



Real Estate Analysis Division

2011 Real Estate Analysis Rules

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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 that ensures the most efficient allocation of resources while promoting and preserving the public interest in ensuring the long-term health of the Department's portfolio. 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 determination of Development feasibility (§2306.0661(f) and §2306.6710(d), Texas Government Code). 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) Definitions.

Terms used in this subchapter that are also defined in Chapter 49 of this title (relating to the 2011 Department's Housing Tax Credit Program Qualified Allocation Plan and Rules, known as the "QAP") have the same meaning as in the QAP. Those terms that are not defined in the QAP or which may have another meaning when used in this subchapter, shall have the meanings set forth in §1.32(b) of this subchapter (relating to Underwriting Rules and Guidelines) and subchapter §1.1 (relating to Definitions for Housing Program Activities).

- (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) **Breakeven Occupancy**--The occupancy level at which rental income plus secondary income is equal to all operating expenses, including replacement reserves and taxes, and mandatory debt service requirements for a Development.
- (4) **Cash Flow**--The funds available from operations after all expenses and debt service required to be paid has been considered.
- (5) **Comparable Unit**--A Unit, when compared to the subject Unit, similar in overall condition, location, 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 Restricted Market 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) **Credit Underwriting Analysis Report**--Sometimes referred to as the "Report." A decision making tool used by the Department and Board containing a synopsis and reconciliation of the application information submitted by the Applicant.
- (8) **Debt Coverage Ratio (DCR)**--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.
- (9) **Effective Gross Income (EGI)**--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) **Eligible Hard Costs**--Hard Costs includable in Eligible Basis for the purposes of determining a Housing Tax Credit Allocation.
- (11) **Environmental Site Assessment (ESA)**--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 §1.35 of this subchapter (relating to Environmental Site Assessment Rules and Guidelines) as it relates to a specific Development.
- (12) **First Lien Lender**--A lender whose lien has first priority.
- (13) **Gross Capture Rate**--The Gross Capture Rate is defined as the Relevant Supply divided by the Gross Demand.
- (14) **Gross Demand**--The sum of Potential Demand from the Primary Market (PMA), demand from other sources, and Potential Demand from a Secondary Market Area (SMA) to the extent that SMA demand does not exceed 25% of Gross Demand.
- (15) **Gross Program Rent**--Sometimes called the "Program Rents." Maximum rent limits based upon the tables promulgated by the Department's division responsible for compliance which are developed by program and by county or Metropolitan Statistical Area ("MSA") or Primary Metropolitan Statistical Area ("PMSA") or national non-metro area.
- (16) **Hard Costs**--The sum total of direct construction costs, site work costs, off-site costs and contingency.
- (17) **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 §1.33 of this subchapter (relating to Market Analysis Rules and Guidelines) as it relates to a specific Development.
- (18) **Market Analyst**--Any person who prepares a market study.

- (19) **Market Rent**--The 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 on properties without rent and income restrictions.
- (20) **Net Operating Income (NOI)**--The income remaining after all operating expenses, including replacement reserves and taxes have been paid.
- (21) **Potential Demand**--The number of income-eligible, age-, size-, and tenure-appropriate target households in the designated market area at the proposed placement in service date.
- (22) **Primary Market**--Sometimes referred to as "Primary Market Area" or "PMA." The area defined by the Qualified Market Analyst as described in §1.33(d)(9) of this subchapter from which a proposed or existing Development is most likely to draw the majority of its prospective tenants or homebuyers.
- (23) **Property Condition Assessment**--Sometimes referred to as "PCA," "Physical Needs Assessment," "Project Capital Needs Assessment," or "Property Condition Report." The PCA provides an evaluation of the physical condition of an existing property to evaluate the immediate cost to rehabilitate and to determine costs of future capital improvements to maintain the property. The PCA must be prepared in accordance with §1.36 of this subchapter (relating to Property Condition Assessment Rules and Guidelines) as it relates to a specific Development.
- (24) **Qualified Market Analyst**--A real estate appraiser certified or licensed by the Texas Appraiser Licensing and Certification Board, a real estate consultant, or other professional currently active in the subject property's market area who demonstrates competency, expertise, and the ability to render a high quality written report. The individual's performance, experience, and educational background will provide the general basis for determining competency as a Market Analyst. Competency will be determined by the Department, in its sole discretion. The Qualified Market Analyst must be a Third Party.
- (25) **Relevant Supply**--The relevant supply of proposed and unstabilized Comparable Units includes:
 - (A) The proposed subject Units;
 - (B) Comparable Units with priority over the subject, based on the Department's evaluation process described in §49.7(g) of this title (relating to Application Process), that have made application to TDHCA and have not been presented to the TDHCA Board for decision; and
 - (C) Comparable Units in previously approved but Unstabilized Developments in the Primary Market Area (PMA); and
 - (D) Comparable Units in previously approved but Unstabilized Developments in the Secondary Market Area (SMA), in the same proportion as the proportion of Potential Demand from the SMA that is included in Gross Demand.
- (26) **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 50% of gross income towards total housing expenses.
- (27) **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.
- (28) **Restricted Market Rent**--The restricted rent concluded by the Qualified Market Analyst for a particular unit type and size after adjustments are made to rents charged by owners of Comparable Units on properties with the same rent and income restrictions.
- (29) **Secondary Market**--Sometimes referred to as "Secondary Market Area." The area defined by the Qualified Market Analyst as described in §1.33(d)(8) of this subchapter.
- (30) **Sub-Market**--An area defined by the Underwriter based on general overall market segmentation promulgated by market data tracking and reporting services from which a proposed or existing Development is most likely to draw the majority of its prospective tenants or homebuyers.

- (31) **Supportive Housing**--Residential rental developments intended for occupancy by individuals or households in need of specialized and specific non-medical services in order to maintain independent living.
- (32) **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, as required and described in Chapter 60, Subchapter A of this title (relating to Compliance Monitoring), and published on the Department's web site.
- (33) **Underwriter**--The author(s) of the Credit Underwriting Analysis Report.
- (34) **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 twelve (12) consecutive months following construction completion.
- (35) **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, a documented estimate from the utility provider proposed in the Application, or for an existing development an allowance calculated by the Department pursuant to §60.109 of this title (relating to Utility Allowances). 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.
- (36) **Work Out Development**--A financially distressed Development seeking a change in the terms of Department funding or program restrictions based upon market changes.

(c) Appeals.

Certain programs contain express appeal options. Where not indicated, §1.7 of this chapter (relating to Staff Appeals Process) and §1.8 of this chapter (relating to Board Appeals Process) include general appeal procedures. In addition, the Department encourages the use of Alternative Dispute Resolution (ADR) methods, as outlined in §1.17 of this chapter.

§1.32. Underwriting Rules and Guidelines.

(a) General Provisions.

The Department Governing Board has authorized the development of these rules under its authority under §2306.148, Texas Government Code. The rules provide a mechanism to produce consistent information in the form of a Credit Underwriting Analysis Report to provide interested parties information the Board relies upon in balancing the desire to assist as many Texans as possible by providing no more financing than necessary and have independent verification that Developments are economically feasible. The Report should consider all information timely provided by the Applicant. The Report generated 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. The Report will be based solely upon information that is provided in accordance with the time frames provided in the current Qualified Allocation Plan (QAP), Program Rules, or Notice of Funds Availability as appropriate. The Report should also identify the number of revisions and date of most current revision to any information deemed to be relevant by the Underwriter.

(c) Recommendations in the Report.

The conclusion of the Report includes a recommended award of funds or allocation of Housing 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) - (3) of this subsection, and states any feasibility conditions to be placed on the award.

- (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 subtracting operating expenses, including replacement reserves and taxes, from EGI 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, which could result in a re-characterization of the Development as feasible based upon specific conditions set forth in the Report.

- (1) **Income.** In determining the Year 1 proforma, 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 Underwriter will update the utility allowance and calculate the appropriate rent on a conservative or Contract Rent basis for comparison to the Applicant's estimate in the Application. To determine the conservative basis, the Underwriter may consider the current rent roll of the subject Development and/or documentation of rents for Comparable Units; this shall be referred to as the "Underwriter's independently verified rents." The conservative basis for a restricted unit is the lesser of the Gross Program Rent less Utility Allowances ("Net Program Rent") or Restricted Market Rent or the Underwriter's independently verified rents. The conservative basis for an unrestricted unit is the lesser of the Market Rent, or Applicant's projected rent where the Applicant's projected rent is reasonable to the Underwriter as supported by documentation of Comparable Units, or the Underwriter's independently verified rents. Where Contract Rents are included, they will be used regardless of the conservative basis derived rent.
- (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 Analysts 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 (relating to Market Analysis Rules and Guidelines).
 - (ii) **Restricted Market Rent.** The Underwriter reviews the attribute adjustment matrix of Comparable Units by unit size and income and rent restrictions 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 Restricted Market Rent by unit, as long as the proposed Restricted Market Rent is reasonably justified and does not exceed the highest existing unadjusted market comparable restricted rent. Random checks of the validity of the Restricted Market Rents may include direct contact with the comparable properties. The Market Analysts 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.
 - (iii) **Gross Program Rents less Utility Allowance or Net Program Rents.** 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 Gross 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. Gross Program Rents are reduced by the Utility Allowance. If Program Rents are adjusted by the Department after the close of the Application Acceptance Period but prior to publication of the Report, the Underwriter will adjust the Applicant's EGI to account for any increase or decrease in Program Rents for the purposes of determining the reasonableness of the Applicant's EGI.

- (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.
- (iv) **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's 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 \$20 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 within the PMA or SMA.
 - (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 an additional fee is charged for the use of an amenity, any cost associated with the construction, acquisition, or development of the hard assets needed to produce the additional fee for such amenity must be reduced from Eligible Basis for Tax Credit Developments.
- (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.** In determining the Year 1 proforma, 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 properties in the same location or region as the proposed Development also provides heavily relied upon data points; the Department's database summary is available on the TDHCA website. 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. Estimates of utility savings from green building components, including on-site renewable energy, must be documented by experience of third parties not related to the contractor or component vendor. 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 fully executed 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 and 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 \$250 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. The Applicant's expense for reserves may be adjusted by the Underwriter if the amount provided by the Applicant is insufficient to fund capital needs as documented by the PCA during the first 15 years of the long term proforma. 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) - (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 a rationale acceptable to the Underwriter 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 Year 1 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 Year 1 NOI figure provided by the Applicant is within 5% of the Year 1 NOI figure calculated by the Underwriter, the Applicant's figure is characterized as reasonable in the Report; however, for purposes of calculating the Year 1 DCR the Underwriter will maintain and use his independent calculation of NOI unless the Applicant's Year 1 EGI, Year 1 total expenses, and Year 1 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. 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. The Underwriter may challenge the interest rate based on data collected on similarly structured transactions.
 - (B) **Amortization Period.** The Department requires an amortization of not less than thirty (30) years and not more than forty (40) years (fifty (50) years for federally sourced loans), 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 thirty (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 acceptable Year 1 DCR range for all priority or foreclosable lien financing plus the Department's proposed financing falls between a minimum of 1.15 to a maximum of 1.35. HOPE VI and USDA Rural Development transactions may underwrite to a DCR less than 1.15 or greater than 1.35 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) - (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 may be based 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) - (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 Proforma.** The Underwriter will create a 30-year operating proforma.
- (A) The base year projection utilized is the Underwriter's Year 1 EGI, Year 1 operating expenses, and Year 1 NOI unless the Applicant's Year 1 EGI, Year 1 total operating expenses, and Year 1 NOI are each within 5% of the Underwriter's estimates.
 - (B) A 2% annual growth factor is utilized for income and a 3% annual growth factor is utilized for expenses.
 - (C) Adjustments may be made to the Long Term Proforma if sufficient support documentation is provided by the Applicant. Support may include:
 - (i) Documentation with terms for project-based rental assistance or operating subsidy;
 - (ii) A fully executed management contract with clear terms;

- (iii) Documentation prepared and signed by the Central Appraisal District (CAD) with jurisdiction over the Development indicating the appraisal methodology consistently employed by the CAD and a ten-year history, beginning with the Application year, of tax rates for each taxing district with jurisdiction over the Development; and
- (iv) Required reserve for replacement schedule prepared and signed by the proposed permanent lender or equity provider. In no instance will the reserve for replacement figure included in the Long Term Proforma be less than the minimum requirements as described in §1.37 of this subchapter (relating to Reserve for Replacement Rules and Guidelines).

(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. The Department's estimate of the total development cost for acquisition/rehabilitation will be based in accordance with the PCA's estimated cost for the scope of work as defined by the Applicant and §1.36(a)(5) of this subchapter (relating to Property Condition Assessment Guidelines). 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 remainder acreage is not being utilized as permanent green space, the value ascribed to the proposed Development will be prorated based on acreage from the total cost reflected in the site control document(s). An appraisal containing segregated values for the total acreage, the acreage for the subject site and the remainder acreage, or tax assessment value may be tools that are used by the Underwriter in making a proration determination based on relative value; 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 or permanent lender:
 - (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 thirty-six (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 subclauses (I) and (II) of this clause.

- (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; and
- (II) If the original acquisition cost evidenced by subclause (I) of this clause is less than the acquisition cost claimed in the application:
 - (-a-) an appraisal that meets the requirements of §1.34 of this subchapter (relating to Appraisal Rules and Guidelines); and
 - (-b-) any other verifiable costs of owning, holding, or improving the Property, excluding seller financing, that when added to the value from subclause (I) of this clause justifies the Applicant's proposed acquisition amount.
 - (-1-) For land-only transactions, documentation of owning, holding or improving costs since the original acquisition date may include Property taxes, interest expense, capitalized costs of any physical improvements made to the Property that benefit the proposed Development, the cost of rezoning, replatting, and any off-site costs to provide utilities or improve access to the Property that benefit the proposed Development. Additionally, an annual return of 10% may be applied to the original acquisition cost and documented holding and improvement costs; this return can be applied from the date the applicable cost is incurred until the date of the Department's Board meeting at which the subject Development's award will be considered.
 - (-2-) For transactions which include existing buildings that will be rehabilitated or otherwise maintained as part of the Development, documentation of owning, holding, or improving costs since the original acquisition date may include capitalized costs of improvements to the Property, and the cost of exit taxes not to exceed an amount necessary to allow the sellers to be made whole in the original and subsequent investment in the Property and avoid foreclosure. Additionally, an annual return of 10% may be applied to the original acquisition cost and documented holding and improvement costs; this return can be applied from the date the applicable cost was incurred until the date of the Department's Board meeting at which the subject Development's award will be considered. For any period of time during which the existing buildings are occupied or otherwise producing revenue, holding costs may not include operating expenses, including, but not limited to, property taxes and interest expense.

- (iii) In no instance will the acquisition cost utilized by the Underwriter exceed the lesser of the original acquisition cost evidenced by clause (ii)(I) of this subparagraph plus costs identified in clause (ii)(II)(-b-) of this subparagraph, or the "as-is" value conclusion evidenced by clause (ii)(II)(-a-) of this subparagraph. The resulting acquisition cost will be referred to as the "identity of interest adjusted acquisition cost."
- (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 building acquisition value utilized by the Underwriter will be equal to the least of the following:
- (i) The Applicant's claimed building acquisition value;
 - (ii) The building acquisition value that results from the proration of the actual acquisition cost or identity of interest adjusted acquisition cost based upon a calculated "as-is" improvement value over the total "as-is" value provided in the appraisal; or
 - (iii) The actual acquisition cost or identity of interest adjusted acquisition cost less the land value in the appraisal.
- (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. If off-site costs are included in eligible basis based on PLR 200916007, a statement of findings from a CPA must also be provided which describes the facts relevant to the Development and affirmatively certifies that the fact pattern of the development matches the fact pattern in PLR 200916007. A certification from a Third Party engineer must also be provided that describes the circumstances of the necessity of the off-site improvement, including the relevant requirements of the local jurisdiction with authority over building codes.
- (3) **Site Work Costs.** Project site work costs exceeding \$9,000 per Unit, exclusive of ineligible demolition costs, 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 §49.8(7)(C) of this title (relating to Threshold Criteria) 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 or equivalent other comparable published third-party cost estimating data source 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 or equivalent other comparable published third-party data source, 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 or specifications not included in the Average Quality standard, the Department will take into account these costs.

- (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; or
 - (III) other Developments by the same Applicant that are similar in design to the subject Development.
 - (B) **Rehabilitation including Reconstruction 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 and/or the Applicant's scope of work, the Underwriter may request a supplement executed by the PCA provider reconciling 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) **Contingency.** All contingencies identified in the Applicant's project cost schedule including any soft cost contingency will be added to Contingency with the total limited to the guidelines detailed in this paragraph. Contingency is limited to a maximum of 7% of direct construction costs plus site work for new construction Developments and 10% of direct construction costs plus site work for rehabilitation Developments. For Housing 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 7% or 10%, as applicable.
- (6) **Contractor Fee.** Contractor fees are limited to a total of 14% on Developments with Hard Costs of \$3 million or greater, the lesser of \$420,000 or 16% on Developments with Hard Costs less than \$3 million and greater than \$2 million, and the lesser of \$320,000 or 18% on Developments with Hard Costs at \$2 million or less. For tax credit Developments, the percentages are applied to the sum of the Eligible Hard Costs in calculating the eligible contractor fees. 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. Additional fees for ineligible costs will be limited to the same percentage of ineligible construction costs but will be ineligible for tax credit basis purposes.
- (7) **Developer Fee.** Developer fee claimed must be multiplied by the appropriate applicable percentage depending whether it is attributable to acquisition or rehabilitation basis. Additional fees for ineligible costs will be limited to the same percentage of ineligible development costs (15% for Developments with 50 or more units, or 20% for Developments with 49 or fewer units) but will be ineligible for tax credit basis purposes. All fees to related parties to the owner or developer for work determined by the Underwriter to be typically completed by the developer will be considered part of the Developer fee claimed.
 - (A) 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 for Developments proposing 50 units or more and 20% of the project's Total Eligible Basis less developer fees for Developments proposing 49 units or less, as defined in the Qualified Allocation Plan and Rules (QAP).

- (B) In the case of a transaction requesting acquisition Tax Credits:
 - (i) the allocation of eligible developer fee in calculating rehabilitation/new construction Tax Credits will not exceed 15% of the rehabilitation/new construction basis less developer fees for Developments proposing 50 units or more and 20% of the rehabilitation/new construction basis less developer fees for Developments proposing 49 units or less; and
 - (ii) no developer fee attributable to an identity of interest acquisition of the Development will be included in Eligible Basis.
- (C) For non-Tax Credit Developments, the percentage can be up to 15% 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 paragraph (8) of this subsection, reserves, and any other identity of interest acquisition cost.
- (8) **Financing Costs.** Eligible construction period interest is limited to the lesser of actual eligible construction period interest, or the interest on one (1) year's fully drawn construction period loan funds at the construction period 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 included in Eligible Basis.
- (9) **Reserves.** The Department will utilize the amount described in the Applicant's project cost schedule if it is within the range of two (2) to six (6) months of stabilized operating expenses less management fees and reserve for replacements plus debt service. Alternatively, the Underwriter may consider a greater amount proposed by the conventional lender or syndicator if the detail for such greater amount is well documented in the conventional lender or syndicator commitment letter.
- (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 Department will review personal credit reports for development sponsors, developer fee recipients and those individuals anticipated to guarantee the completion of the Development. The Underwriter will evaluate the credit report and identify any bankruptcy, state or federal tax liens or other relevant credit risks for compliance with eligibility and debarment requirements in the QAP and statute.

(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) 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.
- (3) **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, management fee, 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 15-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; and/or
 - (D) **Development Costs.** For Supportive Housing that is styled as efficiencies, the Underwriter may use "Average Quality" dormitory costs, or costs of other appropriate design styles 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.

(i) **Feasibility Conclusion.**

An infeasible Development will not be recommended for funding or allocation unless the Underwriter can determine a plausible alternative feasible financing structure and conditions the recommendations of the report upon receipt of documentation supporting the alternative feasible financing structure. A Development will be characterized as infeasible if paragraph (1) or (2) of this subsection applies. The Development will be characterized as infeasible if one or more of paragraphs (3) and (4) of this subsection applies unless paragraph (6)(B) of this subsection also applies.

- (1) **Gross Capture Rate.** The method for determining the Gross Capture Rate for a Development is defined in §1.33(d)(11)(F) of this subchapter. The Underwriter will independently verify all components and conclusions of the Gross Capture Rate and may at their discretion use independently acquired demographic data to calculate demand and may make a determination of the effective Gross Capture Rate based upon an analysis of the Sub-market. The Development:
 - (A) is characterized as a Qualified Elderly Development (including the Elderly section of an Intergenerational Development) and the Gross Capture Rate exceeds 10% for the total proposed units; or
 - (B) is in an Urban Area and targets the general population, and the Gross Capture Rate exceeds 10% for the total proposed units; or
 - (C) is in a Rural Area and targets the general population, and the Gross Capture Rate exceeds 30%; or
 - (D) targets Persons with Special Needs and the Gross Capture rate exceeds 30%.
 - (E) Developments meeting the requirements of subparagraph (A), (B), (C), or (D) of this paragraph may avoid being characterized as infeasible if clause (i) or (ii) of this subparagraph apply.
 - (i) Replacement Housing. The proposed Development is comprised of Affordable Housing which replaces previously existing Affordable Housing within the Primary Market Area as defined in §1.33 of this subchapter on a Unit for Unit basis, and gives the displaced tenants of the previously existing Affordable Housing a leasing preference.
 - (ii) Existing Housing. The proposed Development is comprised of existing Affordable Housing which is at least 50% occupied and gives displaced existing tenants a leasing preference as stated in the submitted relocation plan.
- (2) **Deferred Developer Fee.** Developments requesting an allocation of tax credits cannot repay the estimated deferred developer fee, based on the Underwriter's recommended financing structure, from cashflow within the first fifteen (15) years of the long term proforma as described in subsection (d)(5) of this section.
- (3) **Restricted Market Rent.** The Restricted Market Rent for units with rents restricted at 60% of AMGI is less than both the Net Program Rent and Market Rent for units with rents restricted at or below 50% of AMGI unless the Applicant accepts all Underwriting recommendation that all restricted units have rents and incomes restricted at or below the 50% of AMGI level.
- (4) **Initial Feasibility.** The Year 1 annual total operating expense divided by the Year 1 Effective Gross Income is greater than 68% for rural developments 36 units or less and 65% for all other developments.
- (5) **Long Term Feasibility.** Any year in the first fifteen (15) years of the Long Term Proforma, as defined in subsection (d)(5) of this section, reflects:
 - (A) negative Cash Flow; or
 - (B) a Debt Coverage Ratio below 1.15.

- (6) **Exceptions.** The infeasibility conclusions may be excepted where either of the following apply.
- (A) The requirements in this subsection may be waived by the Executive Director of the Department on appeal if documentation is submitted by the Applicant to support unique circumstances that would provide mitigation.
 - (B) Developments meeting the requirements of one or more of paragraphs (3) - (5) of this subsection will be re-characterized as feasible if one or more of clauses (i) - (vi) of this subparagraph apply.
 - (i) The Development will receive Project-based Section 8 Rental Assistance for at least 50% of the units and a firm commitment with terms including contract rent and number of units is submitted at application.
 - (ii) The Development will receive rental assistance for at least 50% of the units in association with USDA-RD-RHS financing.
 - (iii) The Development will be characterized as public housing as defined by HUD for at least 50% of the units.
 - (iv) The Development will be characterized as Supportive Housing for at least 50% of the units and evidence of adequate financial support for the long term viability of the Development is provided.
 - (v) The Development has other long term project based restrictions on rents for at least 50% of the units that allow rents to increase based upon expenses and the Applicant's proposed rents are at least 10% lower than both the Net Program Rent and Restricted Market Rent.
 - (vi) The units not receiving Project-based Section 8 Rental Assistance or rental assistance in association with USDA-RD-RHS financing, or not characterized as public housing do not propose rents that are less than the Project-based Section 8, USDA-RD-RHS financing, or public housing units.

§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. The Market Analysis must include a statement that the report preparer has read and understood the requirements of this section.

(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) - (3) of this subsection.

- (1) If not listed as approved by the Department, Market Analysts must submit subparagraphs (A) - (F) of this paragraph at least thirty (30) 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) - (C) of this paragraph must be submitted annually on the first Monday in February for review by the Department.
 - (A) Documentation of good standing from the Texas Comptroller of Public Accounts.
 - (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 ninety (90) 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 seventy-two (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) - (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. Include a statement that the report preparer has read and understood the requirements of this section.
- (3) **Table of Contents.** Number the exhibits included with the report for easy reference.
- (4) **Summary Sheet.** Include the Department's Market Analysis Summary exhibit.
- (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 (3) 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 this paragraph, must be contained within the Secondary Market boundaries. The Market Analyst must adhere to the methodology described in this paragraph when determining the secondary market area. (§2306.67055)
 - (A) The Secondary Market Area will be defined by the Market Analyst with:
 - (i) size based on a base year population of no more than 250,000 people inclusive of the Primary Market Area; and
 - (ii) boundaries based on U.S. census tracts, ZIP codes, or place, as defined by the U.S. Census Bureau.
 - (B) The Market Analyst's definition of the Secondary Market Area must include:
 - (i) a detailed description of why the subject Development is expected to draw a significant number of tenants or homebuyers from the defined SMA;
 - (ii) a complete demographic report for the defined SMA; and
 - (iii) a scaled distance map indicating the SMA boundaries as well as the location of the subject Development and all comparable Developments.
- (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 100,000 people;
 - (ii) boundaries based on U.S. census tracts, zip codes, or place, as defined by the U.S. Census Bureau; and

- (iii) the population of the PMA may exceed 100,000 if the amount over the limit is contained within a single census tract or zip code, and if the PMA is defined by census tract or zip code.
 - (B) The Market Analyst's definition of the Primary Market Area must include:
 - (i) a detailed description of why the subject Development is expected to draw a majority of its prospective tenants or homebuyers from the defined PMA;
 - (ii) a complete demographic report for the defined PMA; and
 - (iii) a scaled distance map indicating the PMA boundaries as well as the location of the subject Development and all comparable Developments.
 - (C) **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
 - (I) monthly rent and utility allowance; or
 - (II) 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;
 - (I) occupancy; and
 - (II) turnover.
- (10) **Market Information:**
 - (A) For each of the defined market areas, identify the number of units for each of the categories in clauses (i) - (vi) of this subparagraph; the data must be clearly labeled as relating to either the PMA or the SMA, if applicable:
 - (i) total housing;
 - (ii) rental developments (all multi-family);
 - (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) of this subchapter relating to Underwriting Rules and Guidelines). 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) **Demographic Reports.**
- (i) All demographic reports must include population and household data for a five (5) year period with the year of application as the base year;
 - (ii) All demographic reports must provide sufficient data to enable calculation of income-eligible, age-, size-, and tenure-appropriate household populations; and
 - (iii) For Developments targeting seniors, all demographic reports must provide a detailed breakdown of households by age and by income.
- (E) **Demand.** Provide a comprehensive evaluation of the need for the proposed housing for the Development as a whole and each Unit type by number of Bedrooms proposed and rent restriction category within the defined market areas using the most current census and demographic data available.
- (i) **Demographics.** The Market Analyst should use demographic data specific to the characteristics of the households that will be living in the proposed Development. For example, the Market Analyst should use demographic data specific to elderly population for an elderly Development, if available, and should avoid making adjustments from more general demographic data. If adjustment rates are used based on more general data for any of the following they should be clearly identified and documented as to their source in the report.
 - (I) **Population.** Provide population and household figures, supported by actual demographics, for a five (5) 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.
 - (III) **Household Size-Appropriate.** Adjust the household projections or target household projections, as applicable, for the appropriate household size for the proposed Unit type by number of Bedrooms proposed and rent restriction category based on 1.5 persons per Bedroom (round up).
 - (IV) **Income Eligible.** Adjust the household size appropriate projections for income eligibility based on the income bands for the proposed Unit type by number of Bedrooms proposed and rent restriction category 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 50% 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) or one person for efficiency units.
 - (V) **Tenure-Appropriate.** Adjust the income-eligible household projections for tenure (renter or owner). If tenure appropriate income eligible target household data is available, a tenure appropriate adjustment is not necessary.
 - (ii) **Gross Demand.** Gross Demand is defined as the sum of Potential Demand from the PMA, Demand from Other Sources, and Potential Demand from a Secondary Market Area (SMA) to the extent that SMA demand does not exceed 25% of Gross Demand.

- (iii) **Potential Demand.** Potential Demand is defined as the number of income-eligible, age-, size-, and tenure-appropriate target households in the designated market area at the proposed placed in service date.
 - (I) Maximum eligible income is equal to the applicable gross median income limit for the largest appropriate household size based on 1.5 persons per Bedroom (round up) or one person for efficiency units.
 - (II) For Developments targeting the general population:
 - (-a-) Minimum eligible income is based on a 35% rent to income ratio;
 - (-b-) Appropriate household size is defined as 1.5 persons per Bedroom (rounded up); and
 - (-c-) The tenure-appropriate population for a rental Development is limited to the population of renter households.
 - (III) For Developments consisting solely of single family residences on separate lots with all units having three (3) or more bedrooms:
 - (-a-) Minimum eligible income is based on a 35% rent to income ratio;
 - (-b-) Appropriate household size is defined as 1.5 persons per bedroom (rounded up); and
 - (-c-) Gross Demand includes both renter and owner households.
 - (IV) For Developments targeting the senior population:
 - (-a-) Minimum eligible income is based on a 50% rent to income ratio; and
 - (-b-) Gross Demand includes all household sizes and both renter and owner households.
- (iv) **Demand from Secondary Market Area:**
 - (I) Potential Demand from an SMA should be calculated in the same way as Potential Demand from the PMA;
 - (II) Potential Demand from an SMA may be included in Gross Demand to the extent that SMA demand does not exceed 25% of Gross Demand; and
 - (III) The supply of proposed and unstabilized comparable units in the SMA must be included in the calculation of the capture rate at the same proportion that Potential Demand from the SMA is included in Gross Demand.
- (v) **Demand from Other Sources:**
 - (I) The source of additional demand and the methodology used to calculate the additional demand must be clearly stated;
 - (II) Consideration of Demand from Other Sources is at the discretion of the Underwriter;
 - (III) Demand from Other Sources must be limited to households that are not included in Potential Demand; and
 - (IV) If households with Section 8 vouchers are identified as a source of demand, the Market Study must include:
 - (-a-) Documentation of the number of vouchers administered by the local Housing Authority; and
 - (-b-) A complete demographic report for the area in which the vouchers are distributed.
- (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) - (I) 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 Restricted Market Rent conclusion for each proposed Unit type by number of Bedrooms and rent restriction category. Conclusions of Market Rent or Restricted Market Rent below the maximum Net Program Rent limit must be well documented as the conclusions may impact the feasibility of the Development under §1.32(i) of this subchapter. Rent Adjustments. In support of the Market Rent and Restricted Market Rent conclusions, provide a separate attribute adjustment matrix for each proposed unit type by number of Bedrooms 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% indicate the Units are not comparable for the purposes of determining Market Rent and Restricted Market Rent conclusions.
- (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:**
 - (i) State the Gross Demand for each Unit type by number of Bedrooms proposed and rent restriction category (e.g. one-Bedroom units restricted at 50% of AMFI; two-Bedroom units restricted at 60% of AMFI); and
 - (ii) State the Gross Demand for the proposed Development as a whole. If some households are eligible for more than one unit due to overlapping eligible ranges for income or household size, Gross Demand should be adjusted to avoid including households more than once.
- (E) **Relevant Supply.** The relevant supply of proposed and unstabilized comparable units includes:
 - (i) The proposed subject Units;
 - (ii) Comparable Units with priority over the subject that have made application to TDHCA and have not been presented to the TDHCA Board for decision;
 - (iii) Comparable Units in previously approved but Unstabilized Developments in the PMA; and
 - (iv) Comparable Units in previously approved but Unstabilized Developments in the SMA, in the same proportion as the proportion of Potential Demand from the SMA that is included in Gross Demand.
- (F) **Gross Capture Rate.** The Gross Capture Rate is defined as the Relevant Supply divided by the Gross Demand. The Market Analyst must calculate a Gross Capture Rate for the subject Development as a whole, as well as for each Unit type by number of Bedrooms and rent restriction categories, and market rate Units, if applicable. Refer to §1.32(i) of this subchapter for feasibility criteria.
- (G) A complete demand and capture rate analysis is required in every Market Study, regardless of the current occupancy level of an existing Development.
- (H) **Absorption.** Project an absorption period for the subject Development to achieve Breakeven Occupancy. State the absorption rate.
- (I) **Market Impact.** Provide an assessment of the impact the subject Development, as completed, will have on existing Developments supported by Housing Tax Credits 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) In the event that the PMA for a subject Development overlaps the PMA's of other proposed or unstabilized comparable Developments, the Underwriter may perform an extended Sub-Market analysis considering the combined PMA's and all proposed and unstabilized units in the extended Sub-Market Area; the Gross Capture Rate from such an extended Sub-Market Area analysis may be used as the basis for a feasibility conclusion.
- (g) 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 Provision.

An appraisal 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. The appraisal must include a statement that the report preparer has read and understood the requirements of this section.

(b) Self-Contained.

An appraisal prepared for the Department 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.

(c) Appraiser Qualifications.

The qualifications of each appraiser are determined 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. At minimum, a qualified appraiser must be appropriately certified or licensed by the Texas Appraiser Licensing and Certification Board.

(d) Appraisal Contents.

An appraisal prepared for the Department must be organized in a format that follows a logical progression. In addition to the contents described in USPAP Standards Rule 2, the appraisal must include items addressed in paragraphs (1) - (12) of this subsection.

- (1) **Title Page.** Include a statement identifying the Department as the client, acknowledging that the Department is granted full authority to rely on the findings of the report, and name and address of person authorizing report.
- (2) **Letter of Transmittal.** Include 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, tax assessor's parcel number(s) of the site, estimate of marketing period, and signatures of all appraisers authorized to work on the assignment including the appraiser who inspected the property. Include a statement indicating the report preparer has read and understood the requirements of this section.
- (3) **Table of Contents.** Number the exhibits included with the report for easy reference.
- (4) **Disclosure of Competency.** Include appraiser's qualifications, detailing education and experience.
- (5) **Statement of Ownership of the Subject Property.** Discuss all prior sales of the subject property which occurred within the past three (3) years. Any pending agreements of sale, options to buy, or listing of the subject property must be disclosed in the appraisal report.
- (6) **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.
- (7) **Site/Improvement Description.** Discuss the site characteristics including subparagraphs (A) - (E) 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, energy efficiency measures, etc. All applicable forms of depreciation should be addressed along with the remaining economic life.
 - (E) **Environmental Hazards.** It is recognized appraisers are not experts 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.
- (8) **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 (7)(A) - (E) 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 (legally permissible, physically possible, feasible, and maximally productive) must be considered.
- (9) **Appraisal Process.** It is mandatory that all three approaches, Cost Approach, Sales Comparison Approach and Income Approach, are considered in valuing the property. If an approach is not applicable to a particular property an adequate explanation must be provided. A land value estimate must be provided if the cost approach is not applicable.
- (A) **Cost Approach.** This approach should give a clear and concise estimate of the cost to construct the subject improvements. The 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.
 - (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 (3) 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) - (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 a description of 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) Sales information should include address, legal description, tax assessor's parcel number(s), sales price, financing considerations and adjustment for cash equivalency, date of sale, recordation of the instrument, parties to the transaction, three (3) 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) The method(s) used in the Sales Comparison Approach 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 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.
 - (II) Net Operating Income/Unit of Comparison. The net operating income statistics or the comparables must be calculated in the same manner. 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 must 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 comparables must be confirmed with the landlord, tenant or agent and individual data sheets must be included. 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 comparables 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. Include historical data regarding the subject's assessment and tax rates and a statement as to whether or not any delinquent taxes exist.
 - (v) **Capitalization.** The appraiser should present the capitalization 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.
- (10) **Value Estimates.** Reconciliation final value estimate is required.
- (A) All appraisals shall contain a separate estimate of the "as vacant" market value of the underlying land, based upon current sales comparables. The appraiser should consider the fee simple or leased fee interest as appropriate.
 - (B) 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.
 - (C) 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. The appraiser should consider the fee simple or leased fee interest as appropriate.
 - (D) If required the appraiser must include a separate assessment of personal property, furniture, fixtures, and equipment (FF&E) and/or intangible items. 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.
- (11) **Marketing Time.** 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.
- (12) **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.

(e) **Additional Appraisal Concerns.**

The appraiser(s) must be aware of Department program rules and guidelines and the appraisal must include analysis of any impact to the subject's value.

§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: E1527-05). 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. The ESA report must contain a statement indicating the report preparer has read and understood the requirements of this section.

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

- (1) State if a noise study is recommended for a property in accordance with current HUD guidelines 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) If the subject site includes any improvements or debris from pre-existing improvements, 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;
- (5) If the subject site includes any improvements or debris from pre-existing improvements, state if testing for Lead Based Paint would be required pursuant to local, state, and federal laws, or recommended due to any other consideration;
- (6) 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 such as the age of pipes and solder in existing improvements; and
- (7) 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 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.
- (e) Those Developments which have or are to receive first lien financing from HUD may submit HUD's environmental assessment report, provided that it conforms to the requirements of this subsection.

§1.36. Property Condition Assessment Guidelines.

(a) General Provisions.

The objective of the Property Condition Assessment is to provide cost estimates for repairs and replacements, and new construction of additional buildings or amenities, which are: immediately necessary repairs and replacements; improvements proposed by the Applicant as outlined in a scope of work narrative submitted by the Applicant to the PCA provider that is consistent with the scope of work provided in the Application; and expected to be required throughout the term of the regulatory period and not less than thirty (30) years. For Developments proposing reconstruction, the PCA must only address costs to rehabilitate the existing buildings. 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 report must contain a statement indicating the report preparer has read and understood the requirements of this section. The PCA must include the Department's PCA Cost Schedule Supplement which details all rehabilitation costs and projected repairs and replacements through at least fifteen (15) years. The PCA must also 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) **Statement of Acknowledgement.** The PCA provider must affirm in the report that the Applicant's scope of work for improvements and the immediate needs of the rehabilitation are considered and reconciled within the PCA report and the PCA Cost Schedule Supplement; and
- (5) **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 and scope of work 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 (1) 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 of 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 and no less than fifteen (15) years. 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 report must contain a statement indicating the report preparer has read and understood the requirements of this section. The PCA should be signed and dated by the report provider not more than six (6) 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 Texas Government Code. 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 Texas Government Code.

- (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 thirty (30) days of any receipt or determination thereof; and
 - (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 Texas Government Code 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 Texas Government Code 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 thirty (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) - (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 (1) to five (5) years old; and
 - (B) Not less than \$200 per unit per year for units six (6) 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 thirty (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.