

DATE: September 17, 2007

RE: Comments to the U.S. Department of Housing and Urban Development's Proposed Rule, Use of Public Housing Capital and Operating Funds for Financing Activities, 72 Fed. Reg. 39,546 (proposed July 18, 2007) (to be codified at 24 C.F.R. pts. 905 & 990).

This Memorandum sets forth our comments to the U.S. Department of Housing and Urban Development's ("HUD") Proposed Rule, Use of Public Housing Capital and Operating Funds for Financing Activities, 72 Fed. Reg. 39,546 (proposed July 18, 2007) (to be codified at 24 C.F.R. pts. 905 & 990) (the "Proposed Rule"). While the provisions of the Proposed Rule applicable to Parts 905 and 990 are in many respects fairly similar, there are enough differences that the comments with respect to each are addressed separately.

Part 905 – The Public Housing Capital Fund Program

1. Third Party Documents Required Prior to Approval

The Proposed Rule is very much like the current Capital Fund Financing Program ("CFFP") process (available at <http://www.hud.gov/offices/pih/programs/ph/capfund/cffp.cfm>). Thus, before a public housing agency (a "PHA") can "obtain HUD approval to borrow private capital and pledge a portion of its annual capital fund grant or public housing assets and other public housing property of the PHA as security," the PHA must, among other things provide (1) if required, "a Management Assessment conducted by an independent third party," (2) "a physical needs assessment at the project . . . that covers the PHA's entire public housing portfolio for the term of the financing and takes into consideration existing needs and the life cycle repair and replacement," and (3) "an opinion . . . from a qualified, independent, third-party financial advisor attesting that the terms and conditions of the proposed financing transaction are reasonable given current market conditions." 72 Fed. Reg. 39,546, 39,549-50 (proposed July 18, 2007) (to be codified at 24 C.F.R. §§ 905.700(a), 905.705(e,g,k)).

These requirements add significant expense to a PHA's financing a new development; the PHA will need to procure these parties, negotiate contracts with them and then pay hefty fees (e.g., our clients have been quoted fees for a fairness opinion between \$1,500 - \$10,000 and for a management assessment of \$7,500). We do not believe that a fairness opinion should be required. The financial markets are competitive and if a PHA has properly procured a lending institution, the PHA will receive a fair and competitive rate. The entity confirming that rate earns a fee for providing an unnecessary service.

2. Reporting Requirements

Once HUD's approval is obtained, there is the added quarterly reporting requirement, 72 Fed. Reg. 39,546, 39,551 (proposed July 18, 2007) (to be codified at 24 C.F.R. § 905.705(p)(1)), which may be costly and overly burdensome to a PHA as well. The financing institution will bring market discipline and reporting requirements. HUD should limit its requirements to (a) annual reports in the PHA plan and (b) copies of all reports submitted to the financing institution.

3. Miscellaneous Questions

Some additional questions include:

- (a) Fully Negotiated Documents. It is problematic that the Proposed Rule includes the requirement that "The financing documents are to be submitted to HUD only after they have been negotiated and agreed upon by the other parties to the transaction. HUD will not review preliminary documents that are still under negotiation." 72 Fed. Reg. 39,546, 39,551 (proposed July 18, 2007) (to be codified at 24 C.F.R. § 905.710(b)(3)). For example, counsel to Florida Housing Finance Corporation in connection with its Predevelopment Loan Program ("PLP") does not wish to negotiate PLP documents without assurance that HUD will approve of the security interest needed for the transaction. We believe that the Proposed Rule should make this an option at HUD's discretion.
- (b) Submission by PHA. The sentence "HUD will also return proposals submitted by entities other than the PHA (e.g., the PHA's consultants)", 72 Fed. Reg. 39,546, 39,551 (proposed July 18, 2007) (to be codified at 24 C.F.R. § 905.715(a)), needs to be clarified. The Executive Director will be preparing the transmittal letter. 72 Fed. Reg. 39,546, 39,551 (proposed July 18, 2007) (to be codified at 24 C.F.R. § 905.710(b)(1)). Thus, does that mean that the submission must be mailed from the Executive Director's location as well? Frequently, the submission will come from consultants to the PHA or a procured developer.

Part 990 – The Public Housing Operating Fund Program

1. Requirements and Third Party Documents Needed Prior to Approval

Before a PHA can "obtain HUD approval to borrow private capital and pledge a portion of its annual operating subsidy or other public housing assets as security", the PHA must meet the following requirements:

- (a) "All public housing projects for the PHA must [be] under project-based accounting;"
- (b) the PHA must have submitted "an audited financial statement for each project being financed;"

(c) “HUD may require the PHA to submit a Management Assessment conducted by an independent third party;”

(d) “A PHA must complete a physical needs assessment at the project level, in the form and manner prescribed by HUD, that covers the PHA’s entire public housing portfolio for the term of the financing and takes into consideration the life cycle repair and replacement of major building components. For modernization, the activity to be financed must be identified as a need in the physical needs assessment. Based on the physical needs assessment, the PHA must demonstrate that the capital improvements to be financed cannot be addressed through the Capital Fund program due to the needs and priorities at other projects;”

(e) the PHA must provide “a financial feasibility analysis of each affected project, prepared by an independent party;” and

(f) “The PHA shall provide an opinion . . . from a qualified, independent, third-party financial advisor attesting that the terms and conditions of the proposed financing transaction are reasonable given current market conditions”.

72 Fed. Reg. 39,546, 39,551-53 (proposed July 18, 2007) (to be codified at 24 C.F.R. §§ 990.400(a), 990.405(b,f,h,k,m)). Like the portion of the Proposed Rule addressing Part 905, these requirements add significant expense to a PHA’s financing a new development; the PHA will need to procure these parties, negotiate contracts with them and then pay hefty fees (e.g., our clients have been quoted fees for a fairness opinion between \$1,500 - \$10,000 and for a management assessment of \$7,500).

2. Sufficient Resources to Meet Financing Obligations

The following provision governing sufficient resources is not reasonable:

To be approved for financing activities under the Operating Fund program, the PHA must demonstrate that the project has sufficient resources to meet the financing obligations. Generally, the project being financed must demonstrate debt service coverage of 3.0. Additionally, each project must set aside, in a restricted account, 12 months of debt service payments.

72 Fed. Reg. 39,546, 39,552 (proposed July 18, 2007) (to be codified at 24 C.F.R. § 990.405(j)). The debt service coverage of 3.0 is too high; current deals are in the range of 1 to 1.5. Also, if a PHA successfully demonstrates that the project has sufficient resources to meet the financing obligations, why is a reserve necessary? What funds can be used to fund such reserve?

3. Ten Year Term

A 10 year term, 72 Fed. Reg. 39,546, 39,552 (proposed July 18, 2007) (to be codified at 24 C.F.R. § 990.405(l)(1)), is too short. The terms needs to be at least equal to the tax credit compliance period and fully assumable.

4. Miscellaneous Questions

Some additional questions include:

- (a) Fully Negotiated Documents. It is problematic that the Proposed Rule includes the requirement that “The financing documents are to be submitted to HUD only after they have been negotiated and agreed upon by the other parties to the transaction. HUD will not review preliminary documents that are still under negotiation.” 72 Fed. Reg. 39,546, 39,553 (proposed July 18, 2007) (to be codified at 24 C.F.R. § 990.410(b)(3)). For example, counsel to Florida Housing Finance Corporation in connection with its Predevelopment Loan Program (“PLP”) does not wish to negotiate PLP documents without assurance that HUD will approve of the security interest needed for the transaction. We believe that the Proposed Rule should make this an option at HUD’s discretion.
- (b) Submission by PHA. The sentence “HUD will also return proposals submitted by entities other than the PHA (e.g., the PHA’s consultants)”, 72 Fed. Reg. 39,546, 39,553-54 (proposed July 18, 2007) (to be codified at 24 C.F.R. § 905.415(a)), needs to be clarified. The Executive Director will be preparing the transmittal letter. 72 Fed. Reg. 39,546, 39,553 (proposed July 18, 2007) (to be codified at 24 C.F.R. § 905.410(b)(1)). Thus, does that mean that the submission must be mailed from the Executive Director’s location as well? Frequently, the submission will come from consultants to the PHA or a procured Developer.

5. Performance Measures

The Proposed Rule introduces the concept of performance measures, “The PHA is required to identify in its annual capital plans specific items of work that will be accomplished using the proceeds in the proposed financing proposal. The items, which shall be quantifiable, shall be the basis on which HUD evaluates a PHA’s performance”. 72 Fed. Reg. 39,546, 39,553 (proposed July 18, 2007) (to be codified at 24 C.F.R. § 990.405(q)). The penalties for failure to meet the performance measures are too severe; if something should unexpectedly happen in one transaction such that a performance measure is missed, then the PHA may be blocked from any future financing of development or modernization as the “[f]ailure to meet the performance measures may result in: (1) Failure to receive HUD approval for future financing transactions; (2) Failure to be considered for future competitive grant programs; and (3) Other sanctions HUD deems appropriate and authorized by law or regulation.” Id.

6. Reporting Requirements

Once HUD approval’s is obtained, there is the added quarterly reporting requirement, 72 Fed. Reg. 39,546, 39,553 (proposed July 18, 2007) (to be codified at 24 C.F.R. § 990.405(r)(1)), which may be costly and overly burdensome to a PHA as well. This requirement states that “[t]he PHA shall submit a performance and evaluation report that includes, in addition to information on capital expenses and expenditures, a narrative describing the progress that has been made to date with the improvements associated with the operating fund financing

transaction. At a minimum, the narrative shall discuss the progress of the construction against the schedules, any problems encountered, cost overruns, and any associated claims or litigation. The performance and evaluation report should be submitted to the HUD Field Office on a quarterly basis within 30 days of the end of each quarter, as well as annually in the PHA plan, until a Cost Certification has been accepted by HUD.” The financing institution will bring market discipline and reporting requirements. HUD should limit its requirements to (a) annual reports in the PHA plan and (b) copies of all reports submitted to the financing institution.