McCormack
Baron
Salazar

June 3, 2024

Honorable Brian Schatz
Chair
Committee on Appropriations Subcommittee on Transportation, Housing and Urban Development, and Related Agencies
United State Senate
Committee on Appropriations
Washington DC 20510-6025

Dear Senator Schatz:

My name is Adhi Nagraj, I am the Chief Development Officer at McCormack Baron Salazar (MBS). In this capacity I oversee affordable housing real estate development projects across the country. Based in St. Louis, Missouri, MBS is one of the nation's leading developers, managers and asset managers of economically integrated urban neighborhoods. Since 1973, MBS has been an innovator in community development and urban revitalization in 47 cities, having built more than 22,000 high-quality affordable and mixed-income apartments for families, children, seniors and veterans.

As Congress and the Administration have appropriately prioritized infrastructure investment in the post-pandemic era, it is important to keep affordable housing in that conversation. The U.S. has a shortage of 7.3 million rental homes affordable and available to renters with extremely low incomes, according to the National Low Income Housing Coalition. In fact, no state has an adequate supply of affordable rental housing for the lowest-income renters. Housing insecurity negatively impacts job retention, academic performance, and mental and physical health, including the spread of Covid-19 among essential employees just a few years ago. Housing is infrastructure.

As you may know, housing policy in recent decades has moved away from 100% government supported model that isolated economically vulnerable residents to a more resilient mixed-finance, mixed- income model that brings together public, private and philanthropic interests to strengthen communities and uplift households. Putting the financial pieces together for development and sustaining the community once built is as much art as science. And economic fluctuations add great stress to the model.

Over the past several decades, MBS has worked closely with the U.S. Department of Housing and Urban Development, other federal agencies, Senators and Members of Congress, as well as with state and local partners, to finance our properties and keep rents affordable for our residents. The primary tool that MBS and most other developers use to finance affordable housing is the Low-Income Housing Tax Credit, administered by the Internal Revenue Service. Every individual project that MBS constructs is owned by a separate special purpose entity that

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receives an allocation of credits that it sells to a private investor who secures limited partnership interests in the project. In exchange for receiving the tax credits and other tax benefits, the investor provides the equity needed to construct the building.

In addition to securing equity, MBS and other affordable housing developers often take out private loans from commercial banks to finance construction. As interest rates rise, the amount of debt that any project can leverage goes down, which is why this inflationary market with high interest rates – compounded by increasing construction and labor costs and a soaring property insurance market – has been particularly challenging for the affordable housing industry.

For these reasons we researched with enthusiasm the prospect of utilizing the TIFIA or RRIF loan products – essentially low interest 35-year fully amortizing loans – to help close the gaps of our projects around the country. As a national leader in urban infill development, often at transit locations, MBS felt that our affordable developments and local communities would significantly benefit from this financing tool.

However, our research found that TIFIA didn't pair well with the Low Income Housing Tax Credit program due to incompatible rules at DOT and IRS. Legislative action is needed to effectively pair TIFIA with LIHTC.

Below is a summary of technical challenges with potential solutions:

1. **Ratings of Partnership**

Under TIFIA rules, borrowers need to have an investment-grade rating. However, in the LIHTC industry, developers create special purpose entities that own individual affordable housing projects and have no borrowing history, therefore making them incapable of securing investment-grade credit ratings. Under the RRIF program the rating doesn't have to be any specific grade so this is less of an issue, but RRIF has a much narrower geographic focus and therefore fewer projects qualify. The development community would need a legislative change to this rule in order to use TIFIA funding. One potential solution is to use underwriting metrics from FHA or another HUD office familiar with assessing risk for affordable housing transactions in lieu of securing a specific rating.

2. **Timing**

All funding sources have to be legally binding prior or simultaneously to closing on TIFIA/RRIF loans. The challenge is that many state housing finance agencies require that developers secure written commitments for all funding prior to applying for tax credits. It creates a chicken-and-egg dynamic – we cannot secure a TIFIA loan without securing tax credits, yet we cannot secure tax credits without securing a TIFIA loan. One work around would be for DOT to underwrite specific deals and issue "conditional commitments" to projects that would make closings conditioned upon meeting other obligations, including securing all other financing. That would allow developers to use the TIFIA conditional commitment to secure tax credit and close on all financing simultaneously.

3. **Intercreditor Agreements**

The restrictive RRIF program finances up to 75% of eligible costs, and the TIFIA program finances 49% of eligible project costs. Under RRIF, developers can raise the capital stack 75/25 debt to equity. However, since TIFIA can only provide a loan equal to 49% of project costs, projects often need another lender to help finance the transaction. There's a high likelihood that incorporating a commercial lender into the capital stack will create problems, given the need to negotiate intercreditor agreements between DOT and the subordinate lender, negotiating for example events of default, split of surplus cash, and foreclosure. Additionally, commercial lenders will not be able to meet the DOT maturity terms which means the commercial banks will have a shorter term, and a repayment schedule or residual refinancing risk needs to be negotiated. Refinancing the subordinate loan in the middle of term of the senior DOT lender creates refinancing risk due to interest rate uncertainty.

4. **Year 15 - Resyndications**

At the end of the 15-year tax credit compliance period, owners such as MBS often look to resyndicate properties. During this process, developers secure new tax credits, sell them to a new limited partner, and generate additional tax credit equity needed to pay for the costs to rehabilitate the property and extend the term of affordability. However, the TIFIA rules don't explicitly allow for a refinancing during the 35-year loan term, which would need to be addressed given the frequency and need for properties to be resyndicated after the compliance period ends.

Conclusion

The TIFIA program could be a valuable tool to accelerate the production of affordable housing units across the country. However, the challenges outlined above would need to be addressed before the affordable housing development community could utilize this tool and better incorporate it into the existing array of financing tools, including and especially the Low-Income Housing Tax Credit program.

If you have any questions, please email me at adhi.nagraj@mccormackbaron.com, or call me at 510-289-1502.

Sincerely,

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