LIHTC Rental Underwriting Guidelines
Second Draft

Office of Multifamily Housing | November 15, 2023

Seeking to provide input?

OHFA will be accepting comments on these draft guidelines beginning Wednesday, November 15, 2023 at 12:00 p.m. Eastern Standard Time (EST) through Tuesday, December 5, 2023 at 5:00 p.m. EST. Comments may be submitted via e-mail to QAP@ohiohome.org.
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A. LIHTC Rental Underwriting Introduction

Purpose

The Ohio Housing Finance Agency’s (OHFA’s) Office of Multifamily Housing assists in the creation of affordable rental housing in Ohio through the administration of the federal Low-Income Housing Tax Credit (LIHTC) program. These underwriting guidelines were developed to meet the federal LIHTC statutory underwriting requirements as set forth in 26 U.S.C. §42(m)(2) and regulatory underwriting requirements referenced in 26 C.F.R. §1.42-17(a)(3)-(4) while implementing industry standards to ensure financially-feasible LIHTC rental properties over the 30-year extended use period. If coupling LIHTC with other federal and state gap financing resources such as HOME Investment Partnerships Program (HOME), National Housing Trust Fund (NHTF), and/or Ohio Housing Trust Fund (OHTF) resources, these standards must be overlayed with the applicable programmatic guidelines.

Applicability

OHFA will perform financial underwriting analysis on all LIHTC affordable rental housing applications to ensure compliance with federal LIHTC requirements. The Agency may request further clarification, justification, or documentation for any questions that are identified during the underwriting analysis. At its discretion, OHFA may reduce, alter, or remove items that do not meet the underwriting standards contained in these Guidelines.

These Guidelines will apply to any LIHTC application submitted on or after January 1, 2024. The Guidelines may be subject to change, pending developments in federal and/or state legislative requirements and/or OHFA policy.

Underwriting Process

9% LIHTC Underwriting Process

All developments applying for 9% LIHTCs, with or without OHFA gap financing, must undergo underwriting reviews at the following three stages in accordance with 26 U.S.C. §42(m)(2)(C), 26 C.F.R. §1.42-17(a)(4)(i):

1. At Proposal Application submission to determine if they are eligible for competitive review;
2. At Final Application prior to issuing a Carryover Allocation Agreement; and
3. At the time the development is placed-in-service and requests Internal Revenue Service (IRS) Form(s) 8609.

Such developments must also meet all requirements outlined in the most recently-published 9% LIHTC Qualified Allocation Plan (QAP). All terms capitalized in this section and not otherwise defined will have the same meaning as that defined in the most recently-published 9% LIHTC QAP.
4% LIHTC Underwriting Process

All developments applying for 4% LIHTCs, with or without OHFA gap financing, must undergo underwriting reviews at the following stages in accordance with 26 U.S.C. §42(m)(2)(C) and 26 C.F.R. §1.42-17(a)(4)(i):

1. At Final Application prior to issuing a 42(m) Letter of Eligibility for LIHTCs; and
2. At the time the development is placed-in-service and requests Internal Revenue Service (IRS) Form(s) 8609.

Such developments must also meet all requirements outlined in the most recently-published 4% LIHTC QAP. All terms capitalized in this section and not otherwise defined will have the same meaning as that defined in the most recently-published 4% LIHTC QAP.

B. Underwriting Standards

Analysis of Project Income

Annual Income Escalation Assumption

OHFA will assume a 2% annual residential income increase to demonstrate compliance with Debt Service Coverage Ratio (DSCR), income-to-expense ratio, and deferred developer fee repayment standards.

Rental Income Analysis

OHFA will compare the achievable LIHTC rents, maximum LIHTC rents, and comparable market rents from a market study meeting the Market Study Standards to conclude reasonable rental income. Tenant-paid gross rents must be set at the lower of the maximum allowable LIHTC Rents or the achievable LIHTC rents as indicated in the Market Study.

Project-Based Rental Subsidy

For developments with project-based rental subsidy, the budgeted rents in the AHFA must match the rental subsidy documentation included in the application submission. Rental subsidy documentation must meet the requirements stated in the applicable QAP and/or program guidelines under “Rental Subsidy Contracts”. The entity must provide documentation providing the rental subsidy (e.g., HUD, local PHA, etc.) and detail the approved rents/subsidies for the development and may come in the form of a formal contract, comfort letter, or email from the entity providing the subsidy. If this is not available, OHFA will underwrite to the lower of the achievable LIHTC rents in the Market Study or 100% of Fair Market Rent (FMR).

Commercial Income

Income from commercial space, including cellphone towers, will not count in the cash flow analysis toward meeting either Hard Debt Service Coverage Ratio (DSCR) or non-DSCR requirements.

Vacancy

OHFA will assume a 7% vacancy rate beginning with the first stabilized year to calculate the effective gross income.

- Existing projects seeking to be rehabilitated with LIHTC with project-based rental subsidy for at least 70% units may use a 5% rate if they can document a strong occupancy/low vacancy history and the market study agrees.
- New Construction developments with project-based rental subsidy for at least 70% units may use a 5% rate if the market study agrees.
Tenant Utility Allowances

In accordance with 26 U.S.C. §42(g)(2)(B)(ii) and 26 C.F.R. §1.42-10, gross rent for LIHTC projects must be reduced by a utility allowance if the cost of any utility (other than telephone, cable television, or internet) is to be paid directly by the tenants. All utility allowances must conform to OHFA's Utility Allowance Request Procedure.

Other Income

Fees and other income such as laundry, pet deposits, and parking must be reasonable and comparable to similar properties within the region and the developer’s portfolio. If fees other income above $100 per unit per year is projected, the income must be supported by existing financial audits from the property, similar property or third-party documentation. OHFA may request justification for any fees that appear unreasonable.

Analysis of Project Expenses

Annual Operating Expense Escalation Assumption

OHFA will assume a 3% annual expense increase to demonstrate compliance with DSCR, income-to-expense ratio, and deferred developer fee repayment standards.

Operating Expense Reasonableness

OHFA will evaluate operating expense reasonableness by comparing application expenses to similar developments, as determined by building type, population served, type of financing, and location, using the most recent Operating Expense Calculator. For existing properties, OHFA will consider audited financials in evaluating operating expense reasonableness. OHFA may use other data sources to assess operating expense reasonableness.

OHFA may require additional information for developments that exceed expected budget projections based on the comparable developments and/or adjust match industry norms.

Developments will be subject to any additional expense requirements imposed by the specific program to which application is made, if applicable.

Service Coordination Expenses and Fees

Service coordination or supportive services expenses and fees will be limited to $275 per unit per year. OHFA may grant exceptions to Service Enriched developments (including integrated permanent supportive housing), senior developments, or developments that must have a higher service coordination fee based on a federal program requirement.

Syndicator Expenses

Reasonable investor/syndicator asset management fees will be permitted as either a capitalized development cost or a “soft” operating expense repaid from available cash flow, after amortizing permanent mortgages before deferred developer fee and soft loan repayments.
Analysis of the Development Budget (Uses)

Cost Reasonableness
OHFA will evaluate development cost reasonableness pursuant to the applicable QAP and/or program guidelines and may require additional information for developments that exceed expected budget projections based on comparable developments. Developments will be subject to any additional cost requirements imposed by the specific program to which application is made, if applicable.

Building Acquisition and Land Costs
OHFA will subtract the land valuation identified in the as-is appraisal submitted at application from the total property valuation or the purchase price, whichever is less, to arrive at the allowable acquisition basis. If the total purchase price is less than the total property valuation, OHFA will use the percentage of the property’s land valuation in comparison to the total property valuation to determine allowable acquisition basis. OHFA will limit the property valuation to the as-is valuation.

Lease Option Agreements
Counties, townships, or municipal/non-profit corporations that are exempted from property taxes under the Ohio Revised Code and will option to lease the property on a long-term basis must submit a lease option agreement for a minimum 35-year term.

Hard Construction Costs
Hard Construction Costs include the following line items found in the Agency’s template proforma, the Affordable Housing Funding Application (AHFA): Demolition, On-Site Improvements, Hard Construction (Residential New Const.), Hard Construction (Residential Rehab.), Hard Construction (Commercial), Hard Construction (Amenity Fee Items), Construction Contingency, and Furniture, Fixtures & Equipment.

Hard Construction Cost Contingency
The maximum Hard Construction cost contingency is limited to a percentage of Hard Construction Costs net of the Construction Contingency based on the following construction types: 5% for new construction, 10% for rehabilitation, and 15% for adaptive reuse. Projects that have blended construction types may contact OHFA for additional guidance.

OHFA may allow exceptions to this limit if the applicant can demonstrate that another funding source requires a higher contingency. The requirement must be evidenced in a commitment letter from that funding source.
Contractor Fee and Cost Limits

The maximum contractor fee amount is determined and locked-in at either Final Application or at execution of the signed general contractor agreement. If locking in the contractor fee at execution of the signed general contractor agreement, the applicant must deliver a copy of that agreement and a lock-in request to OHFA within 30 days of the agreement’s execution.

Upon lock-in, this amount cannot be increased if costs are higher but is also not required to be decreased if final hard construction costs are lower than underwritten. Contractor cost limits are as the following percent of Hard Construction Costs:

- Contractor Profit: 6%
- Contractor Overhead: 2%
- Contractor General Requirements: 6%

General Requirements includes but is not limited to project management, superintendent, temporary construction sign, field office expense, storage trailers, portable restrooms, temporary utilities, and dumpsters.

OHFA will consider reasonable adjustments to these requirements, not to exceed 14%, across general requirements, overhead, and profit, for contractors that are not related parties.

General Contractor Cost Savings

If the final general contractor cost certification identifies savings, OHFA will divide such amounts 50%/50% between it and the developer for related-party contractor entities and 67% to developers for third-party contractors.

OHFA may take its share in any one or more of the following ways.

- Reducing the development’s Housing Development Assistance Program (HDAP) award, if applicable
- Reducing LIHTCs
- Supplementing reserves
- Achieving deeper income targeting
- Upgrading specific items in the project, or
- Pre-paying Housing Development Loan (HDL) and/or Multifamily Lending Program (MLP) debt, if applicable

Owners must contact OHFA prior to requesting IRS Form(s) 8609 or completing their Final Performance Report (HDAP only) regarding the above options.

Professional Soft Costs Definition

Professional Soft Costs are defined in the Agency’s AHFA as the following: Survey(s) Costs, Architectural Fees, Engineering Fees, Appraisal, Market Study, Environmental Report, Title & Recording, Rent-up Costs/Marketing, Legal Fees (not syndication related), Accounting Fees, Developer Fee, Application/Development Consultant Fees, Construction Management Fees, Guarantee Fees, Developer-Charged Financing Fees, Organizational Fees, Soft Cost Contingency, Syndication Expenses, and Developer-Charged Asset Management Fees.

Professional Soft Cost Limits

Developments may have a total professional soft cost no higher than 25 percent of the total development cost.
**Developer Fee**

Maximum developer fees are as defined the applicable QAP. Applicants must show that any deferred developer fee can be paid in full from development cash flow within the first 15 years. Any unpaid or deferred balance after year 15, may be transitioned to a capital contribution if it is stated in the developer fee commitment letter. Any unpaid or deferred balance after year 15 that is not automatically transitioned to a capital contribution will be deducted from the LIHTC eligible basis. If this results in a lower eligible basis amount, the basis will be reduced to the appropriate amount and may result in a lower LIHTC allocation.

**Soft Cost Contingency**

The maximum soft cost contingency is 3% of professional soft costs, exclusive of the soft cost contingency.

**Capitalized Operating Reserves**

The minimum Operating Reserve for a development is 4 months of the first stabilized year’s projected operating expenses, hard debt service payments, and replacement reserve contributions. The maximum is 12 months of the same.

**Capitalized Replacement Reserves**

Capitalized Replacement Reserves are not permitted for new construction developments, except for adaptive reuse developments and single-family development properties intended for eventual tenant ownership.

Lease-purchase properties may include up to $5,000 per unit in capitalized prefunded replacement reserve set aside in escrow to cover major capital expenditures prior to transitioning the home to the buyer. An additional $3,000 per unit may be set aside in escrow to cover closing costs. An independent housing inspector approved by OHFA must complete an inspection before reserves can be accessed.

**Ongoing Replacement Reserve Contributions**

OHFA’s minimum replacement reserve amounts by product type are as follows; the below distinctions are based on population served and construction type, not by funding pool:

- Senior, New Construction = $300 per unit
- Family/Service Enriched, New Construction = $400 per unit
- Single Family Homes = $400 per unit
- Senior, Rehabilitation = $350 per unit
- Family/Service Enriched, Rehabilitation = $425 per unit

Projects that have blended construction types may contact OHFA for additional guidance.

OHFA may permit an exception to these minimum replacement reserves if required by another funding source. The requirement must be evidenced in a financial commitment letter from that funding source.

**Special Reserves**

OHFA will allow special reserves if required by HUD or USDA Rural Development to the extent indicated in supporting documentation. The requirement must be evidenced in a financial commitment letter from that funding source.

OHFA will permit special reserves for single-family developments for wheelchair lifts as an alternative to ramp requirements under accessibility criteria.
Analysis of LIHTC Calculation

Codified Basis Boost

In accordance with 26 U.S.C. §42(d)(5)(B), buildings located in Qualified Census Tracts (QCTs) or Difficult Development Areas (DDAs) are statutorily eligible for an increase in eligible basis of up to 130%. Such designations are typically determined by HUD in October of the prior year in which such buildings are eligible. To determine if a building is located in a QCT or DDA, visit HUD’s Office of Policy Development and Research (PD&R) Web site here.

Discretionary Basis Boost (9% LIHTC Only)

In accordance with 26 U.S.C. §42(d)(5)(B)(v), state housing credit agencies may allow for buildings to be considered located in a DDA and therefore eligible for an increase in eligible basis of up to 130% if needed for such buildings to be financially feasible as part of a qualified 9% LIHTC project. Buildings that are part of a 4% LIHTC transaction are federally prohibited from receiving a discretionary basis boost.

9% LIHTC Only Calculation

The LIHTC amount reserved will not increase after the Proposal Application underwriting for 9% LIHTC applications. OHFA may require a legal opinion from a qualified tax credit attorney, at the applicant’s expense, for any items that do not clearly count as eligible basis.

LIHTC Stewardship

In accordance with 26 U.S.C. §42(m)(2), OHFA shall allocate no more in LIHTC than it deems necessary to ensure the projects financial feasibility. In making this determination, OHFA will review the sources and uses of funds and the total financing planned for the project, any proceeds or receipts expected to be generated by reason of tax benefits, the percentage of the LIHTC amount used for project costs other than the cost of intermediaries, and the reasonableness of the development and operational costs of the project.

Analysis of the Development Financing (Sources)

All Sources Identified

Applicants and owners must identify all funding sources, including LIHTC equity, hard debt, gap financing, seller financing, soft or non-recourse loans, grants, development team contributions, interest during construction and reserves used to fund redevelopment. Applications must include commitment letters for all non-OHFA sources. All commitments must be fully executed and dated within 60 days of the application.
Federal LIHTC and/or Ohio LIHTC (OLIHTC) Equity Commitment

OHFA will evaluate the conditional equity commitment provided by the syndicator/investor at proposal and final application. Conditional equity commitments must include the following:

- Gross and Net equity amount and pricing;
- proposed terms and conditions;
- Detailed equity installment schedule, including pay-ins during construction;
- If seeking HDL, the additional requirements as listed in the most recently published HDL Guidelines.

If a syndicator/investor is providing equity for more than one type of credit, each type of credits terms, conditions and pay in schedule must be listed separately. OHFA may require adjustments based on comparable, historical, and/or current market conditions and trends.

As a construction source, OHFA will consider equity installments commencing at financial closing up to, but not including, the 100% Construction Completion installment, if applicable.

Other Tax Credits

Projects with non-OHFA allocated credits such as Federal Historic Preservation Tax Incentives or federal Solar Investment Tax Credits must submit the following:

- Documentation, such as an allocation agreement, from the administering entity indicating the total credit amount and type of credit, and
- A conditional equity commitment letter from the syndicator with the proposed terms and conditions and a detailed equity installment schedule.

Debt Financing

OHFA will evaluate all funding source terms and may choose to underwrite at different terms for any funding source which OHFA determines will cause unnecessary or excessive subsidy.

Proposal and Final Applications must include conditional financial commitments for all debt sources and evidence of current balances for all assumed debt and replacement reserves.

Other Sources of Funding

- Assumed or Restructured Debt: The applicant must provide supporting documentation detailing the terms and conditions of any assumed or restructured debt including the current outstanding balance and the projected outstanding balance at equity closing.
- Competitive Sources: Any source of funds that is not at least conditionally committed will not be considered.
- HOME Investment Partnerships Program (HOME) and Other Federal Funds not administered by OHFA: The applicant must submit a preliminary award letter or commitment letter reserving the funds that includes the anticipated term, amortization, rate, fees or specify that the funds will be a grant.
Analysis of the Development Cash Flow

Debt Service Coverage Ratio (DSCR)
The minimum acceptable DSCR is 1.20 for the first year of stabilized operations. OHFA may make exceptions for the first year of stabilized operations where the DSCR is no lower than 1.15 and improved and upward trends in DSCR are sustained over 15 years.

The development must maintain an annual DSCR above 1.00 during the entire 15-year compliance period. The average hard DSCR over the 15-year compliance period must not be greater than 1.5.

Income-to-Expense Ratio (I/E Ratio)
For developments with no hard debt, the developments must maintain an annual expense ratio above 1.00 during the entire 15-year compliance period. The average expense ratio over the 15-year compliance period must be at least 1.10 and may not exceed 1.50.
C. Underwriting Exception Requests

Underwriting exceptions must be submitted with the application. Additional exceptions may be permitted or disallowed per the applicable program guidelines.

Underwriting exceptions must be submitted with the applicable application. The following underwriting exceptions to these Guidelines are permitted:

1. Development Budget: Construction Contingency
   If the applicant can demonstrate that another funding source requires a higher contingency.

2. Development Budget: Reserves
   If different amount required by another funding source.

3. Development Budget: Cost Containment
   If higher costs are justified by project type (i.e., adaptive reuse)

4. Income and Expense Analysis: Income/Expense Escalations
   Properties in which operating subsidy is provided by HUD, RD, or the local public housing authority to achieve break-even operations at the property.

5. Income and Expense Analysis: Service Coordination Expenses
   Service Enriched developments, senior developments, or developments that must have a higher service coordination fee based on a federal program requirement.

6. Income and Expense Analysis: Debt Coverage Ratio
   Where the first year DSCR is at least 1.15 and improved and upward trends in DSCR are sustained over 15 years.