the established reserve for replacement requirements; and

(3) A statement by the First Lien Lender

(A) That the Development has met all established reserve for replacement requirements; or

(B) Of the plan of action to bring the Development in compliance with all established reserve for replacement requirements, if necessary.

(d) If the Development meets the minimum unit size described in subsection (a) of this section and the establishment of a Reserve Account for repairs has not been required by the First Lien Lender or Bank Trustee, each Owner receiving Department assistance for multifamily rental housing shall set aside the repair reserve amount as described in subsection (e)(1) through (3) of this section through the date described in subsection (f)(2) of this section through the appointment of an escrow agent as further described in subsection (b)(3) of this section.

(e) If the Department is the First Lien Lender with respect to the Development, each Owner receiving Department assistance for multifamily rental housing shall deposit annually into a Reserve Account through the date described in subsection (f)(2) of this section:

(1) For new construction Developments:

(A) Not less than \$150 per unit per year for units one to five years old; and

(B) Not less than \$200 per unit per year for units six or more years old.

(2) For rehabilitation Developments:

(A) An amount per unit per year established by the Department's division responsible for credit underwriting based on the information presented in a Property Condition Assessment in conformance with §1.36 of this subchapter; and

(B) Not less than \$300 per unit per year.

(3) For either new construction or rehabilitation Developments, the Owner of a multifamily rental housing Development shall contract for a third-party Property Condition Assessment meeting the requirements of

§1.36 of this subchapter and the Department will reanalyze the annual reserve requirement based on the findings and other support documentation.

(A) A Property Condition Assessment will be conducted:

(i) At appropriate intervals that are consistent with requirements of the First Lien Lender, other than the Department; or

(ii) At least once during each five-year period beginning with the 11th year after the awarding of any financial assistance for the Development by the Department, if the Department is the First Lien Lender or the First Lien Lender does not require a third-party Property Condition Assessment.

(B) Submission by the Owner to the Department will occur within 30 days of completion of the Property Condition Assessment and must include:

(i) The complete Property Condition Assessment;

(ii) First Lien Lender and/or Owner response to the findings of the Property Condition Assessment;

(iii) Documentation of repairs made as a result of the Property Condition Assessment; and

(iv) Documentation of adjustments to the amounts held in the replacement Reserve Account based upon the Property Condition Assessment.

(f) A Land Use Restriction Agreement or restrictive covenant between the Owner and the Department must require:

(1) The Owner to begin making annual deposits to the reserve account on the later of:

(A) The date that occupancy of the Development stabilizes as defined by the First Lien Lender or in the absence of a First Lien Lender other than the Department, the date the property is at least 90% occupied; or

(B) The date that permanent financing for the Development is completely in place as defined by the First Lien Lender or in the absence of a First Lien Lender other than the Department, the date when the permanent loan is executed and funded.

(2) The Owner to continue making deposits until the earliest of the following dates:

(A) The date on which the Owner suffers a total casualty loss with respect to the Development;

(B) The date on which the Development becomes functionally obsolete, if the Development cannot be or is not restored;

(C) The date on which the Development is demolished;

(D) The date on which the Development ceases to be used as a multifamily rental property; or

(E) The later of

(i) The end of the affordability period specified by the Land Use Restriction Agreement or restrictive covenant; or

(ii) The end of the repayment period of the first lien loan.

(g) The duties of the Owner of a multifamily rental housing Development under this section cease on the date of a change in ownership of the Development; however, the subsequent Owner of the Development is subject to the requirements of this section.

(h) If the Department is the First Lien Lender with respect to the Development or the First Lien Lender does not require establishment of a Reserve Account, the Owner receiving Department assistance for multifamily rental housing shall submit on an annual basis within the Department's required Owner's Financial Certification packet:

(1) Financial statements, audited if available, with clear identification of the replacement Reserve Account balance and all capital improvements to the Development within the fiscal year;

(2) Identification of costs other than capital improvements funded by the replacement Reserve Account; and

(3) Signed statement of cause for:

(A) Use of replacement Reserve Account for expenses other than necessary repairs, including property taxes or insurance;

(B) Deposits to the replacement Reserve Account below the Department's or First Lien Lender's mandatory levels as defined in subsections (c), (d) and (e) of this section; and

(C) Failure to make a required deposit.

(i) If a request for extension or waiver is not approved by the Department, Department action, including a penalty of up to \$200 per dwelling unit in the Development and/or characterization of the Development as Materially Non-Compliant, as defined in §60.1 of this title, may be taken when:

- (1) A Reserve Account, as described in this section, has not been established for the Development;
- (2) The Department is not a party to the escrow agreement for the Reserve Account;
- (3) Money in the Reserve Account
 - (A) Is used for expenses other than necessary repairs, including property taxes or insurance; or
 - (B) Falls below mandatory deposit levels;
- (4) Owner fails to make a required deposit;
- (5) Owner fails to contract for the third party Property Condition Assessment as required under subsection (e)(3) of this section; or
- (6) Owner fails to make necessary repairs, as defined in subsection (k) of this section.

- (j) On a case by case basis, the Department may determine that the money in the Reserve Account may:
- (1) Be used for expenses other than necessary repairs, including property taxes or insurance, if:
 - (A) Development income before payment of return to Owner or deferred developer fee is insufficient to meet operating expense and debt service requirements; and
 - (B) The funds withdrawn from the Reserve Account are replaced as cashflow after payment of expenses, but before payment of return to Owner or developer fee is available.
 - (2) Fall below mandatory deposit levels without resulting in Department action, if:
 - (A) Development income after payment of operating expenses, but before payment of return to Owner or deferred developer fee is insufficient to fund the mandatory deposit levels; and
 - (B) Subsequent deposits to the Reserve Account exceed mandatory deposit levels as cashflow after payment of operating expenses, but before payment of return to Owner or deferred developer fee is available until the Reserve Account has been replenished to the mandatory deposit level less capital expenses to date.

(k) The Department or its agent may make repairs to the Development if the Owner fails to complete necessary repairs indicated in the submitted Property Condition Assessment or identified by physical inspection. Repairs may be deemed necessary if the Development is notified of the Owner's failure to comply with federal, state and/or local health, safety, or building code.

- (1) Payment for necessary repairs must be made directly by the Owner or through a replacement Reserve Account established for the Development under this section.
- (2) The Department or its agent will produce a Request for Bids to hire a contractor to complete and oversee necessary repairs.

(l) This section does not apply to a Development for which the Owner is required to maintain a Reserve Account under any other provision of federal or state law.