DEI Analysis of AHIC's Underwriting Guidelines
February 2023

Introduction

As part of its mission, the Affordable Housing Investors Council (AHIC) develops guidelines for underwriting and asset managing low-income housing tax credit (housing credit) transactions. These tools have been widely adopted by the field and have contributed to the success of the program and its position as one of the best-performing real estate asset classes in the United States.

AHIC has created *Underwriting Guidelines* (available on AHIC's website on the Tools and Resources page*)* for direct, proprietary, and multi-investor housing credit investments. Last revised in 2018, the guidelines examine how to analyze the financial strength and expertise of the development team; the key points to understand about the sources and uses in the development budget; critical facets of underwriting the deal; best practices in due diligence; and tools for reviewing the capacity of syndicators.

In 2020 as a part of the racial reckoning embraced by many US organizations, AHIC committed to review our guidelines through the lens of fairness and justice, noting "**At the very least, our investments should be evaluated absent racial bias, and ideally we should approach our work with the mission of broadly advancing equity through the developments we support.**"

The task we gave ourselves was to look at each AHIC standard and practice and ask:

- How did we get here?
- Do these standards and practices widen the racial wealth gap for communities of color?
- How can we do better?

It is widely recognized within the industry that, although the *AHIC Underwriting Guidelines* lay out parameters for deal terms, each transaction is evaluated upon its own merits. Underwriting involves balancing positive and negative deal attributes and seeking a financial structure that leads to a viable, healthy development.

It is often the case that developments with experienced sponsors or in strong markets will receive additional flexibility in the underwriting process. This can occur even when the particulars of the deal fall short of AHIC standards.

For example, with certain developers – based on their track record or an ongoing relationship – the underwriter could get comfortable with a scenario that assumes maximum rents in an untested market, requires less cushion in operating expenses relative to comparable properties, allows for a lower vacancy rate, or permits a 1.15 DSCR on a 4% bond deal. This could result in a higher loan amount, fewer challenges to securing financing, or additional paid developer fee.

AHIC does not support the perception that there is a greater risk associated with developers of color, who, due to historical barriers and structural racism, have experienced challenges to entering and advancing in the affordable housing field – especially in the areas of garnering experience and amassing financial resources. This perception could lead the underwriter to keep to the most demanding underwriting standards, guidelines, and policies.

In a similar vein, underinvestment, lack of community infrastructure, and challenging economic market conditions that plague some communities of color could lead these areas to be perceived as higher risk locations for siting investments. In addition, bringing outside developers into these neighborhoods, if the sponsors do not solicit the community's voice and perspectives, could lead to missed opportunities to support residents and meet their needs.

Taken together, this can have a compounding and disproportionate negative effect on Black, Indigenous and People of Color (BIPOC) developers and communities.

Recognizing this context, AHIC's Underwriting Committee created a working group that analyzed the 2018 version of the *Underwriting Guidelines*, asking the following questions:

- What is being evaluated/mitigated?
- Why is this a guideline?
- In what ways could the guideline create barriers to participation?
- What additions or changes to the guidelines are recommended?

The goal of this effort is to open pathways to underrepresented developers so they can be successful in our field and build wealth for themselves and their communities.

The examination of these parameters starts with the first recommendation included in the guidelines - *AHIC recommends that a developer have experience with at least five LIHTC or affordable multi-family rental developments that are comparable in size and complexity* – and ends with a discussion of developer fees, capital contributions, and construction liquidity.

It is important to note that deviating from guidelines is a necessary response to everyday realities and deal-specific variables – but the practice presents an opportunity for individual and systemic biases to have an impact on decision-making. It is also important to look at a deal holistically, rather than focus solely on the number of variances to the guidelines.

This analysis seeks to bring the potential for individual bias into the open, mitigate for and minimize biases, support underwriters in employing the underwriting standards flexibly, and help them reframe the perception of risk to enhance opportunities for underrepresented BIPOC

developers while maintaining the integrity of the underwriting process. While every individual brings his or her own perceptions and biases to any human endeavor, the hope is that investors will seek to implement policies and processes to help minimize them in the underwriting process: the goal is to challenge biases, not reinforce them.

While undertaking this initiative, we repeatedly heard the suggestion from AHIC members and outside reviewers that those investors who would like to support underrepresented developers entering the field could consider setting aside capital dedicated specifically to those projects at more favorable terms. Additional project capital through a higher price per credit and/or additional capitalized fund-level reserves would greenlight the projects that may not "fit the box" for the general investor audience or simply not pencil out. In exchange for lower economic returns, these investors would help expand the developer community and, if financial institutions, benefit from illustrating to their regulators the “innovative or complex” attributes of their Community Reinvestment Act (CRA) investment strategy.

Many also expressed the wish that as these kinds of transactions grow to be more widespread, it would become common to see them in every multi-investor fund in the market.

It is the hope this this resource will facilitate that outcome.

Members of the Affordable Housing Investors Council have developed this resource for informational and educational purposes only. Nothing contained here should supplant individual analysis by an investor, nor should it be construed as mandating any specific deal terms.

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Guideline:	Review 3 years of Guarantor Audited Financial Statements

2. What is being evaluated/mitigated?

This requirement provides the underwriter with information to efficiently (1) establish that the development entity (or the guarantor entity back-stopping the development entity obligations) is a going concern, (2) evaluate past financial performance, and (3) assess go-forward capacity of the entity to provide economic stability to the developer entity.

3. Why is this a Guideline?

The guideline assumes that successful development relies on access to sufficient liquidity to satisfy normal cash needs during the development phase, including but not limited to funding:

- Predevelopment costs (e.g., market studies, legal representation, appraisals, land purchase options)
- Subcontractor draws, sufficient to keep trades active on-site during periods while construction loan and/or equity draw requests are being reviewed
- Over-runs or change orders that may (or may not depending on cause) ultimately be acceptable uses of project funds
- Construction uses when sources are out of balance, as when inflation, unexpected conditions, labor/material cost increases, delays, or some combination inflates uses
- Gaps that may exist at permanent loan conversion and
- Adjusters and compliance guarantees with outside financial support, in the event internal resources (including real estate value) are inadequate.

The guideline assumes that successful development also relies on access to sufficient short-term liquidity to satisfy unexpected cash needs that might arise, for instance:

- Government shut-downs that result in HUD or Rural Development rental assistance budget short-funding
- Subsidy overhang risk for deals with above-market subsidized rents could lead to income shortfalls of the subsidy is reduced or lost
- Decline in area medium income (AMI) could lead to stagnant rents
- New tariffs and material/labor shortages could lead to increased construction costs
- Unexpected operating expense increases could hamper a property's ability to achieve breakeven operations and
- Pandemics, eviction moratoria, natural disasters and recession could affect property income in numerous ways.

The guideline assumes that audited financial statements provide a reasonably efficient mechanism for assessing financial capacity.

- A three-year period provides a snapshot of the current state of financial performance and enough historical detail to provide insight into trends (stability versus volatility of components of cash flow, shifting of profit/loss intra-period via balance sheet line items, and growth or contraction of income streams).

- Three years is sufficient to demonstrate patterns and trends and that fewer years might fail to disclose episodic or volatile business conditions and/or fail to highlight activity shifting between balance sheet and income statements.
- By specifying audited statements, the guideline implies financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP); the guideline assumes GAAP statements (Balance Sheet, Income Statement, Statement of Cash Flows, Notes) encourage consistency, aiding in efficiency of review, and that the standardized format encourages apples-to-apples comparison.
- GAAP financials are customarily prepared/reviewed by certified public accountants; the guideline assumes a level of professional responsibility for the contents of the financials on the part of the professional CPA firm which goes beyond management-provided results or un-audited compilations that are not subject to testing or evaluation. The reputation of a licensed accounting firm is assumed to be connected to the accuracy of the statements.

In addition to guarantor assets providing a source for contingent financial resources external to the subject development, the fact that a guarantor puts its balance sheet at risk is assumed to provide incentive for that entity to stand meaningfully behind the feasibility of the development and to financially support turn-key development obligations to stabilize the project. The guideline assumes that personal and corporate assets at risk represent "skin-in-the-game" and that by putting meaningful assets at risk, a developer stands behind the requirement to meet development obligations adequately and proactively.

4. In what ways could the Guideline create barriers to participation?

Requiring GAAP financials might:

- Disadvantage entities who lack an existing relationship with a CPA firm, since obtaining three years of historical GAAP audited financial statements represents a barrier-to-entry for new or emerging entities that have yet to access traditional formal financial sources of capital
- Favor larger and/or established entities that have already undergone the potentially arduous process of bringing an auditor up-to-speed with their systems and procedures (initiation of an audit relationship often takes 4-6 months or more)
- Disadvantage entities that arise from communities that are historically under-banked (favoring entities that have previously experienced requirements for an audit)
- Disadvantage entities whose past participation has been primarily in informal economic relationships, which are devalued in the context of traditional GAAP/audit analysis and
- Disadvantage mission-driven entities whose primary focus has been social rather than economic outcome tracking (for instance where service-delivery to residents takes precedence over profitability).

Requiring three years of financial reporting might:

- Disadvantage newer developers with limited existing track records and
- Advantage incumbents, since a track record implies an existing platform.

5. What additions and/or changes to the guidelines are recommended?

FLEXIBILITY: Underwriters may choose to accept unaudited management financials or compilations, particularly if personal guarantees are provided. An investor could establish an "alternate standard" that can be used with emerging developers who do not have audited statements (i.e., x years of unaudited statements, bank accounts statements, tax returns, etc.).

FLEXIBILITY: A traditional alternative is to encourage under-capitalized developers to partner with guarantors with demonstrably stronger financials. This can occur at several deal levels, including at the lower-tier in the form of co-development JVs, at the upper-tier in the form of syndicator JV and/or syndicator (especially but not exclusively NASLEF) 'war-chests', at the project level in the form of enhanced G/C capacity (more robust P&P bonding coupled with strong fixed-price contracts minimizes financial volatility during the construction phase).

Warning: This begs the question whether underwriting an under-capitalized developer is essentially outsourced from financial institutions to the stronger guarantor (who becomes the one to choose whether to partner with the weaker JV partner).

Warning: This begs the question of whether developer profits being shared by the stronger guarantor essentially increase the cost of capital of an under-capitalized developer (slowing their financial growth relative to organically growing their own balance sheet independently). In this scenario, is the price-of-admission for an under-capitalized developer essentially junior partnership status with a stronger guarantor in a way that ultimately holds back the under-capitalized developer's organizational development?

FLEXIBILITY: An alternative is to place additional emphasis on internal deal capitalization to lessen the reliance on guarantor financial strength as a mitigant. This might take the form of greater operating reserves, additional hard/soft cost contingencies, greater underwritten rent advantages (allowing optionality to increase rents, albeit at the expense of future resident affordability), and/or lower leverage (leaving more robust cash flow and residual as collateral for contingent future problem-solving). These alternatives are especially common in the case of projects with enhanced special needs involving particularly robust social service delivery components. Because these alternatives make the project more expensive to execute for the under-capitalized developer, mitigation – such as a release of increased reserves or ability to increase debt – could be factored in if the project meets certain operating benchmarks over time.

FLEXIBILITY: The underwriter can also consider certain deal characteristics and structures that help mitigate risks, such as long-term rental subsidies, equity holdbacks through

completion and stabilization, and significant community support as evidenced by state and local funding sources.

FLEXIBILITY: An alternative is to structure more robust kick-out rights, so that an unproven developer partner is more closely monitored and can be replaced more expeditiously if serious problems arise.

FLEXIBILITY: An alternative is to initially look to internal deal sources that are reasonably *foreseeable*, such as cash development fees, to mitigate what might otherwise present as a lack of demonstrable financial capacity. Additional development fee holdbacks could mitigate concerns about financial capacity. Cash sweep or cash collateral agreements could also be adjusted. However, this strategy envisions resources that may or may not be available when they needed.

FLEXIBILITY: An alternative is performing a more bespoke financial analysis of the developer/guarantor, absent actual GAAP financial statements. While this may sometimes be feasible, it typically requires a greater degree of credit-review expertise on the part of the underwriter and typically results in materially higher expense to perform an equivalent analysis. As always, and with respect to the guidelines as a whole, an alternative is to focus less on binary decisions (audits or no, three years or no) and focus instead on the implied perceived risk. In other words, asking foundational questions such as 'Is the relative financial capacity of the guarantor reasonably demonstrated by some diligence short of audited financials?'

Guidelines: Minimum net worth should be the greater of $5MM or 25% of total development costs. Minimum net liquid assets should be the greater of $1MM or 5% of total development costs.

2. What is being evaluated/mitigated?

The guideline provides a benchmark to gauge the financial capacity of the guarantor at a moment in time.

3. Why is this a Guideline?

LIHTC projects are structured with funding contingencies that would be available to meet unforeseen needs during construction, lease up, and stabilized operations. These contingencies include hard and soft cost contingencies, cash developer fee holdbacks, lease up reserves, operating reserves, and other items. In addition to these contingencies, developers typically provide financial guarantees for construction, leasing, and stabilized operations to ensure projects have supplemental support. The net worth and liquidity guidelines are meant to illustrate the minimum financial capacity of project guarantors needed to meet the financial guarantees provided.

In addition to establishing that the guarantor has the financial wherewithal to meet short and long-term financial obligations to the partnership, the guidelines additionally establish that a guarantor has placed material personal or corporate assets at risk and are willing to satisfy those obligations. The guideline is an attempt to avoid instances where a developer isolates its assets (ex. minimally capitalized special purpose entity (SPE)) from the downside consequence of having to perform financial obligations.

- Net Worth
  - *Why Net Worth:* Assets included in net worth can be used to support guarantees, particularly more significant guarantees including construction completion and repurchase guarantees, if needed, from the cash flow generated by the assets or from their sale. This assumes that the assets are marketable at the values included in net worth – the underwriter will need to understand whether this is indeed the case.
  - *Why $5MM:* The $5MM minimum serves as a floor for smaller projects and investments so that net assets would approximate the amount of the investment.
  - *Why the greater of 25% of TDC or $5MM:* For larger projects, the $5MM minimum net worth may be insufficient and the 25% of TDC minimum is meant to account for the larger investment.

- Liquidity
  - *Why Liquidity:* Liquid assets are defined as cash, cash equivalents, and other assets that can be converted to cash in a short time without loss of value that can be used to immediately support project guarantees and the project overall. Uses might include construction cost overruns, credit adjusters in excess of available cash developer fee, and operating deficits in excess of project reserves.
  - *Why $1MM:* The $1MM minimum serves as a floor for smaller projects and is based on historical industry practice.
  - *Why the greater of $1MM or 5% of TDC:* For larger projects, the $1MM liquidity minimum may be insufficient and the 5% TDC minimum is based on historical industry practice.
  - Liquidity requirements are also included specific to construction, and these include:
    - New Construction: liquidity equal to at least 3% of total development costs and
    - Rehabilitation: liquidity equal to at least 5% of total development costs.

4. In what ways could the Guideline create barriers to participation?

Requiring a minimum net worth might:

- Disadvantage those mission-driven entities whose primary focus has been social rather than economic outcome tracking (for instance where service-delivery to residents takes precedence over profitability)

- Disadvantage those entities that develop without maintaining long term ownership (turnkey developers) and
- Disadvantage those newer developers with less net worth, even though net worth net of contingent liabilities may be more than a more established developer.

Requiring a minimum Liquidity might:

- Disadvantage those mission-driven entities whose primary focus has been social rather than economic outcome tracking (for instance where service-delivery to residents takes precedence over profitability)
- Disadvantage those entities that develop without maintaining long term ownership (turnkey developers) and
- Disadvantage those newer developers with less liquidity even though net worth net of contingent liabilities may be more than a more established developer.

5. What additions and/or changes to the guidelines are recommended?

- **Revision:** Consider basing liquidity and net worth minimum requirements on the size of the guarantee or the project size and factoring in contingent liabilities.
- **Revision:** Consider providing guidelines for net worth and liquidity minimums based on project lifecycle, with the highest minimums for construction and reduced for leasing and operational stages. These thresholds could allow for separate guarantors for the various development stages (e.g., in select circumstances a well-capitalized general contractor may be willing to provide a construction guarantee, with the less well capitalized developer providing guarantees after completion, although the fees associated with this may be so steep as to be untenable for the emerging developer to accept).

FLEXIBILITY: The risk profile of the project can be considered when considering whether to accept lower net worth and/or liquidity for project guarantors. Measuring risk varies by investor, but some deals factors that may be considered to lower risk on a project include standard construction (2 story walk up new construction as opposed to adaptive reuse); long term rental subsidies; low project leverage relative to project equity; seasoned project partners including general contractors, consultants, and property managers; minimal-to-no equity at risk prior to completion or stabilization; cushions built into the construction and leasing projections (thus lowering timing adjuster and/or placed in service risk); and the execution structure (e.g., multi-fund with supplemental reserves, syndicator with strong monitoring).

FLEXIBILITY: An alternative is to place additional emphasis on internal project liquidity such that less reliance is placed on guarantor financial capacity and lower net worth and liquidity can be accepted. Areas of focus could include larger hard/soft cost contingencies; larger holdbacks of cash developer fee; greater underwritten rent advantages and larger potential for increases if needed; lower leverage and lower hard debt payments; and larger project reserves (operating reserve, subsidy reserve, rent-up reserve, supportive services reserve, etc.).

Guideline: AHIC recommends that a developer have experience with at least five LIHTC or affordable multi-family rental developments that are comparable in size and complexity and has the organizational and financial capacity to undertake the development and manage growth.

2. What is being evaluated/mitigated?
This guideline evaluates a sponsors' ability to manage the complexities of a LIHTC transaction. The five prior affordable housing developments requirement is meant to ensure the sponsor's technical expertise within the industry, commitment to the craft, and support of the industry. An underwriter evaluates capacity to determine whether the developer has the staff and financial resources to take on the development or to manage multiple developments at once.

3. Why is this a Guideline?
Execution of a LIHTC transaction involves managing numerous complexities that are both associated with and outside the scope of traditional multifamily real estate development. Winning a tax credit allocation and conducting compliance related to on-going affordability require a keen attention to detail that goes beyond the traditional scope of development and property management for multifamily properties.

Lack of construction and development experience or capacity could lead to construction issues that cannot be fixed within the time allotted to complete the project. Missing deadlines have more severe consequences than typical multifamily real estate projects. In addition, mismanagement and failure to understand tax credit compliance could lead to loss of credits or removal of the general partner. Because the projects themselves generally have narrower operating margins than typical multifamily real estate projects, attention to detail around budgeting and operations is very important. Finally, the developer fee that is structured into the development budget is often the sole means of profitability for the sponsor and serves as "deal liquidity" that can be used for unforeseen construction and operational issues. Sponsors that have consistently earned their fees, maintained profitability, and delivered their projects on time and on budget are assumed to be at lower risk for poor execution and management.

At a minimum, investors generally want to see a solid understanding of multifamily real estate fundamentals, the resources necessary to carry out the development, a development team that is reliably on time and on budget, and key project personnel well versed in the LIHTC program, including structuring the development, selecting and overseeing a general contractor, managing the property, and overseeing compliance. Some investors may be concerned that a small number of transactions is not a clear indicator that a sponsor can continue to be successful.

4. In what ways could the Guideline create barriers to participation?

- It confers an advantage to incumbent developers: those that have, get more.
- New and emerging developers may be passed by due to actual or perceived lack of experience or capacity.

- Joint ventures with more accomplished developers could mean less of a profit and less spotlight for the inexperienced developer, regardless of the developer's work on the project.
- Talented emerging developers may be hesitant to enter the market due to perceived lack of profitability.

5. What additions and/or changes to the guidelines are recommended?

- **Revision:** In addition to serving as primary developer, examples of other types of experience with demonstrated key responsibilities and decision-making authority that could be viewed favorably by the underwriter include a joint venture partner, executive director of a non-profit developer, senior project manager, market rate multifamily development experience if working with a tax credit consultant, or a senior position with a state housing agency or syndicator.

- Give more weight to experience and factors other than the number of LIHTC developments, including:
    - Community involvement and support (e.g., financing from city, county, or state)
    - Individuals' experience while at prior development companies: depending on their role, the emerging developer may have a wealth of experience executing LIHTC transactions, but not the balance sheet that matches the experience
    - Other types of experience, such as property management or general contractor experience
    - A pledge of personal versus corporate versus SPE guarantees.

- Create more transparency around joint venture agreements so investors can gain insights into (1) who is benefitting from the profit-sharing arrangement; and (2) how are duties being structured to ensure that the less experienced developer or developer with less capacity gains the requisite expertise and resources to undertake future development on their own. It is not incumbent upon investors to dictate the terms of the agreement, but investors can decline projects that do not achieve desired learning outcomes or benefit all members of the development team equitably.

- Require the sponsor to engage a consultant to provide tailored and targeted services; this could be paid for by the investor or syndicator so as not to further disadvantage the sponsor and should be structured in a manner that will allow the nascent developer to gain experience instead of watching someone else perform required tasks. The scope of services, qualifications, and compensation should be part of the underwriter's due diligence process. Consider building in some sort of look-back mechanism that makes the parties to the transaction accountable for revisiting the efficacy of the capacity-building component of the consulting arrangement.

- Investors should seek transparency from state housing finance agencies (HFA) that award projects and should explore disconnects between the Investor's conclusions about the sponsor's experience and capabilities and the HFA's.

- Check references to determine whether the desired capacity is present **without** a track record (e.g., are key principals or former senior employees of a larger, more experienced organization?

FLEXIBILITY: The original guideline suggests a narrow definition of "experience" as one who has led a firm with five prior developments completed. A more flexible view could encompass prior professional engagement in the field through, for example, experience working for a state allocating agency or a lending or investing institution; as a syndicator or an architect; or in a senior position with a nonprofit or profit developer.

FLEXIBILITY: Where the parties to the transaction are willing to accept diminished economics in favor of enhanced DEI outcomes that support underrepresented developers, investors could pay more per credit and/or contribute more equity to enhance capitalized fund-level reserves to create additional deal liquidity.

FLEXIBILITY: While developer experience and capacity are good indicators of success; other factors such as community and local government focus, individual team member experience, deal structure and characteristics, and scope of the project should all be taken into consideration. A straightforward, low-levered, and adequately budgeted project could be viewed as a lower risk execution that would not necessarily warrant a sponsor with a 5+ project track record or extensive capacity.

FLEXIBILITY: An area where the investor can be helpful is to suggest the developer engage consultants within the industry who would not take over the execution for the sponsor and or not command a large share of the profit. Other opportunities could include project specific one-on-one technical assistance paid for by the investor to supplement the personnel. The cost would likely be minimal to the investor and would help set the sponsor up for success. Long term, investors may want to consider staffing consultants in their own institutions to assist more inexperienced sponsors or those with less capacity. This is somewhat similar to first time homebuyers receiving financial management assistance from their lender. Finally, if the sponsor and project meet all of the investor requirements except the experience requirement, the investor could fund additional reserves or contingency to mitigate risk.

Guideline: Investor should conduct a background check on the developer, including lien and litigation searches, no sooner than 45 days prior to lower tier closing. For developers and guarantors, updates to background checks may be done periodically (annually) for compliance violations, arrests, bankruptcies, lawsuits, or other pertinent information. The frequency of ongoing background checks may be driven by an investor's internal credit policy and may taper off after credit delivery.

2. What is being evaluated/mitigated?

This guideline is helpful in evaluating the relevant professional experience and financial capacity of a sponsor, which is fundamental to sound credit underwriting. Sponsors should demonstrate a history of sound business, personal and credit history as an indicator of future performance and behavior.

3. Why is this a Guideline?

In addition to regulatory requirements such as know your customer (KYC), anti-money laundering (AML), and Volcker obligations, industry best practices suggest that an underwriter perform appropriate inquiries and analyses to assess the business experience and financial capacity of sponsors. This is not something unique to LIHTC transactions but has historically been foundational for extending credit of any type. A background check can be tailored to reveal how a sponsor may have fared during a particular real estate cycle, whether foreclosure or any other material defaults have occurred, or if evidence of fraudulent behavior exists. Lien and litigation searches can also help to evaluate a sponsor's financial capacity to successfully execute on the proposed transaction. In all cases of background checks, it is important to note that the exercise itself merely brings facts and circumstances into view and the guideline does not explicitly suggest how to interpret these findings: judgment is left to the investor.

4. In what ways could the Guideline create barriers to participation?

- The guideline itself does not suggest how to apply findings of the background check, it merely suggests the "what" and "how" of this best practice for extending credit. The potential risk or barrier is in how particular investors (or the industry in general) choose to interpret findings and apply them to sponsors and whether their processes and policies are designed to mitigate bias. Except for certain "high risk" factors associated with AML, most of the interpretation is not regulatory driven.
- Sponsors with negative factors including criminal records, bankruptcies, lawsuits, or other reputational risk factors may not meet an investor's underwriting and due diligence standards. These standards have subjective elements and, therefore, could include interpretations leading to outcomes that may favor or disfavor certain sponsors.
- It is important that investors recognize criminal background checks could also reinforce inherent bias; their evaluation should be handled carefully, with an eye towards ensuring that their use does not perpetuate stereotypes.

5. What additions and/or changes to the guidelines are recommended?

- A background check is a **starting point** for evaluating the business practices and financial capacity of a sponsor. Factors like criminal records, bankruptcies, foreclosures, liens, etc. may or may not be good indicators of future challenges worth avoiding with a particular sponsor. Instead of being automatically disqualifying, these issues should trigger further diligence and discussion with the developer to obtain additional information to make an informed decision. The investor must ultimately interpret the findings of a background check and make the final judgment on the sponsor. At the same time, this subjective nature of this judgment could allow for instances of bias. Some investors have an internal committee or formal process to consistently evaluate these rare situations of instances of negative findings or unique situations that raise questions of reputational risk. This may be a good "best practice" for other investors.

Guideline: Market rate units should provide less than 20% of total project revenue.

2. What is being evaluated/mitigated?

This guideline is used to determine whether a project:

- Primarily serves low- and moderate-income households
- Is optimally structured to maximize tax-advantaged benefits
- Has a risk-reward profile commensurate with market-rate rather than affordable housing exposure and
- Is Public Welfare Investment and CRA eligible (this is relevant to regulated financial institutions).

3. Why is this a Guideline?

In housing credit developments, tax-advantaged equity replaces must-pay debt in the capital stack, enabling affordable rents for lower-income households. Under the Code there are multiple set-asides that allow projects to flexibly serve mixed-income tenancies within a single development.

- **Practitioners typically aim to maximize affordable reach by minimizing market-rate components.** Generally, the more market-rate tenants, the less a project relies on credits to replace debt with equity and hence the less a project can feasibly target and serve affordable households. Prior to the advent of the new average in come test, most transactions utilizing LIHTCs were so-called 40/60 projects with 100% (rather than only 40%) of the units restricted to low- or moderate-income tenants. Absent some external limiting factor (such as a state agency desiring a credit allocation limit), the greater the credits that can be generated by increasing the proportion of affordable units, the greater the equity raise and the lower the levels of debt. Absent an external limiting factor, fewer market-rate units result in a greater affordability reach.
- **The inclusion of market-rate merges traditionally distinct asset classes.** AHIC members typically sit within corporate groups focused on tax-advantaged investments. In some instances, members have multiple forms of capital at their disposal, but generally a priority is placed on investing capital in tax credit equity transactions. To the extent a

project fails to maximize tax advantaged benefit streams by pursuing less than 100% low-income set asides, members may view the lost credit opportunity as a less-than-optimum execution. In some instances, AHIC members report that their internal teams are dedicated to housing credit investing and the expertise in underwriting, structuring, and conducting due diligence on market-rate investments resides elsewhere. Some members report that investing in market-rate is outside the scope of their authority or they are specifically discouraged from underwriting developments with mixed-incomes.

- **Market-rate potentially changes the risk-reward characteristics of an investment.** The farther a transaction strays from 100% housing credit units, (characterized by limited investor real estate risk and similarly limited cash equity returns) the farther the transaction migrates from traditional tax equity risk profile. Integrating market-rate units changes the risk-reward equation, causing transactions to resemble market-rate more closely, preservation, workforce housing, or commercial asset classes. The presence of market-rate units could involve additional risk, since the project must be comparable to other market-rate properties in the area to attract residents and there is a chance of negative bias against the affordable tenants.

AHIC guidelines call for a minimum 10% market-rent advantage for all units, including market-rate units, which serves as a risk mitigant by: 1) allowing for favorable marketability relative to the competition; and 2) allowing for a margin of error in estimating achievable rents. Including a discount to market on restricted units may offset the inconvenience to those low-income residents of having to income-certify, complete arduous applications, and provide tenant income certification and third-party income and asset verification as well meet other logistical hurdles. This could allow the subject to compare favorably against competition that requires only normal credit and background verifications.

AHIC members may be comfortable with the tax-advantaged inefficiency of up to 20% units at market rents so long as market-rate units maintain a 10% advantage (like the LIHTC units). Other investors may seek higher discounts, depending on market conditions.

On the other hand, some investors believe these mixed-income projects carry less risk since the market-rate units require no tenant income certification yet maintain the favorable 10% market rent advantage versus true market-rate competition.

Where sufficient market feasibility has been established, some AHIC members are comfortable with up to 20% units at market rent *without* 10% market rent advantage. This generally is the case in stronger markets characterized by low vacancy among LIHTC and market-rate comps, low penetration and capture rates, and high barriers to entry.

LIHTC investments are generally structured and perceived to be structured on the lower end of a risk spectrum relative to equity investments in other multifamily apartment communities. Multifamily investments structured for cash flow, value-add repositioning, or residual benefits generally carry increased levels of risk and correspondingly higher target return hurdles. The

more a LIHTC investment contains elements of the broader asset class, the more weight an underwriter reasonably places on the risk exposure target return expectation.

Public Welfare Investment (PWI) permissibility and Community Reinvestment Act (CRA) treatment can be gating factors, because many investors are regulated financial institutions. Bank regulators and various state insurance regulations govern the eligibility of and regulatory risk capital weights assigned to Public Welfare Investments. In addition, bank regulators perform CRA exams on member institutions and, by statute and regulation, control the PWI and CRA treatment of LIHTC investment vehicles. These rules are complex but in almost all instances require that at least 50% of units serve low- to moderate-income households. In addition, under the current examination regime some regulators reduce the amount of CRA credit to only the prorata equity associated with the affordable component of a development. Accordingly, these investors can view projects with larger market-rate components as inefficient from the perspective of placing CRA designated capital in CRA eligible developments.

4. In what ways could the Guideline create barriers to participation?

Mixed-income housing is believed by many to yield desirable social outcomes. It can be linked to overcoming NIMBYism, fostering fluidity of economic migration, and combatting stigmatization of a neighborhood and the affordable developments. Limiting the proportion of market-rate in LIHTC transactions might result in the following.

- Less community support (and/or more vocal opposition) for siting affordable housing properties in areas of economic opportunity.
- Municipal and political resistance to the presence of LIHTC projects due to perceptions of negative impacts on property tax assessments or real estate valuation and/or the additional burden placed on municipal services.
- Less fluid opportunities for housing choice and migration among residents as their personal income grows (i.e., income growth leading to ineligibility potentially leading to housing insecurity thereby paradoxically inhibiting income growth).
- Less opportunity for day-to-day mixing of economic strata leading to less empathy or understanding among economic cohorts (i.e., stigmatization of those experiencing poverty and conversely resentment of working-class values).
- Concentrations of poverty exacerbating or creating pockets of crime, abuse, neglect, etc.
- Increased difficulty combatting urban decay within specific neighborhoods.
- Lack of political support for areas under-represented by robust voting-age politically active economically independent taxpayers.

Conversely, easing restrictions on market-rate components might have the unintended consequence of leading to tightened underwriting standards for deals with >20% market-rate. This might express itself in calls for greater vacancy assumptions, greater market-rent discounts, lower debt sizing, lesser lower-tier pricing (because of the greater risk), and increased cash-flow-sharing with investors to compensate for additional risk — all of which might have the impact of constricting capital to mixed-income projects.

5. What additions and/or changes to the guidelines are recommended?
The number of affordable properties with market-rate components is increasing, and there are many examples where the successful economic performance of market-rate components has had a material positive impact on overall project feasibility. Investors who seek to flexibly deploy tax-advantaged capital in housing credit developments with market-rate components should focus on local market demand, the history of similar projects, and the characteristics of the multiple tenant populations being considered. When revenue from the non-LIHTC units can support operating expense and debt service coverage, their underwriting can be critical to the success of the project.

Revision: When determining whether an investor can get comfortable with a mixed-income development, the underwriter can explore the following.

- Utilizing broader income eligibility bands, embracing greater vacancy assumptions on non-LIHTC units, underwriting market rate units with greater discounts to market rents, and sizing debt assuming a maximum of 60% of AMI LIHTC rents for market units.
- Sponsor and management company experience with the tenancy: the success of mixed income properties is based on site staff understanding the needs of different tenants and creating an inclusive, harmonious environment.
- Mitigants may include:
  - Upper tier, fund level reserves as an additional source for property deficit.
  - Supplemental fund level reserves, if present
  - Syndicator-level guarantees
  - Fund diversification – in the case of a multi-fund investment
  - Experience of the development and management team and
  - Equity capital at-risk prior to stabilization.

Guideline: Review Other Income [specifically income derived from late fees]

2. What is being evaluated/mitigated?
Revenue from sources such as laundry and parking should be reasonable and comparable to other properties within the region and the developer's portfolio. The budget should only include items that are recurring, defensible, and voluntary to the tenant (e.g., do not underwrite rent late fees and other charges). If underwriting an acquisition/ rehab project, other income should be supported by historical operations.

3. Why is this a Guideline?
This guideline ensures that the property will earn enough revenue to cover operating expenses, reserves, and debt service with some cushion. Late fees should not be relied upon in structuring a deal and should be reasonable, consistent, and applied uniformly.

4. In what ways could the Guideline create barriers to participation?
While this guideline does not create barriers to participation, it does have a social justice and racial equity component as it relates to low-income residents, who may already be experiencing financial hardships. Imposing additional costs and fees in affordable housing properties could potentially be financially detrimental to them.

- **Laundry/Parking Fees:**
  Access to onsite and included laundry or private parking could save tenants time and money. Depending on the location and access to public transportation, having a vehicle can be a necessity if there are no other reasonable means to get to work, school, doctor's appointments, a laundromat, etc. Laundry may also be considered by some to be a necessity. While charging for laundry can improve operations, it increases the financial burden on tenants who are already paying a large portion of their income towards housing costs. Depending on the location of the property, having laundry access onsite or private parking available could also help to improve safety concerns for tenants. However, if such fees are included in the rent - this could prove to be a burden to developers and property managers who are already struggling to keep costs low to ensure the success of the development and meet affordable housing credits criteria.

- **Late-Fees:** Imposing late-fees could encourage tenants to pay rent on time and deter late payments while maintaining the property's cash flow. This could also help create or teach good financial habits for residents. Charging late fees can improve operations, but it increases the financial burden on tenants who may already be struggling to make payments on their rent.

5. What additions and/or changes to the guidelines are recommended?
For late fees, Investors could encourage developers to provide support to residents and take a more flexible approach, rather than relying on traditional late fees as a stick to motivate compliance. Some examples include:

- Additional grace periods before penalties kick in, if they are implemented in a way that does not endanger the property's sustainability
- Adopt creative ideas to support tenants in developing healthy financial habits:
  - Provide tenants with a rental app that has automated reminders/alerts of due dates, late notices, etc.
  - Provide tenants with financial education/support
  - Provide new tenant orientation to help set up tenants for success
  - Offer weekly or bi-monthly payment options
  - Support tenants in building credit scores by reporting rent payments
  - Implement a "Back on Track" Program that forgives certain amounts of overdue rent fees in exchange for volunteer work https://www.tampabay.com/news/pinellas/2020/12/21/pinellas-landlord-forgives-100-in-rent-for-every-hour-tenants-volunteer-for-local-charities/

Guideline: The Operating Deficit Guarantee (ODG) cap is typically sized to six months of operating expenses, replacement reserves and debt service (OERDS).

2. What is being evaluated/mitigated?

The ODG covers operating deficits that are not funded from the operating reserve.

3. Why is this a Guideline?

Developers are required to make certain financial obligations to the investor to back up their commitment to operate the property pursuant to the partnership agreement. The guideline establishes an industry standard minimum threshold for the developer's exposure to fund operating deficits out of pocket. This exposure represents "skin in the game", which should incentivize developers to ensure their properties are operating well.

Failure to fund deficits under the ODG is typically an event of default in the partnership agreement and can result in removal of the general partner. Operating deficits can result in foreclosure or impaired operations if debt service is not paid.

4. In what ways could the Guideline create barriers to participation?

- Emerging developers or mission-driven organizations may not have access to sufficient liquid assets to back an obligation equal to six months of OERDS.
- The ability of these entities to access a commercial line of credit in the event it is needed may be limited.
- Failure to fund deficits under the ODG is typically an event of default in the partnership agreement and can result in removal of the general partner. A n emerging developer or mission-driven entity may not be willing to accept this risk.
- Additional ODGs lead to higher contingent liabilities, which result in more scrutiny of the guarantor and its financial wherewithal to do the deal.

5. What additions and/or changes to the guidelines are recommended?

FLEXIBILITY: Allow all or a portion of the operating reserve to be drawn prior to the ODG. This would provide the developer with more cushion before they are obligated to fund out of pocket. Any draws on the operating reserve should be replenished by cash flow or otherwise secured by additional assets.

FLEXIBILITY: If the project can support an operating reserve greater than 6 months of OERDS, allow a reduction in the ODG such that the sum of the ODR and ODG is 12 months of OERDS. If the project is generating excess cash flow, consider annual deposits to the ODR offset by a reduction in the ODG.

FLEXIBILITY: If the debt is sized at greater than 1.20 initial DSC (and does not exhibit negative trending over the compliance period), consider an operating reserve sized at 6 months OERDS and an ODG cap at 3 months OERDS, especially if there are favorable deal characteristics such as rental subsidies, low or no hard debt leverage, large discounts to market rents, or pent-up market demand.

FLEXIBILITY: Consider allowing a letter of credit or another financial instrument to replace the ODG fully or partially. This would reduce the guarantor's contingent liabilities and future financial exposure but would also increase project cost.

Guideline: Commercial Space Lease Guarantees by Developer

Projects may have commercial space owned by the project and leased to private parties. Some project general partners lease the commercial space from the partnership for a fixed rate and then lease the space to individual private parties, a structure typically referred to as a "master lease." An investor may rely solely on the creditworthiness of the master lessee (the general partner-related tenant) or may want comfort as to the creditworthiness of the commercial space subtenant or the overall marketability of the space at underwritten rents should either the subtenant and/or master lessee fail to meet their obligations.

2. What is being evaluated/mitigated?

There is a risk that a commercial lessee could fail to pay the rent or that a commercial space could sit vacant, which could then affect the marketability of the entire property.

3. Why is this a Guideline?

The guideline protects the property and investors from operating deficits if the property is relying on the commercial space to generate income, which is why net operating income from commercial space is rarely included in proforma operating income.

4. In what ways could the Guideline create barriers to participation?

- Mission-driven and emerging developers doing business in very low-income communities may be required, or incented through a competitive tax credit process, to include ground floor commercial space even in areas that cannot support such space.
- Developers may not have the resources to master lease the commercial space or be unwilling to take the risk of failing to fund deficits under a master lease agreement, which is typically an event of default in the partnership agreement and can result in removal of the general partner. To allow for deeper income targeting, the project may need to underwrite and rely on commercial income, however, commercial income raises other underwriting challenges.

5. What additions and/or changes to the guidelines are recommended?

FLEXIBILITY: If the proforma demonstrated that the property can operate at a level the underwriter deems sufficient while assuming no operating income from the commercial space, one option is to allow the developer to forego a master lease agreement.

FLEXIBILITY: Keep the master lease agreement (structured as triple net so that the developer/master tenant covers any utilities and taxes if the space is vacant) but require payments to the partnership under the master lease only if the property is operating below breakeven.

FLEXIBILITY: If the operating proforma shows that commercial income is needed to assure the property operates above breakeven, allow the property to fund an additional operating deficit reserve to cover all or a portion of that shortfall rather than requiring a master lease arrangement.

FLEXIBILITY: If the developer cannot find a commercial tenant, consider suggesting that the developer identify potential temporary occupants (i.e., community art gallery) for the commercial space even if those tenants cannot pay rent, so the commercial space does not sit vacant. Alternatively, the developer could design and fit out the commercial space as a display space, so it does not appear vacant. Consider whether to plan for additional funds (upper-tier reserve or project level reserve) to engage a commercial broker to find a tenant, cover fit-out costs to make the space more marketable, and/or pay for items such as insurance and utilities that may have to be borne by the owner.

FLEXIBILITY: If the commercial space directly benefits the tenant population (i.e., a daycare center), investors or syndicators could consider other ways to help fund or lend to the commercial space if the potential operating deficits do not create too large of a risk.

Guideline: Tax Credit and Recapture Guarantee should match the initial compliance and credit recapture period of 15 years, and include the amount recaptured, interest, and penalties. The guarantee should be unlimited in amount and payable via a general partner advance rather than from property cash flow at any point during the compliance period. Investors should be mindful of carve-out provisions excluding certain events other than a change in the Internal Revenue Code or transfer of the limited partnership interest.

2. What is being evaluated/mitigated?

The Tax Credit and Recapture Guarantee covers investor losses up to the full amount of any recapture and/or lost credits, including penalties and interest.

3. Why is this a Guideline?

A low-income housing tax credit (LIHTC) property earns LIHTCs over 15 years (the compliance period), but the property delivers the credits to investors over an accelerated 10 years (the tax credit period). If the property does not operate as planned, a proportionate amount of the accelerated credits may have to be returned to the Internal Revenue Service (IRS). Recapture occurs either: (1) through a disposition of the building – if the new owner does not maintain affordability; (2) noncompliance of rent restricted units; or (3) a casualty loss that causes a tax credit unit or units to be out of service for a certain period. If there is an event of recapture or credit loss, the guarantor is obligated to make the investor whole.

4. In what ways could the Guideline create barriers to participation?

- Mission-driven and emerging developers may not have access to sufficient liquid assets to back such a large obligation.
- Failure to fund a guarantee obligation is typically an event of default in the partnership agreement and can result in removal of the general partner, a risk that an emerging developer or mission driven entity cannot bear.

5. What additions and/or changes to the guidelines are recommended?

FLEXIBILITY: Allow a cap on the tax credit guarantee up to the amount of the paid developer fee. This is already a fairly common practice among sophisticated nonprofit developers, who claim they cannot provide an uncapped guarantee under guidance issued years ago by the IRS, lest they jeopardize their tax-exempt status. Investors have been willing to accept the risk on deals with nonprofit developers, so they can consider providing the same flexibility to emerging developers.

Warning: The investor would have to cover any tax credit loss beyond what the developer's resources would cover.

FLEXIBILITY: Set up emerging developers for success by providing closer oversight or a third-party compliance specialist to oversee activiites such as tenant qualification and file review. This additional support could be phased out after a positive track record is established by the sponsor to handle this independently.

FLEXIBILITY: Establish a pooled resource or identify an existing fund for emerging developers to quickly access low-cost capital for repairs in the case of a casualty loss, while the developer works through the insurance process.

Guideline: Contributions + Holdbacks and Construction Liquidity Requirements

- **Developer fee contributions or holdbacks**
    - <=25% of cash fee paid at Closing
    - <=75% cumulative paid through Completion
    - <=90% cumulative paid through Stabilization/Conversion
    - >=10% of Permanent Loan Amount held back until Stabilization/Conversion
    - No more than 40% of total fee should be deferred
- **Capital contributions and/or hold back requirements**
    - >=60% held back until Completion and beyond
    - >=25% held back until Stabilization/Conversion and beyond
    - Sufficient equity held back until 8609 to cover potential downward adjusters
- **Construction Liquidity Requirements**
    - 15% for new construction and 25% for rehabilitation projects, calculated as the sum of (1) cash development fee held back until 100% completion, (2) hard cost contingency, and (3) guarantor liquidity divided by hard cost construction costs
    - 12% for new construction and 20% for rehabilitation projects, excluding guarantor liquidity from the calculation.

2. What is being evaluated/mitigated?

The guideline evaluates the percentage of equity and cash fee paid at each project milestone (closing, completion, stabilization/conversion, and 8609). Holding back equity and cash fee payments ensures that there is sufficient cushion in a deal to mitigate unforeseen circumstances, such as development cost overruns, permanent loan downsizings, and downward credit adjusters.

3. Why is this a Guideline?

Housing credit investments are structured with guarantees that obligate the guarantor to complete the development and deliver tax credits regardless of any cost overruns, delays, loan resizing, or other unforeseen circumstances that negatively affect a project. However, it is preferable to structure financial safeguards into the deal rather than relying solely on the guarantees. These in-deal mitigants are most clearly visible in line items included in the development budget such as hard and soft cost contingencies and lease up and operating deficit reserves, but the timing of capital contributions and cash fee payments are also important risk mitigants.

For example, cash developer fee (not deferred) that is held back until completion or beyond can be used to mitigate construction cost overruns that exceed the owner's hard cost contingency (HCC); the equity that was underwritten to be paid out as developer fee at completion can instead be redirected to project costs to cover the cost overruns. Similarly, cash fee held back until conversion or beyond can be redirected to cover a gap in permanent sources at conversion if the permanent loan needs to be resized to an amount lower than what was committed, due to a lower-than-underwritten stabilized net operating income (NOI) figure.

Equity holdbacks can be used to mitigate any potential downward adjusters; it is easier to pay out a smaller, downwardly adjusted amount of equity at 8609 than it is to retroactively recover capital that has already been contributed to a project.

Holdbacks vary on a deal-to-deal basis, depending on the inherent risks of each deal and developer, and they are considered in conjunction with other mitigants (e.g., an HCC below 5% might warrant a higher cash fee holdback). The timing of equity pay-ins and developer fee payments is an important tool that investors can use to mitigate risk without adding cost to a development budget. It is also a tool over which the investor has direct control, compared to the more difficult task of calling on a guarantee.

Holdbacks can either mitigate or intensify certain deal risks, so proper structuring of these levers is important (i.e., if there is placed in service deadline risk and a large amount of equity is contributed prior to completion, the risk is compounded by the aggressive equity pay-in).

4. In what ways could the Guideline create barriers to participation?

In contrast to investors, who prefer to backload capital contributions and developer fee payments, developers prefer earlier equity payouts and to receive as much cash fee as early as possible. The following are the ways in which AHIC guidelines might create barriers to participation:

Cash fee holdback requirements might:

- Disadvantage smaller and newer developers whose primary source of revenue is cash developer fees rather than management fees, payment of deferred fees, fundraising, or other sources that more-established firms might be able to rely upon.
- Disadvantage mission-driven entities whose primary focus has been social rather than economic outcome tracking (for instance where service-delivery to residents takes precedence over profitability) and who rely heavily on cash fee payments to cover staffing and overheard costs associated with development, predevelopment, and resident services.
- Disadvantage developers working in markets where the state or city housing finance agency, state, or local department of housing, or other government funder restricts total developer fee to a below-market rate percentage. For example, a cash fee holdback through stabilization of an amount equal to 10% of the permanent loan might represent a very large percentage of the total developer fee in the budget, if the fee has been capped by the city or state agency.

Equity holdback requirements might:

- Disadvantage smaller and less experienced developers who have fewer options for construction financing, since backloading equity will increase the construction loan amount as well as the loan-to-value and loan-to-cost metrics, potentially beyond an eligibility threshold. A higher construction loan will also add cost to the budget in the form of a higher origination fee and interest reserve, which might reduce cash fee (if

additional fee is deferred to cover the higher costs), making it harder for the developer to pay its staffing and overhead costs and to fund predevelopment costs for future projects.

Construction liquidity requirements might:

- Run into the same pitfalls described above under Cash Fee Holdbacks and in a separate guideline review (see page 8) that analyzes liquidity requirements.

5. What additions and/or changes to the guidelines are recommended?

- **Revision:** Right-size cash fee holdbacks to mitigate specific risks of the deal and other mitigants already present in the deal, rather than relying on a hard and fast percentage.
    - For example, if a project has an underwritten DSCR of 1.20x but the permanent loan and equity require only 1.15x, then the project does not necessarily need a cash fee holdback through conversion equal to 10% of the perm loan amount, since NOI can decline (in an increment that corresponds to a decline in DSCR from 1.20x to 1.15x) and the deal will still support the full permanent loan amount.
    - If a project has a hard or soft cost contingency that exceeds the recommended amount per the AHIC guideline, then consider accepting lower cash fee holdbacks, since the risk of cost overruns may be better mitigated by the in-budget contingencies.

Warning: Unlike a reserve or development fee holdback, which requires investor consent to be released, budget line items can be used by the developer and therefore may not be viewed as comparable by all investors.

- **Revision:** Consider paying developer fee at interim milestones, such as 75% completion or 100% lease-up. More frequent developer fee payouts may help emerging developers without creating additional risk for investors (see examples below). AHIC guidelines could be adjusted to provide percentage thresholds for the minimum amount of fee that should be held until less conventional milestones, such as 75% completion and 100% occupancy.
    - Cash fee held until Stabilization/Conversion is typically used to mitigate the possibility that Stabilized NOI ends up below the underwritten level. Once a property is 100% leased at underwritten rent levels, the investor has more certainty that underwritten NOI will be achieved at stabilization, and it may be appropriate to pay the developer a portion of the fee that they would otherwise receive 3+ months later at stabilization/conversion.
    - Similarly, a project that is 75% complete and on-budget will often have less risk of cost overruns than a project that is just beginning construction. It may be appropriate to pay out an increment of developer fee that is being held back until completion at this earlier milestone, since construction risk has decreased as the project has progressed.

    - Structuring a deal with more interim milestones for cash fee payments may help developers who rely heavily on developer fee payments to cover staffing and overhead costs, without creating additional risk for investors.

- **Revision:** Consider reducing equity holdbacks for projects that cannot afford or guarantee a higher construction loan, especially if the project has a strong social impact or helps an emerging developer get a foothold in the industry and begin to build a pipeline of projects that will be able to handle more traditional structuring in the future.
    - Consider providing equity early as a convertible bridge loan at a lower rate than a construction loan.
    - Since accelerating equity pay-ins has an impact on yield, investors could consider intangible benefits such as the value of building relationships with new developers and the social value of giving a small advantage to an emerging developer.

Warning. The guideline cannot just look at the percentage of cash fee, since if there is a very small fee (e.g., a deal has a budget problem prior to closing and the developer defers most of its fee; or the agency requires a low fee to win a 9% award), then more may need to be held back since 25% of a small number is less security against a set construction contract budget amount than 25% of a large number. The underwriter needs to examine this in relation to hard costs and the permanent loan to provide context to understanding the risk (the amount a construction budget could be exceeded or the amount a permanent loan could be downsized). This is even more important when there are guarantors with less cash. There is dilemma to balance, when investors would feel they need more security in the deal, but the emerging developer needs more fee upfront to build his or her business.

FLEXIBILITY: The risk profile of the project can be considered when determining cash fee and equity holdbacks. Measuring project risk varies by investor but some examples might include projects with more standard construction (2 story walk up new construction as opposed to adaptive reuse); long term rental subsidies; low project leverage relative to project equity; seasoned project partners including general contractors, consultants, and property managers; and the execution structure (multi fund with supplemental reserves, syndicator with strong monitoring).

FLEXIBILITY: An alternative to high cash fee holdbacks is to place additional emphasis on other areas of internal project liquidity, when an emerging developer's deal is already strong in these areas, such as larger than typical hard/soft cost contingencies, greater underwritten rent advantages in excess of AHIC guidelines, lower leverage, lower hard debt payments, underwritten Y1 NOI above the required level, and larger operating reserves (when these metrics exceed the guideline by a substantial amount). Many projects will already have some of these mitigants built in, and investors and syndicators could consider these as justification for accelerating cash fee payouts to emerging developers.

FLEXIBILITY: Consider accepting higher liquidity covenants as a mitigant for other risks, such as an accelerated fee payout. This compromise would give emerging developers more fee upfront with the idea they take only part of it to reinvest in the “next deal” while keeping a portion of that fee on their balance sheet as cash to back their guaranty to the investor.