Best Practices to Prevent Substandard Conditions in Low-Income Housing Tax Credit Properties

An Examination of Replacement Reserves Policies in Texas' LIHTC Program

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Executive Summary

Adequately funded replacement reserves play a critical role in the long-term financial and physical viability of Low Income Housing Tax Credit (LIHTC) properties but are often inadequate to address a property's capital needs. This report examines Texas' policies related to replacement reserves at LIHTC properties and how these policies could be improved to help ensure LIHTC properties remain in good condition throughout their affordability term.

Issues with Texas' Replacement Reserve Policies

Many of the issues with LIHTC properties having inadequate replacement reserves to address capital needs are baked into properties from day one, in policies related to the tax credit award and underwriting process. The competitive nature of the program and the underwriting requirements, among other factors, contribute to many LIHTC properties operating on thin margins, without adequate income after debt service to cover maintenance needs. A second set of policy issues relates to what happens to LIHTC properties after year 15 (and sometimes after year 10), as the capital needs at the property are escalating, the original investors exit the property, and the property takes on new debt. Absent additional policy interventions, the LIHTC program does not adequately incentivize investors and the new owners to prioritize the long-term physical vitality of their properties.

Against this backdrop, the following are the specific issues we identified with Texas' replacement reserve policies at LIHTC properties that could be strengthened through reforms:

Problems at Year One

1. **TDHCA's annual replacement reserve deposit requirements for LIHTC properties are too low and not indexed to inflation.** TDHCA's replacement reserve requirements fall below the reserve levels recommended by the National Council of State Housing Finance Agencies and have not been increased since 2004 for rehabilitation projects and 2013 for new construction projects.
2. **Texas does not limit replacement reserves to capital expenses.** Given the tight operating margins of LIHTC properties, several stakehlders we interviewed reported it is a common practice for owners to spend replacement reserves on routine maintenance of the unit, limiting the capacity of the replacement reserve fund to cover critical capital needs.

Problems after Year 15

1. **Texas does not require replacement reserves to remain with a LIHTC property when the investors exit the partnership.** As a result of this policy, stakeholders we interviewed reported that many investors take the replacement reserves with them at the exit.
2. **Texas does not routinely require a rigorous comprehensive assessment to identify LIHTC properties' physical conditions and capital needs, except in the resyndication process.** Although lenders require additional capital needs assessments outside the resyndication process, these assessments vary in qualify and reliability. A developer we spoke with called these assessments "MAIs," which he said stood for "Made As Instructed."

3. **Texas lacks strong protections in the investor exit and property flip process for ensuring a LIHTC property's capital needs are met**. Although TDHCA's executive director has discretion to withhold the approval of an ownership transfer in certain conditions, this authority is limited in scope and could be strengthened.

Policy Reform Opportunities

In this report, we present five categories of reforms for policies around replacement reserves and assessments of capital needs:

1. **Adopt More Robust Replacement Reserve Requirements.** TDHCA should consider strengthening its minimum replacement reserve deposit requirements through regulations increasing the deposit requirements and adjusting them annually for inflation.

2. **Restrict the Use of Replacement Reserves.** To prevent replacement reserves from being used for routine maintenance and turnover expenses, TDHCA should consider adopting regulations restricting the use of the reserves to capital improvements and extraordinary repairs.

3. **Require Capital Reserves to Stay with the Property.** TDHCA should consider adopting regulations requiring that replacement reserves stay with the property whenever an investor exits a property or the property is sold.

4. **Strengthen Policies Governing Investor Exits and Property Sales.** Building off best practices adopted in other states, TDHCA should consider strengthening its policies governing investor exits and sales of LIHTC properties by requiring TDHCA to deny LIHTC property transfers (including investor exits) unless the following three conditions are met:

    - The new owner secures a 20-year capital needs assessment, based off of TDHCA's rigorous Scope and Cost Review standards, setting out the property's capital needs, the cost of repairs needed, and projected contributions from reserves needed to accomplish the work.

    - The new owner submits a covenant committing to complete any health and safety issues immediately, to complete short-term needs within three years, and to complete long-term needs within the timeframe identified in the needs assessment.

    - The new owner sets aside at the closing adequate funds to address the property's health and safety issues and short-term capital needs and submits a covenant to make deposits to the reserve account to fund the long-term work.

    The latter two conditions would not apply to the extent there is insufficient net project equity to address the property's capital needs.

5. **Require Periodic Comprehensive Assessments of LIHTC Properties' Short- and Long-Term Capital Needs.** We recommend TDHCA consider obtaining a comprehensive assessment of capital needs at each LIHTC property every seven years, utilizing a third-party engineer secured by the Department and new assessment standards developed for these reviews. The assessment should include an examination of the property's replacement reserves and overall financial capacity to address the property's capital needs.

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We welcome your feedback on the report at housingpolicy@law.utexas.edu. For electronic access to the report, visit https://law.utexas.edu/clinics/housing-policy.

Introduction

This report focuses on Texas' policies related to replacement reserves in Low Income Housing Tax Credit (LIHTC) properties, to understand how these policies align with evolving best practices and how they could be improved to help ensure that LIHTC properties remain in good condition throughout their affordability term. This report is one of two reports created for Texas Housers as part of a Fall 2023 and Spring 2024 UT Housing Policy Clinic study of policies in Texas related to LIHTC building conditions.

The Housing Policy Clinic's study was completed in response to concerns raised about substandard conditions at a series of LIHTC properties in Texas. These properties included Coppertree Village Apartments in Houston and Rosemont at Oak Valley Apartments in Austin, where wide-ranging substandard living conditions jeopardized tenants' well-being. In addition, a group of LIHTC developers recently raised concerns to the Texas Legislature about challenges keeping LIHTC properties in good condition, in lobbying for legislation to roll back the 45-year affordability term in LIHTC properties.[1]

> *"Rosemont tenants still fighting for better living conditions after repairs show no change."*
>
> KEYE News,
> April 7, 2022

The findings in this report are based on a comprehensive literature review, research of other state policies, and interviews with 25 LIHTC experts and stakeholders, including a half-day roundtable we hosted in March 2024.[2] The individuals we interviewed included for-profit and non-profit developers, policy professionals, tenant advocates, and former and current housing finance agency staff.

The report is broken down into three primary sections: The first section focuses on issues related to replacement reserves that are baked into properties in the initial tax credit award process. The second section focuses on reserve issues related to LIHTC properties after year 15 (and sometimes after year 10) as investors exit the property and the property ownership changes. The third section identifies a series of opportunities for policy reforms related to replacement reserves in Texas to help keep LIHTC properties in good condition throughout their affordability term.

Background on Replacement Reserves

Replacement reserves, also called capital reserves, are funds set aside from a property's operating cash flow to cover future costs of replacing building components and equipment as they wear out, such as heating equipment, hot water heaters, roofs, flooring, and plumbing equipment.[3] These funds are controlled by the lender for the development. According to the National Council of State Housing Agencies, adequately funded replacement reserves are "essential to a rental development's long-term financial and physical viability."[4] Adequate reserves "are particularly important in Housing Credit developments, because rents are restricted and may not keep pace with operating, maintenance, and replacement costs."[5]

Despite the important role that replacement reserves play in ensuring the long-term upkeep of tax credit properties, the reserves are "usually insufficient after 15 years to cover current needs for renovation and upgrading" according to a study of the LIHTC program for the U.S. Department of Housing and Community Development (HUD).[6] As a result, according to one industry publication, "[e]very year thousands of [LIHTC] properties reach Year 15 of the initial tax credit compliance period and are faced with extensive physical needs but inadequate reserves to address them."[7] One large investor interviewed for the HUD study thought "that most LIHTC properties—with a few large-scale properties perhaps exceptions—run out of reserves by Years 5 to 8 and, after that, spend reserves as soon as they are funded."[8] The Joint Center for Housing Studies has also identified concerns with the LIHTC program's regulations and incentives for failing to ensure adequate replacement reserves.[9]

> *Adequately funded replacement reserves are "essential to a rental development's long-term financial and physical viability."*
>
> *National Council of State Housing Agencies, Recommended Practices in Housing Credit Administration*

A later study prepared for the Washington State Housing Finance Commission and Department of Commerce drilled down on the deficiencies in reserves even further, finding that only 4% of that state's LIHTC and Housing Trust Fund (HTF) properties had sufficient reserve funds to cover 75% to 100% of projected capital needs. Moreover, only 25% of their LIHTC and HTF properties had adequate reserve funds to cover 25% to 50% of their projected capital needs.[10]

While no similar quantitative evaluation of reserve deficiencies in Texas' LIHTC portfolio has been conducted, many of the stakeholders we spoke to during our study stated that the replacement reserves at LIHTC properties are inadequate to address the properties' capital needs and identified this is an area ripe for policy reform. A more precise examination of the reserve deficiencies in Texas' LIHTC properties, along the lines of the Washington State study, is included as a recommendation in this report.

Section 1. Problems on Day 1

Many of the issues causing LIHTC properties' inadequate replacement reserves are baked into properties from day one, in the tax credit award and underwriting process. For example, in the highly competitive tax credit program, housing finance agencies as "distributors of scarce resources … have been charged with providing each project with the minimum amount of subsidy necessary to make the deal work."[11] The competitive nature of the LIHTC program and the underwriting requirements, among other factors, contribute to many LIHTC properties operating on thin margins, without enough income after debt service to cover maintenance needs.[12] Many of the stakeholders we interviewed confirmed that LIHTC properties in Texas often end up operating on thin margins or even a negative cash-flow, leaving them with inadequate cash flow to address the properties' capital needs.

The LIHTC program's policies and incentives have failed to ensure that properties have adequate reserves to cover their capital needs.

Since LIHTC properties operate on such thin margins, policies in the tax credit award and underwriting process are especially critical to ensure properties set aside adequate reserves to address repair and capital needs.[13] Despite the essential role of reserves in LIHTC properties' long-term financial and physical viability, the LIHTC program's policies and incentives have failed to ensure that properties have adequate reserves to cover their capital needs. In addition to setting reserve minimums that are inadequate to cover capital needs, housing finance agencies may also place caps on replacement reserves.[14] One LIHTC developer we spoke with, for example, expressed concerns about the growing pushback they are receiving from a housing finance agency about the large reserves they incorporate into their pro formas submitted with applications for funding, even though these reserves have been critical to allowing the developer to address the capital needs at their properties.

Issues with Texas' Replacement Reserve Policies in the Tax Credit Award and Underwriting Process

The following are specific issues we identified with Texas' replacement reserve deposit requirements that could be strengthened through policy reforms, with a focus on issues related to policies governing LIHTC projects in the tax credit award and underwriting process.

1. The state's replacement reserve deposit requirements are too low.

In our discussions with several stakeholders about reserves, there was broad agreement that the Texas Department of Housing and Community Affairs' (TDHCA) requirements for annual replacement reserve deposits are too low. If TDHCA is the first lien lender or the first lien lender does not have a replacement reserve requirement, TDHCA requires LIHTC development owners to deposit annually $250 per unit for new construction developments, beginning when the

occupancy at the property has stabilized.[15] Although first-lien lenders are not required to adopt TDHCA's minimum reserve requirements, stakeholders told us it is industry practice to do so. Rehabilitation projects are required to deposit $300 per unit annually or an amount established through TDHCA's resyndication and "Scope and Cost Review" assessment process, if greater.[16]

A HUD guidebook on the HOME and LIHTC programs notes that lender reserve requirements have historically been inadequate in affordable housing programs since the requirements have been drawn from lender reserve requirements for market-rate housing.[17] The reserve needs in market-rate housing are relatively small because, unlike affordable housing programs, the first mortgage loans at these properties are refinanced every few years and the net operating income increases annually, both typically providing adequate capital along the way for capital improvements. These lower reserve requirements do not translate well to affordable apartments with capped rents.[18]

2. The state's minimum replacement reserve deposit requirements have not been adjusted for inflation

One reason why Texas' minimum replacement reserve deposit requirements are too low is that the minimum annual deposit requirements are not regularly adjusted for inflation.[19] The minimum deposit requirement for rehabilitation projects ($300) has not increased since it was adopted two decades ago,[20] while the deposit requirement for new construction developments ($250) has not increased since 2013.[21] If these deposit requirements had been adjusted for inflation, replacement reserve deposits for rehabilitation projects would start at $493 a year per unit in 2024 and deposits for new construction development would start at $333 a year per unit.[22]

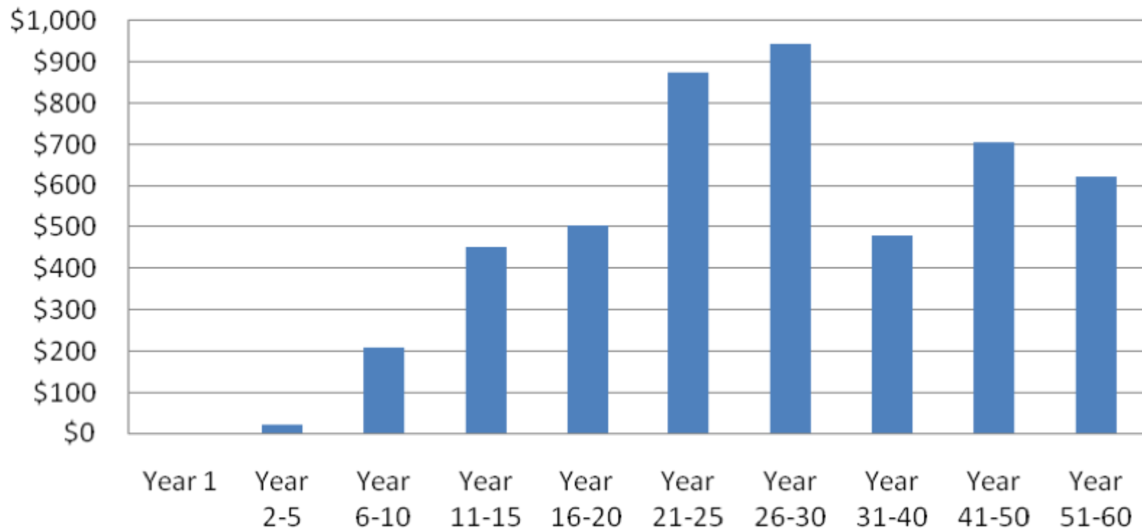
3. Texas does not limit expenditure of replacement reserves to capital expenses.

An additional issue is that the state's policies do not restrict reserves to capital expenses but instead allow the reserves to be used for any "necessary repairs."[23] Given the tight operating margins of LIHTC properties, several LIHTC owners we interviewed reported it is a common practice for owners to spend replacement reserves on routine maintenance of the unit, such as painting units and tenant turnover expenses, limiting the capacity of the replacement reserve fund to cover critical capital needs.

Section 2. Problems After Year 15

A second set of issues related to inadequate reserves is driven by what happens to LIHTC properties after year 15 (and sometimes after year 10), as investors exit the property and when the property ownership changes. Beginning in the 11th to 15th year after a new LIHTC property is put into service, the capital needs at the property begin to escalate, as depicted in Figure 1. And after Year 15, "virtually any building will need replacement and upgrading of major systems"[24]—such as roofs, appliances, water heaters, and HVAC equipment—with capital investment needs peaking in years 21-30.[25]

Figure 1. Average Annual Capital Needs Per Unit (constant dollars)



Source: U.S. Department of Housing and Urban Development, HOME and the Low-Income Housing Tax Credit Guidebook[26]

At the same time the capital needs of the property are mounting, the original investors begin exiting the property. Since the primary financial motivation of the original investors is receiving the tax credits, which are allocated over the first ten years, and the IRS no longer has authority after year 15 to recapture tax credits for noncompliance with program rules, most investors (i.e., the limited partner investors) exit the LIHTC partnership at year 16[27] (although there's been a recent trend of investors interests' being purchased before year 15).[28] Absent additional policy interventions, the program does not adequately incentivize investors to prioritize the long-term physical strength of LIHTC properties.[29]

Furthermore, when the limited partnership agreement's terms and state policies allow an investor to sell its limited partnership interest to the general partner for a price that exceeds the amount of the outstanding debt and exit taxes, the investors' exit from the property will often encumber the property with significant additional debt.[30] This additional debt limits "the cash flow that is available for operating the property and meeting its capital needs over time."[31]

Once the investors sell their interest or the LIHTC property ownership otherwise flips, several of the stakeholders we interviewed reported that the new owners have limited financial incentive to invest in repairs and capital improvements beyond the bare minimum required to pass inspection. These owners often end up deferring repairs that will not become urgent until after their planned exit. Unlike with market-rate properties—where new owners will invest in improvements to the property if the improvements can support an increase in the rents (i.e., tenants are willing to pay more for the property if it is "nicer" or has certain upgrades)—rents are capped at LIHTC properties.

When the LIHTC property ownership flips, the new owners have limited financial incentive to invest in repairs and capital improvements beyond the bare minimum required to pass inspection.

We heard from several stakeholders that it's a common practice for each new round of owners to put "lipstick on a pig" through purely cosmetic repairs, such as new paint, rather than investing in any type of significant capital improvements. According to these stakeholders, it's also typical for these new owners to not secure an adequate comprehensive assessment of the capital needs at the property and to not set aside adequate reserves to address those needs. Thus, with each change in ownership, these particular properties continue to take on more debt while the property conditions continue to deteriorate.

One of the stakeholders we spoke with identified this dynamic as the core issue at play with the substandard conditions at a particular substandard LIHTC property in Austin, which flipped ownership four times. At each flip, the property took on more debt without any significant investment in capital improvements.

A for-profit developer we spoke with shared an example of a LIHTC property up for sale with $2 million in capital needs, but the broker reported that the lender never requires more than $500,000 in up-front reserves.

A related issue with LIHTC property flips is that the lender underwriting the ownership change typically does not take into account the investments in capital improvements needed to support the long-term habitability of the property. For example, a for-profit developer we spoke with shared an example of a LIHTC property up for sale with $2 million in capital needs, but the broker reported that the lender never requires more than $500,000 in up-front reserves. One driver of lenders' inadequate reserve policies is that lender underwriting, including lender requirements around capital improvements and reserves, is typically based on a short-term horizon. That's because for-profit buyers typically own multifamily properties as a short-term investment (one study identified a three- to seven-year hold period as typical).[32]

A final structural flaw in the LIHTC program called out by stakeholders that impacts property conditions is that the program incentivizes owners to intentionally delay expenditures on capital improvements in order to qualify the property for a new allocation of tax credits. These new allocations of credits, called resyndications, require minimum per-unit rehab costs. One housing industry publication recommends, for example, that LIHTC property owners "correct any current minor physical deficiencies to maintain the property's occupancy level and curb appeal," but try and delay any major capital improvements until the resyndication.[33]

Summary of Texas' Policies Governing Ownership Transfers

With a few exceptions, written approval from TDHCA's executive director must be secured before a LIHTC property or a controlling interest in the property is sold or otherwise transferred.[34] Exceptions to this policy include exits of the investment limited partner or non-controlling limited partner, as well as a few other circumstances designated in the Department's regulations and Post-Award Activities Manual.[35]

For LIHTC property transfers requiring TDHCA's approval, the owners must provide written notice and a completed ownership transfer packet to TDHCA at least 45 days before the transfer of the property.[36] The packet requires a detailed 30-year operating pro forma, among other information.[37]

When the ownership transfers, TDHCA's Asset Mangement Division has discretion to request an assessment of the physical condition of the property if one has not already been submitted.[38] The industry standard is to obtain a Capital Needs Assessment (CNA) at this stage. We heard from multiple stakeholders that the CNAs vary drastically in quality and reliability. TDHCA has adopted a rigorous, comprehensive and more reliable assessment process in the Real Estate Analysis Rule, called a Scope and Cost Review, or SCR, to identify a property's physical condition and capital needs. However, the Department requires this assessment process only at the time of underwriting a resyndication for rehabilitation and adaptive reuse projects (usually meaning a property transfer, but not always).[39]

The regulations and guidelines governing the executive director's approval of an ownership transfer provide limited guidance for when approval may be denied and appear to be aimed at a review of the new owner's qualifications. Specifically, TDHCA's guidelines provide that the Department may deny an application for an ownership transfer when "it cannot be demonstrated that the proposed new individuals or entities have the financial capacity or experience" to serve as an owner of the development.[40] And the regulations provide that the executive director "may not unreasonably withhold approval of the transfer requested in compliance with this section."[41]

In certain instances, TDHCA may require the prospective development owner to increase the amount of regular deposits to the replacement reserve account. This authority arises if the development has (1) a history of uncorrected inspection violations, (2) ongoing issues with keeping the property safe, sanitary, and decent,[42] or (3) an account balance that is below the annual reserve deposit amount or that appears insufficient to meet capital expenditure needs as indicated by the repair needs identified in the property needs assessment for the development.[43] As a condition of approving the transfer, the Department may also require the submission of a plan and timeline addressing how the departing or incoming owner will address the needed repairs or renovations.[44]

Issues with Texas' Policies After Year 15

We identified the following issues with Texas' policies governing LIHTC properties after year 15 that contribute to inadequate reserves and unaddressed capital needs at properties.

1. Texas does not require replacement reserves to remain with a LIHTC property when the investors exit the partnership.

TDHCA's regulations allow investors to take the replacement reserves with them when they exit the partnership.[45] As a result of this policy, stakeholders reported that many investors take the replacement reserves with them at the exit, depleting whatever funds may have been dedicated for capital improvements. This policy reduces the incentives for investors to use the reserves for capital improvements at the property. At the same time, several stakeholders we spoke with noted that these replacement reserves may already be spent down by year 15, as LIHTC owners commonly use these reserves for routine maintenance rather than capital expenses, due to properties operating on very thin margins.

2. TDHCA does not routinely require rigorous capital needs assessments of LIHTC properties outside of the resyndication process.

Except in resyndication projects, TDHCA does not regularly require a rigorous assessment during the operation of the property or when the property ownership flips to identify a property's capital needs and adjustments needed to reserves. Although lenders routinely require capital needs assessments in underwriting a new loan for the property, we heard from multiple stakeholders that these assessments vary drastically in quality and reliability, as discussed above. In emphasizing the extremely ad hoc nature of these assessments, one for-profit developer we spoke to even called these assessments "MAIs," which he said stood for "Made As Instructed." After year 15, TDHCA staff conducts a physical inspection of LIHTC properties at least once every three years, but these inspections are different in scope from a capital needs assessment, which examines a property's anticipated future capital expenses.

3. Texas lacks strong protections in the investor exit and property flip process for ensuring investors address a LIHTC property's capital needs before stripping equity from the property or saddling the property with additional debt.

Although TDHCA's executive director has discretion to withhold the approval of an ownership transfer in certain conditions, this authority is limited in scope and could be strengthened to better incentivize investors and property owners to address a LIHTC property's capital needs before they pull a lot of equity out of the property and the property takes on increased debt. For instance, the executive director's authority to deny a transfer does not extend to limited-partner investor exits.[46] And in instances where a property has outstanding capital needs—even when those needs are creating major health and safety issues for the tenants—the Department's authority to condition an ownership transfer on completion of the repairs is merely discretionary, rather than mandatory.[47] The state's regulations also lack guarantees to ensure that pressing capital needs identified in a property assessment will be completed by a certain time.

4. Annual increases to a property's replacement reserve deposit requirement do not extend throughout the property's affordability term.

Although TDHCA has not adjusted for inflation the initial baseline requirement for replacement reserve deposits, TDHCA requires developers to use a three percent annual escalator for 15 years, via the 15-year pro forma submitted with the tax credit application.[48] For example, in year one the reserve deposit requirement for a new construction project would be set at $250 a unit and then adjusted by three percent each year after that for a 15-year period. TDHCA's escalator requirement, however, is insufficient to ensure that LIHTC owners will continue to adjust for inflation the replacement reserve deposits throughout the affordability period, which can run as long as 45 years for 9% LIHTC projects.[49]

Section 3. Reform Opportunities

In this Section we present a number of opportunities for reforms to help ensure LIHTC properties in Texas have adequate replacement reserves to address their capital needs and remain in good physical condition.

Reform Opportunity #1: Adopt More Robust Replacement Reserve Requirements

TDHCA could enhance its minimum replacement reserve deposit requirements through the following policy changes:

1. **Increase the state's annual replacement reserve deposit requirements, with annual adjustments in inflation for future projects receiving credits.**
2. **Incorporate the Department's three percent annual escalator requirement for reserve deposits into TDHCA's regulations and require the escalator to extend throughout the affordability term of a LIHTC property.**

Ideally, these minimum requirements would apply regardless of whether TDHCA is the first lien lender, unless the first lien lender requires higher reserves.

As we mentioned earlier, there was broad agreement among the stakeholders we spoke with about reserves—including both nonprofit and for-profit developers—that Texas' current minimum reserve requirements are inadequate to address properties' long-term capital needs. According to a study from Washington State, "even a marginal increase to replacement reserve set-aside amounts on new projects will improve the overall risk profile and financial health" of the state's affordable housing portfolio.[50]

We do not offer a specific figure for the recommended increase in the minimum deposit requirements, although we recommend that the deposit requirements reflect at least the present dollar value of the requirements when they were last adjusted by TDHCA. These adjusted figures in 2024 dollars are $493 per unit for rehabilitation projects and $333 per unit for new developments. The figures should also be informed by the National Council of State Housing Agencies' recommended practices for minimum replacement reserve deposits in LIHTC properties, which start at $300 per unit for senior new construction projects and $350 per unit for other properties, with adjustments for inflation.[51] NCSHA's recommended practices further state that a housing finance agency's "analysis of trends in reserve balances may suggest higher reserve requirements than the above minimums for certain developments."[52]

As per NCSHA's best practices, we also recommend TDHCA conduct an analysis of trends in reserve balances at LIHTC properties in Texas. TDHCA already gathers information about LIHTC properties' reserve account balances, through the annual financial certificate packet that owners must submit to TDHCA's asset management division,[53] which could be used in the analysis. The required certificate must also include, among other items, a description of capital improvement expenses made during the year and the date of the most recent CNA.[54] Analysis is also needed to consider what level of reserve

increases could be supported without changing the state's financing of LIHTC projects and when financing changes would be necessary.

State Policies and Models

Below are examples of more robust reserve requirements adopted by other states:

- **Minnesota** requires annual deposits of $450 per unit for non-senior projects and $300 per unit for senior projects.[55] If the 20-year CNA indicates a higher amount is needed, then the housing finance agency will require one or more of the following: higher annual deposits, annual escalators to the reserve deposit, and a borrow-funded initial deposit.[56] If the project is only receiving tax credits from the state, the state's housing agency may defer to the syndicator or lender requirements.[57]
- **Oregon** requires annual deposits of $350 per unit for non-senior projects and $300 per unit for senior projects.[58] The developer's operating pro forma submitted with a LIHTC application must "demonstrate that the Project will continue to be economically feasible and have adequate replacement reserves for an extended use period of an additional fifteen (15) years after the initial compliance periods."[59] The operating pro forma "must list each of the compliance periods and extended use periods separately and include assumptions, notes and explanations regarding the respective income and expense projections."[60]
- **Utah** requires annual deposits of $350 per unit for rehab and $300 per unit for new construction, with adjustments for inflation.[61]
- **Vermont** requires annual deposits of $400 per unit or the amount recommended by the property's CNA, whichever is greater.[62]

A 2015 briefing paper by the Association for Neighborhood and Housing Development, a trade association for neighborhood-based housing groups in New York City, recommended that up-front reserves in 9% LIHTC properties be set at $15,000 per unit with annual reserve requirements set at $750 a year and increased 5% per year.[63] These recommendations were based on detailed underwriting scenarios that the association commissioned to identify policies needed to support permanent affordability in LIHTC properties and other properties receiving public subsidies. The briefing paper recognized that this level of change to replacement reserves would require changes in the financing of LIHTC developments.[64]

Considerations

Increasing the minimum reserve requirements will increase LIHTC properties' operating expenses, decreasing the amount of private debt that can be leveraged to fund tax credit projects. Because rents are capped, increases to reserve requirements may result in cost cutting elsewhere at the property in the absence of additional public subsidies.

Reform Opportunity #2: Adopt Regulations Regarding Permissible Uses of Replacement Reserves

To prevent replacement reserves from being used for routine maintenance, TDHCA could adopt regulations restricting the use of replacement reserves to capital improvements and extraordinary repairs. Ideally, the regulations would apply regardless of whether TDHCA is the first lien lender. The Department could also consider regulations requiring the Department's approval of replacement reserve expenditures over a certain amount.

State Policies and Models

States that have adopted policies outlining the permissible uses of replacement reserves or requiring approval of expenditures from reserve accounts include:

- **California** dictates that replacement reserves may be used only for capital improvements or repairs.[65]
- **New Hampshire** prohibits developers from using replacement reserves for "normal repair or maintenance items."[66] Developers must request written approval from the state housing finance agency for withdrawals greater than $5,000 or "for items not considered part of ordinary turnover considered major expenses."[67] The state's housing finance agency provides a list of capital needs that replacement reserves can be used for and the range of their useful life.[68]
- **Oregon** requires tax credit properties financed solely through the Department to utilize replacement reserves solely for replacement of capital items, certain part replacements, and "extraordinary" repairs or maintenance, which are defined in the state's guidelines.[69] The state also requires owners to submit a request for approval from the housing finance agency for the expenditure of replacement reserve funds.[70] The request must include a description of the items to be funded from the reserves and provide justification for items that involve extraordinary repairs or maintenance replacement of a capital item.[71]
- **Vermont** requires written approval for withdrawals from reserve accounts.[72] The state's housing finance agency dictates that replacement reserves may be used only for replacing "structural elements, mechanical equipment, or other similar purposes."[73] Additionally, Vermont reserves the right to request any unused amount budgeted for maintenance in the operating reserves be deposited into the reserve account.[74]
- **The National Council of State Housing Agencies** recommends that state housing agencies develop asset management procedures for LIHTC properties that may include agencies managing replacement reserves and requiring approval of expenditures from reserve accounts.[75]
- **HUD's** policies governing replacement reserve accounts in certain properties—including those with HUD-insured and HUD-held mortgages and Section 202 funding—contain a detailed list of the types of expenditures that are eligible and ineligible for reimbursement from the replacement reserves.[76]

- **USDA Rural Development** includes a detailed list of program guidelines governing withdrawals from reserve accounts in properties receiving multifamily housing loans from the agency.[77]

Reform Opportunity #3: Require Capital Reserves Stay with the Property When Investors Exit or the Property Is Sold

When an investor exits a property or the property is sold, we recommend TDHCA require that replacement reserves stay with the property. There was broad support for this policy among the stakeholders we spoke to about this policy proposal.

State Policies and Models

States that require reserves to stay with the property include the following:

- In **California**, replacement and operating reserves must remain with the project upon ownership transfer "except when a public lender funds rent subsidy and/or service reserves and requires repayment of unused rent subsidy and/or service reserves."[78] The buyer or seller may purchase replacement reserves for an amount equal to the reserve account balance.[79]
- In **Minnesota**, reserves must stay with the property for the entire extended use period.[80] "The Limited Partnership Agreement must include a provision … that specifically states that upon the transfer of any ownership interest or at the end of the compliance period, whichever is earlier, any funds remaining in the reserve accounts must remain with the development for the term of Minnesota Housing's loan or the Extended Use Period, whichever is longer."[81]
- **Oregon** requires replacement reserves to remain with the property when there is a transfer of ownership or the property is sold if the developer has a loan from the Department.[82]

The NCSHA also recommends that state housing agencies require reserves to stay with a development at the time of the investor exit and that agencies review partnership agreements to ensure this policy is enforced.[83] NCHSA recognizes that control of the reserves is a "controversial" topic.[84] Investors "often seek the return of unused reserve balances" when they exit a LIHTC partnership, while the owner "typically expects these reserves to stay with the property" in case capital repairs need to be made.[85] Despite this controversy, NCHSA states that retaining the reserves is essential for facilitating preservation of the property.[86]

Considerations

If investors do not get to keep replacement reserves when they exit the partnership, they may be less incentivized to scrutinize how replacement reserves are used at the property. This could in turn exacerbate the issue of capital reserves being used for things like routine maintenance and turnover expenses. However, adopting regulations governing how replacement reserves are spent, which is identified as a reform opportunity above, would ameliorate this concern.

Reform Opportunity #4: Strengthen Policies Governing Investor Exits and Property Sales

The following set of reforms would strengthen the state's policies governing investor exits and sales of LIHTC properties to protect against investors taking money out of the property while leaving capital needs unaddressed. These reforms are modeled on the state best practices discussed below. Specifically, these reforms would require the Department to deny LIHTC property transfers unless the following conditions are met (with the definition of a transfer including investor exits and changes to any general partner, member, or equivalent responsible party).

Recommended conditions for LIHTC property transfers and investor exits

- **The owners secure a 20-year capital needs assessment**, based off of TDHCA's rigorous Scope and Cost Review standards, setting out the property's capital needs, the cost of repairs needed, and projected contributions from reserves needed to accomplish the work (see below in Recommendation #5 for recommendations regarding additional policy reforms needed to improve the quality and reliability of capital needs assessments);
- **The new owner submits a covenant** committing to complete any health and safety issues immediately, to complete short-term needs within three years, and to complete long-term needs within the timeframe identified in the property needs assessment; and
- **The new owner sets aside at the closing adequate funds** to address the property's health and safety issues and short-term capital needs and submits a covenant to make deposits to the reserve account to adequately fund the long-term work.

TDHCA's executive director should have authority to waive these requirements where there is insufficient net project equity to address the capital needs (see California's transfer policy regulations for more useful detail regarding this authority along with other appropriate exceptions to the transfer policy[87]). In addition, for LIHTC property transfers involving a resyndication of tax credits, if there is an equity takeout involved in a transfer, the takeout should be used first to cover the capital needs at the property.

We received positive feedback on this proposed policy reform from several stakeholders, including nonprofit and for-profit developers.

States' Policies and Models

We identified several policies in other states that have more robust procedures and regulations governing the sale or transfer of LIHTC properties that promote the long-term preservation of these properties. These policies can help inform avenues for policy reform in Texas.

When a LIHTC property's ownership flips, California's policies ensure that any equity in the property is first used towards addressing the property's capital needs before flowing out of the property. The policy has saved the state millions of dollars in public resources.

- **California** has adopted a set of robust policies directed towards the transfer of a LIHTC property to ensure the property is set up for long-term success upon transfer. The covered transfers include changes to the project ownership and partnership interest in the project.[88] The reform opportunity discussed immediately above is largely drawn from California's policies.

  The following is a summary of California's transfer and equity take-out policy, with additional detail available in the state's regulations governing transfers[89] and the California Tax Credit Allocation Committee's Compliance Online Reference Manual.[90]

  - Before a property is transferred, the property owners must submit a capital needs assessment setting forth the capital needs of the property for the next 15 years, the cost of the repairs needed, and the projected contributions to reserves that will be needed to accomplish that work.[91]
  - The new owner is required to submit a covenant committing to (1) perform the short-term work within three years of the transfer event; (2) set aside at the closing "adequate funds" to perform the short-term work identified in the assessment; (3) make deposits to the reserve account necessary to fund the long-term work; and (4) complete the long-term work. A property cannot be transferred without meeting these standards unless it falls under an exception.[92]
  - For LIHTC property transfers involving a resyndication of tax credits, if there is an equity takeout involved in a transfer, the takeout must be used first to cover the short-term capital needs at the property.
  - California conducts a due diligence review of the proposed owner and management company.[93]

  The executive director of the state's Tax Credit Allocation Committee may waive these requirements in the event the transfer does not produce sufficient net equity after certain allowable distributions to the limited partners.[94]

We spoke to the former and current executive directors of California's Tax Credit Allocation Committee, who both reported that the state's transfer policy, which was adopted in 2015, has overall been very successful in supporting the physical upkeep of LIHTC properties.[95] But there has been some likely gaming by property owners that could be addressed through additional policy reforms. For example, the former director mentioned that some owners seem to direct the assessor evaluating the property's conditions to shift short-term needs to long-term needs in the property's capital needs assessment.[96]

California's transfer reforms were developed with input from developers after an owner made a huge profit from selling a large affordable housing portfolio in the state without addressing the property's capital needs, expecting tax credits to fund the repairs. Two employees with the Tax Credit Allocation Committee are responsible for implementing California's transfer policy. Overall, the transfer policy has saved the state millions of dollars in public resources, by ensuring that any equity in the property is first used towards addressing properties' short-term capital needs before flowing out of the property, rather than leaving the state on the hook to fund properties' capital needs.[97]

- **Oregon** requires a capital needs assessment before approving an ownership transfer or property sale if the developer has a loan from the state's housing finance agency (HFA).[98] Health and safety issues must be corrected immediately by the seller.[99] If there are other "significant findings" that cannot be corrected before the transfer, the HFA may require that the seller's proceeds from the sale equaling 150 percent of the bid or estimated cost of repairs be held in an escrow under the HFA's control.[100] The HFA also requires that "any compliance review findings, deferred maintenance, and/or repairs identified" through inspections of the property be corrected before the transfer.[101] An estimate of the repairs as well as a plan for funding must be provided during the transfer approval process. [102] The HFA then performs a physical inspection prior to the closing to confirm all repairs have been completed.[103]
- **New York City** conditions the housing finance agency's consent to an ownership transfer based on an assessment of capital needs, project reserves, and cash flow for the remainder of the regulatory term.[104]

Considerations

As discussed above, a policy denying investor exits and other forms of property transfers without assurances that a property's capital needs will be met could result in gaming on the part of investors, such as classifying short-term capital needs as long-term needs in a capital needs assessment. For resyndication projects, this risk in Texas is mitigated by TDHCA's rigorous requirements governing Scope and Cost Reviews. Outside of the resyndicatin process, a policy reform that would help combat the risk of gaming is for TDHCA to standardize capital needs assessments for ownership transers (see below for further discussion of this policy reform).

Reform Opportunity # 5: Require Periodic Comprehensive Assessments of Property Conditions

We recommend TDHCA require a comprehensive capital needs assessment at all LIHTC properties every seven years. We also recommend TDHCA adopt new standards governing these assessments, using a modified Scope and Cost Review Process with a focus on health and safety issues and core building system components. These assessments should include an examination of the property's short- and long-term capital needs, the adequacy of the property's replacement reserves, and the property's overall financial capacity to address the capital needs.

Further research is needed to more precisely identify the types of requirements and guidelines needed for the periodic assessments. For example, one stakeholder recommended TDHCA maintain a standardized assessment form listing out the major building components that must be assessed (e.g., roof, HVAC system, etc.) and require that the age of the building components be listed, along with the useful life remaining. Ideally, to ensure quality control, the assessments would be obtained by TDHCA from a third party engingeer, rather than being secured by the owner. More detailed standards would also help provide quality control.

The state models listed below could provide additional guidance for such a policy. For example, Vermont's detailed assessment guidelines include tables with the estimated useful life for property systems and components, removing some of the discretion involved in these assessments.

State Policies and Models

State requirements vary widely in terms of the horizon of capital needs assessments for LIHTC properties (i.e., how far into the future the assessment examines the property's capital needs), how often the assessment must be performed, how much the state's housing finance agency regulates the scope of the assessment, and what the housing finance agency does with the assessment.

Here is a summary of what we reviewed regarding capital needs assessments in a few states:

- **New Hampshire** requires a capital needs assessment every 10 years through the life of the loan for properties refinanced through the state housing finance agency or acquired with agency financing.[105] The assessment must include a 20-year forecast of capital improvements, cost estimates for capital improvements recommended in the first 10 years, and an accessibility study.[106] The state agency has discretion to request changes to the assessment.[107]

- **New York State** requires a 20-year capital needs assessment for all rehab properties.[108] The state has issued detailed guidelines on the scope of these assessments, which also integrates energy efficiency and health-related improvements.[109] The assessment must be done by a firm from the state's list of pre-qualified assessors, which the state creates using a request for qualifications process.[110]

- **Vermont** requires a capital needs assessment performed by an approved third party every five years for all LIHTC properties (with an option for an in-house assessment by the property owner at years 5, 15, 25, etc.).[111] Vermont requires the assessments to cover a 20-year period and provides detailed guidelines on what the assessment must examine, including an

assessment of every building system, the age of each system or item, and "[a] detailed year-by-year cost summary of all of the anticipated capital needs."[112] The assessment must also "evaluate existing capital reserves and annual contributions to reserves against the long-term spending plan."[113] The state's capital needs assessment guide includes tables with the estimated useful life for property systems and components. Further, Vermont specifies the minimum qualifications for assessors[114] and offers a list of approved vendors.[115]

- **HUD**: A couple of stakeholders also reported that HUD maintains a list of approved property appraisers to conduct capital needs assessments for properties receiving certain types of HUD financing.

The NCSHA has identified a number of best practices regarding capital needs assessments. NCHSA recommends that a "competent third party, such as a licensed architect or engineer" perform the assessments.[116] NCHSA also recommends that assessors conduct both a site visit and physical inspection of the property and an interview with "on-site property management and maintenance personnel to inquire about past repairs/improvements, pending repairs, and existing or chronic physical deficiencies."[117] NCHSA has identified areas the assessment should examine and analyze, including structural systems, mechanical systems, and "[p]otential risks the property faces considering the impact of recent natural disasters and hazards in the area."[118]

Section 4. Areas for Further Research

The following are areas where we recommend further exploration and analysis:

- **BEST PRACTICES FOR CAPITAL NEEDS ASSESSEMENT GUIDELINES.** Capital needs assessments are required in most affordable housing programs and, if implemented appropriately, appear to be a best practice in catching any red flags in a property's financial capacity to meet its long-term capital needs. As discussed above, further research is necessary to understand which standards make the most sense for conducting periodic assessments of LIHTC properties outside of the resyndication and ownership transfer process. One avenue worth exploring is looking at HUD's standards, which several stakeholders reported are very comprehensive and could serve as a guide for state reforms. Vermont has also promulgated comprehensive guidelines for periodic assessments. TDHCA's Scope and Cost Review standards utilizated in resyndications are also a good model.
- **ANALYSIS OF RESERVES AT LIHTC PROPERTIES IN TEXAS.** More research is needed on reserve balances at tax credit properties in Texas in comparison to capital needs, to help guide policy decisions around increasing the minimum reserve deposit amounts. This recommendation is aligned with the NCSHA recommendation that housing finance agencies conduct an analysis of trends in their portfolio's reserve balances.[119] Research is also needed to understand when increases in reserves will require changes to the financing of LIHTC projects.
- **REFORMS TO TEXAS' RIGHT OF FIRST REFUSAL (ROFR) LAWS**. Several stakeholders shared ongoing concerns with changes to the state's ROFR policies that have made it more difficult for nonprofit housing providers to acquire the property after Year 15 for the Minimum Purchase Price (basically, the outstanding debt + exit taxes). These stakeholders reported that this policy is resulting in more LIHTC properties taking on additional debt, making it more difficult to address the properties' capital needs. This particular area of reform was outside the scope of this research project but merits further examination.[120]

Conclusion

This report presents a set of potential policies to safeguard the physical integrity of LIHTC properties across Texas through reforms to the state's replacement reserve policies. From bolstering replacement reserve policies in the underwriting process to addressing reserves in investor exits and property sales, there are number of reform opportunities around reserve policies for Texas policymakers to consider that would support the long-term physical integrity of the state's LIHTC property portfolio and help ensure low-income renters have access to safe and decent living conditions. Although effective replacement reserve policies are by no means the only tool needed for safeguarding the physical integrity of LIHTC properties, they are a critical tool.

Endnotes

[1] Tex. H.B. 3591, 88th Leg., R.S. (2023); hearing on House Bill 3591 before the Texas House Urban Affairs Committee, 88th Leg., R.S. (Mar. 28, 2023).

[2] *See infra* Appendix 1 for the list of stakeholders we interviewed for this project.

[3] VT. HOUS. & FIN. AUTH. & VT. HOUS. & CONSERVATION BD., CAPITAL NEEDS ASSESSMENT (CNA) GUIDANCE 2 (2015). Operating reserves, on the other hand, are used to cover day-to-day expenses, such as utilities, maintenance and repairs, and marketing and leasing. U.S. DEP'T OF HOUS. & URBAN DEV., COVID-19 HOMELESS SYSTEM RESPONSE: ESTABLISHING A CAPITALIZED OPERATING RESERVE 1 (2021).

[4] NAT'L COUNCIL OF STATE HOUS. AGENCIES, RECOMMENDED PRACTICES IN HOUSING CREDIT ADMINISTRATION 24 (2023).

[5] *Id.*

[6] U.S. DEP'T OF HOUS. & URB. DEV., WHAT HAPPENS TO LOW INCOME HOUSING TAX CREDIT PROPERTIES AT YEAR 15 AND BEYOND, at xiii (2012).

[7] Allen Feliz, *Preparing for a Post-Year 15 LIHTC Property Re-Syndication: An Overview*, TAX CREDIT ADVISOR, June 2012, at 22. See also Alex Schwartz and Edwin Meléndez, *Challenges with the Low-Income Housing Tax Credits after Year 15*, 19:2 HOUSING POLICY DEBATE 261, 263 ("The chief finding of our research is that the biggest threat to the long-term viability of tax credit housing as a resource for low-income households stems less from the expiration of income and/or rent restrictions and more from the need for major capital improvements.").

[8] U.S. DEP'T OF HOUS. & URBAN DEV., *supra* note 6, at 48.

[9] JOINT CENTER FOR HOUSING STUDIES OF HARVARD UNIVERSITY, LONG-TERM LOW INCOME HOUSING TAX CREDIT POLICY QUESTIONS (Nov. 2010), at 24.

[10] HOUS. DEV. CTR., WASHINGTON STATE AFFORDABLE HOUSING PORTFOLIO STUDY 6 (2015). In addition, many stakeholders interviewed for the Joint Center for Housing Studies study discussed above "were concerned that long-term capital funding for LIHTC properties was insecure." JOINT CENTER FOR HOUSING STUDIES, *supra* note 9, at 24. One informant reported, for example, that replacement reserves were "consistently under budgeted," and the only reason more LIHTC properties have not faced financial difficulty is because of favorable trends in interest rates—a factor that no longer exists. *Id.*

[11] U.S. DEP'T OF HOUS. & URBAN DEV., *supra* note 6, at 43.

[12] *See, e.g.,* Jill Stonehouse, *Housing Tax Credit Investments, Adjusters, and Timing*, AFFORDABLE HOUSING FINANCE (Oct 1, 2007), noting that in any given year, approximately one-third of LIHTC properties have an operating deficit.

[13] NAT'L COUNCIL OF STATE HOUS. AGENCIES, *supra* note 4, at 24.

[14] Jakob B. von Trapp, *Rethinking Year 15: What Determines the Terminal Valuation of LIHTC Financed Transactions?*, Massachusetts Institute of Technology Master's Thesis, at 47, available at https://dspace.mit.edu/bitstream/handle/1721.1/84168/867563551-MIT.pdf?sequence=2.

[15] 10 Tex. Admin. Code § 10.404(a)(3)(A) (2024).

[16] 10 Tex. Admin. Code § 10.404(a)(3(B) (2024). The Department's 2024 Qualified Allocation Plan (QAP) also requires TDHCA's underwriter to use a minimum reserve of $250 per unit for new construction and $300 for rehab projects. *Id.* at § 11.301(d)(2)(I). The QAP further provides that "[h]igher reserves may be used if documented by a primary lender or syndicator." *Id.* The project's underwriter may adjust the applicant's assumption for reserves is it is "insufficient to fund capital needs as documented by the SCR" during the first 15 years of the project's long-term pro forma. *Id.* TDHCA's regulations also refer to CNAs as Scope and Cost Reviews (SCRs).

[17] U.S DEPT. OF HOUSING AND URBAN DEVELOPMENT, HOME AND THE LOW-INCOME HOUSING TAX CREDIT GUIDEBOOK (2023) [HUD GUIDEBOOK], at 82.

[18] *Id.*

[19] Section 2 discusses how TDHCA has adopted an annual 3% escalator requirement for replacement reserves and other operating expenses in a LIHTC project's pro forma, but the initial baseline requirements for annual reserves are not regularly adjusted for inflation.

[20] 29 Tex. Reg. 10941 (Nov. 26, 2004).

[21] 38 Tex. Reg. 81 (Jan. 4, 2013).

[22] *U.S. Inflation Calculator*, COINNEWS MEDIA GRP. (Apr. 2024), https://www.usinflationcalculator.com/.

[23] 10 Tex. Admin. Code § 10.404(a)(7)(C)(i). TDHCA bars withdrawals from the replacement reserve account for the first five years following the date of a tax credit award except in special circumstances such as natural disasters. *Id.* at § 10.404(a)(3(A).

[24] Schwartz and Meléndez, *supra* note 7, at 283, citing David A. Smith, et al, *The Low-Income Housing Tax Credit Effectiveness and Efficiency: A Presentation of the Issues*, Recapitalization Advisors, Inc. (2002), at 22.

[25] HUD GUIDEBOOK, *supra* note 17, at 82.

[26] *Id.*

[27] U.S. DEP'T OF HOUS. & URB. DEV., *supra* note 6, at 29; Office of the Comptroller of the Currency, *Low-Income Housing Tax Credits: Affordable Housing Investment Opportunities for Banks*, CMTY. DEV. INSIGHTS (March 2014, Rev. April 2014).

[28] David A. Davenport & Samuel T Johnson, *Year-15 Disputes in the Low-Income Tax Credit Program, Aggregators, and Their Playbooks*, 31 J. AFFORDABLE HOUSING AND CMTY. DEV. LAW 59, 85 (2022) (discussing the recent, troubling emergence of aggregators that are acquiring investor interests in LIHTC properties before year 15 to "wring economic benefits out of the LIHTC owner entity" and "extricate … further financial windfalls that are not in line with the LIHTC program's goals.").

[29] Jakob B. von Trapp, *supra* note 14, at 44. *See also* Pamela J. Jackson, Congressional Research Service, THE LOW-INCOME HOUSING TAX CREDIT: A FRAMEWORK FOR EVALUATION (2008), at 17-18 (discussing studies on the program's incentives for investors).

[30] U.S. DEP'T OF HOUS. & URB. DEV., *supra* note 6, at 30. For an overview of scenarios for the disposition of the investors' interest, see Davenport & Johnson, *supra* note 28, at 66-69.

[31] U.S. Dep't of Hous. & Urb. Dev., *supra* note 6, at 30.

[32] U.S. Dep't of Hous. & Urb. Dev., *supra* note 6, at 52.

[33] Allen Feliz, *supra* note 7, at 22.

[34] Tex. Govt. Code § 2306.6713; 10 Tex. Admin. Code § 10.406(a); TEX. DEP'T OF HOUS. & CMTY. AFFS., ASSET MGMT. DIV., POST AWARD ACTIVITIES MANUAL 47–48 (2021).

[35] 10 Tex. Admin. Code §10.406(b); TEX. DEP'T OF HOUS. & CMTY. AFFS., *supra* note 34, at 47–48.

[36] 10 Tex. Admin. Code § 10.406(a). *See also* TEX. DEP'T OF HOUS. & CMTY. AFFS., *supra* note 34, at 48–49.

[37] TEX. DEP'T HOUS. & CMTY. AFFS., OWNERSHIP TRANSFER FORMS – UPDATED MARCH 2020 (XLSX), at Exhibit E: Property Sale Proforma (2020), available at https://www.tdhca.texas.gov/post-award-activities-manual.

[38] 10 Tex. Admin. Code § 10.406(k).

[39] 10 Tex. Admin. Code § 11.306 (2024).

[40] Tex. Dep't of Hous. & Cmty. Affs, *supra* note 34, at 48.

[41] 10 Tex. Admin. Code § 10.406(a).

[42] *See* 10 Tex. Admin. Code, § 10.621(a) (stating that TDCHA will use HUD's Uniform Physical Condition Standards to determine compliance to determine whether a property is "decent, safe, sanitary, in good repair, and suitable for occupancy").

[43] 10 Tex. Admin. Code § 10.406(k). See also Section 10.404(a), which provides additional provisions under which the Department may increase the reserve requirements at a property.

[44] 10 Tex. Admin. Code § 10.406(k).

[45] The only exception where reserves must remain with the property is when the reserves were funded by the HOME American Rescue Plan. 10 Tex. Admin. Code § 10.406(c)(5).

[46] 10 Tex. Admin. Code § 10.406(b)(3).

[47] 10 Tex. Admin. Code § 10.406(k).

[48] TEX. DEP'T HOUS. & CMTY. AFFS., UNIFORM APPLICATION 2024 (XLSX), at Exhibit 27: Pro Forma (2024), available at https://www.tdhca.texas.gov/apply-funds.

[49] 10 Tex. Admin. Code § 11.9(e)(5)(A).

[50] HOUS. DEV. CTR., WASHINGTON STATE AFFORDABLE HOUSING PORTFOLIO STUDY 11 (2015).

[51] NAT'L COUNCIL OF STATE HOUS. AGENCIES, *supra* note 4, at 23.

[52] NAT'L COUNCIL OF STATE HOUS. AGENCIES, *supra* note 4, at 23.

[53] TEX. DEP'T OF HOUS. & CMTY. AFFS., COMPLIANCE DIV., ANNUAL OWNER FINANCIAL CERTIFICATION REPORTING INSTRUCTIONS 8–12 (2019).

[54] *Id.*

[55] MINN. HOUS. FIN. AGENCY, MULTIFAMILY UNDERWRITING STANDARDS 28 (2024).

[56] *Id*.

[57] *Id.*

[58] OR. HOUS. & CMTY. SERVS., QUALIFIED ALLOCATION PLAN FOR LOW INCOME HOUSING TAX CREDITS 63 (2022).

[59] *Id.*

[60] *Id.*

[61] UTAH HOUS. CORP., 2024 FEDERAL AND STATE HOUSING CREDIT PROGRAM ALLOCATION PLAN 103 (2023).

[62] VT. HOUS. FIN. AGENCY, MULTIFAMILY UNDERWRITING GUIDELINES 4 (2016).

[63] BENJAMIN DULCHIN, ASS'N FOR NEIGHBORHOOD & HOUS. DEV., PERMANENT AFFORDABILITY: PRACTICAL SOLUTIONS 12 (2015).

[64] *Id.* at 11 ("Owners can be provided not only with sufficient resources to ensure long-term project viability, but also a healthy return on their investment, with some up-front financing changes.").

[65] Cal. Code Regs. tit. 4, § 10327(c)(7)(A).

[66] N.H. HOUS. FIN. AUTH., REPLACEMENT RESERVE AND RESIDUAL RECEIPTS RULES § 204.05(a) (2021).

[67] N.H. HOUS. FIN. AUTH., REPLACEMENT RESERVE POLICY 1 (2019).

[68] *Id.* attach. A.

[69] OR. HOUS. & CMTY. SERVS., OHCS ASSET MGMT. & COMPLIANCE FILE, CDM MEMORANDUM 8.T1, RESERVE FOR REPLACEMENT 3-4 (2024).

[70] *Id.* at 4.

[71] *Id.*

[72] VT. HOUS. & FIN. AUTH., REQUIREMENTS FOR YEAR-END AUDITED FINANCIAL STATEMENTS: VHFA FINANCED PROJECTS 12 (2016).

[73] *Id.*

[74] *Id.* at 3.

[75] Nat'l Council of State Hous. Agencies, *supra* note 4, at 45–46.

[76] U.S. Dept. of Housing and Urban Dev., Multifamily Asset Management and Debt Servicing Handbook (4350.1), at 4-9.

[77] USDSA Rural Development, HB-1-3560 MFH Loan Origination Handbook, at 4.13.B (2-24-05).

[78] Cal. Code Regs. tit. 4, § 10327(c)(7).

[79] *Id.*

[80] Minn. Hous. Fin. Agency, *supra* note 55, at 13.

[81] *Id.*

[82] Or. Hous. & Cmty. Servs., Risk Sharing & Elderly/Disabled Loan Programs, Transfer of Ownership and Assumption Application 4 (2020). A transfer of ownership is defined as transfer of any interest of a general partner, any interest in a joint venture, more than 25% of the limited partner's interest, more than 10% of a corporate owner's interest, or any individual interest. *Id.* at 3.

[83] Nat'l Council of State Hous. Agencies, *supra* note 4.

[84] *Id.* at 24.

[85] *Id.*

[86] *Id.*

[87] Cal. Code Regs. tit. 4, § 10320.

[88] Exceptions to this policy can be found in Part 3.11 of the Agency's Compliance Online Reference, available at https://www.treasurer.ca.gov/ctcac/compliance/manual/manual.pdf

[89] Cal. Code Regs. tit. 4, § 10320.

[90] California Tax Credit Allocation Committee, Compliance Online Reference Manual, Part 3.11 at 46-48.

[91] Cal. Code Regs. tit. 4, § 10320(b)(2)(A); *Id.* at § 10302(kk).

[92] *Id.* at § 10320(b)(2)(B).

[93] Memorandum from the Cal. Tax Credit Allocation Comm. – Compliance Section to Low Income Hous. Tax Credit Project Owners 1 (Nov. 18, 2020), available at https://www.treasurer.ca.gov/ctcac/compliance/covenant/questionnaire.pdf.

[94] The executive director may waive these requirements if "the owner can demonstrate that the Transfer Event will not produce, prior to any distributions of Net Project Equity to parties related to the sponsor, developer, limited partner(s) or general partner(s), sufficient Net Project Equity to fund all or any portion of the work contemplated by the Qualified Capital Needs Assessment." Cal. Code Regs. tit. 4, § 10320(b)(2). If no "Net Project Equity from the Transfer Event is distributed to [the] parties . . . other than a distribution or a payment to the limited partner(s) of the selling entity in the amount equal

to, or less than, all federal, state, and local taxes incurred by the limited partner(s) as a result of the Transfer Event," it is presumed that the transfer has insufficient net project equity. *Id.*

[95] Interview with Marina Wiant, Executive Director, California Tax Credit Allocation Committee, California State Treasurer's Office (March 28, 2024); Interview with Mark Stivers, Director of Legislative and Regulatory Advocacy, California Housing Partnership (Apr. 4, 2024).

[96] Interview with Mark Stivers, Director of Legislative and Regulatory Advocacy, California Housing Partnership (Apr. 4, 2024).

[97] *Id.*

[98] OR. HOUS. & CMTY. SERVS., *supra* note 82, at 5.

[99] *Id.*

[100] *Id.*

[101] *Id.*

[102] *Id.*

[103] I*d.*

[104] N.Y.C. DEP'T OF HOUS. PRES. & DEV., LOW INCOME HOUS. TAX CREDIT PRES. PROGRAM, TRANSFER CONSENT APPLICATION 1 (2021), available at https://www.nyc.gov/assets/hpd/downloads/pdfs/services/year-15-transfer-consent-application.pdf.

[105] N.H. HOUS. & FIN. AUTH., DESIGN AND CONSTRUCTION STANDARDS FOR REHABILITATION 1 (2022).

[106] Id.

[107] Id.

[108] SUSTAINABILITY GUIDELINES: INTEGRATED PHYSICAL NEEDS ASSESSMENT, N.Y. STATE: HOMES & CMTY. RENEWAL, https://hcr.ny.gov/sustainability-guidelines (last visited Apr. 23, 2024).

[109] N.Y. STATE HOMES & CMTY. RENEWAL ET AL., INTEGRATED PHYSICAL NEEDS ASSESSMENT (IPNA) STANDARD 10–14 (2024).

[110] N.Y.C. HOUS. DEV. CORP. ET AL., INTEGRATED PHYSICAL NEEDS ASSESSMENT (IPNA) PRE-QUALIFIED FIRMS LIST (2024), available at https://www.nyserda.ny.gov/All-Programs/Multifamily-Building-Programs/Integrated-Physical-Needs-Assessment.

[111] VT. HOUS. & FIN. AUTH. & VT. HOUS. & CONSERVATION BD., CAPITAL NEEDS ASSESSMENT (CNA) GUIDANCE 4 (2015).

[112] *Id.* at 5–6.

[113] *Id.* at 6.

[114] *Id.* at 6–7.

[115] Vt. Hous. & Fin. Auth., Appendix I – VHFA Approved Independent CNA Consultants (2022), available at https://www.vhfa.org/sites/default/files/documents/multifamily/CNA%20Approved%20Vendors.pdf.

[116] Nat'l Council of State Hous. Agencies, *supra* note 4, at 27.

[117] *Id.* at 27–28.

[118] *Id.* at 28.

[119] *Id.*

[120] A discussion of the state's ROFR policies is included in a prior report by the Entrepreneurship and Community Development Clinic at The University of Texas School of Law, available at this link: https://law.utexas.edu/wp-content/uploads/sites/11/2019/06/2018-ECDC-LIH-TaxCreditProg-TX.pdf.

Appendix 1:
Stakeholders and Experts Interviewed

Laura Abernathy – Senior Director of State and Local Policy, National Housing Trust

Sarah Anderson – Owner, Anderson Consulting

Sidney Beaty – Research Analyst, Texas Housers

Ericka Bowman – Tenant Navigator, Texas Housers

Sabrina Butler – Director of Real Estate Development, Foundation Communities

Dan Emmanuel – Senior Research Analyst, National Low Income Housing Coalition

Stephan Fairfield – Founder & Chief Executive Officer, Covenant Community Capital

Michael Furrow – Vice President for Affordable Housing, Bellwether Enterprise

Matt Hull – Executive Director, Texas Association of Community Development Corporations

Jean Latscha – Vice President, Development, Pedcor Investments

James May – Housing and Community Development Officer, City of Austin

Walter Moreau – Executive Director, Foundation Communities

Patricia Murphy – Owner, Patricia Murphy Consulting; Former Director of the Compliance Division, Texas Department of Housing and Community Affairs

Charlie Price – President, Development Corporation of Tarrant County

Mark Shelburne – Housing Consultant, Novogradac

Brent Stewart – Real Estate Consultant

Mark Stivers – Director of Legislative and Regulatory Advocacy, California Housing Partnership; Former Executive Director, California Tax Credit Allocation Committee, California Treasurer's Office

Moha Thakur – Public Policy & Mid-Atlantic Initiatives Manager, National Housing Trust

Matthew Vruggink – Partner, Ojala Holdings

Deborah Welchel – Senior Development Director for Texas, Volunteers of America

Marina Wiant – Executive Director, California Tax Credit Allocation Committee, California Treasurer's Office

Anthony Zeto – Deputy Executive Director, California Tax Credit Allocation Committee, California Treasurer's Office