RhodeIslandHousing
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January 2, 2014

Ms. Sharon Conard-Wells
West Elmwood Housing Development Corporation
224 Dexter Street
Providence, R.I. 02907

Councilman David Salvatore
Chairman
Special Committee on Ways and Means
Providence City Hall
25 Dorrance Street, Room 301
Providence, R.I. 02903

Re: Tax Stabilization as an Alternative to Eight Percent Tax Treatment

Dear Ms. Conard-Wells and Councilman Salvatore,

Rhode Island Housing has reviewed the proposed ordinance providing a tax stabilization plan for Sankofa Apartments, a fifty-unit affordable rental housing project to be developed by the West Elmwood Housing Development Corporation ("WEHDC") in the West End of Providence (the "Proposed Ordinance"). Rhode Island Housing appreciates the City's efforts to put forward a tax plan for the development that recognizes the unique financial circumstances that flow from its intended use as deed-restricted affordable housing. However, the proposed ordinance raises several policy and financial concerns for Rhode Island Housing: (1) the proposed ordinance states that Sankofa is ineligible for eight percent tax treatment under state law; (2) the proposed ordinance contains provisions that could result in a retroactive revocation of the tax treatment if certain benchmarks are not met; and (3) the Proposed Ordinance gives the City a "first lien" position, and raises other practical concerns from an investor or lender perspective.

By way of background, Rhode Island Housing has been designated responsibility for administering the federal Housing Tax Credit ("HTC") Program for the State of Rhode Island. The federal HTC is the primary source of funding for the development of affordable rental homes in Rhode Island. Rhode Island Housing allocates HTCs to development projects on a competitive basis in accordance with IRS requirements. Sankofa is one of more than a dozen affordable housing developments that have applied to receive financing in connection with the 2014 HTC funding round. Rhode Island Housing has already allocated HTCs to one applicant and expects to do so for two or three more in early 2014. The IRS imposes strict limits on the income of the tenants and the rents that may be charged for HTC-financed rental homes. Those limits must be reflected in long-term deed restrictions. As a result, projects financed with HTCs are particularly sensitive to changes in operating expenses, including real property taxes, as the rents are restricted by the IRS and cannot be raised to accommodate increased costs. These tenant income and rent limitations negatively affect the value of the properties and their financial viability.

Most of the money for a development such as Sankofa comes from private investors who use HTC benefits and would suffer major financial penalties if a development goes into default in the first 15 years of operation. As a result, investors will not invest in a project that cannot demonstrate positive cash flow for the first 15 years. The second largest source of funds comes from state bonds, including those issued by Rhode Island Housing. We have a fiduciary obligation to ensure project feasibility for the life of the bonds, which generally exceeds 20 years. The primary benefit of the eight percent tax treatment and the problems with the City's proposed ordinance flow from this need to assure long term viability prior to the start of construction.

1. Eligibility of Sankofa for 8% Tax Treatment

By its plain language, the state law affording eight percent tax treatment applies to all residential properties subject to a recorded use restriction containing limitations on rents or tenant incomes. See R.I. Gen. Laws §§ 44-5-12(a)(1), -13.11. The Proposed Ordinance declares that Sankofa, despite its intended use, is ineligible for this manner of assessment. As we have discussed previously, we do not agree with the City's view that new construction developments such as Sankofa are categorically precluded from receiving this benefit. We urge the City to review our letters dated December 14, 2012 and November 6, 2013 (attached), which more fully explain our interpretation.

By declining to acknowledge new construction projects as eligible for eight percent tax treatment, the City reverses a position espoused by every previous administration since the enactment of the eight percent law. For more than a dozen years, investors, lenders and developers were able to rely on the City's confirmatory "eight percent letter" that an affordable housing development would receive consistent tax treatment for the term of its financing. While a municipality's refusal to afford eight percent treatment does not disqualify a project from HTC financing, it could adversely affect a project's ranking for financial feasibility and readiness to proceed. If these components receive a very low ranking, the project could fail altogether under the threshold criteria for consideration and not be selected.

Moreover, by adopting the Proposed Ordinance disavowing the applicability of the eight percent tax treatment, the City would set a troubling precedent that could be used by other Rhode Island communities that may be intent on discouraging the development of affordable housing. Some communities use every possible opportunity to prevent the construction of affordable housing.

2. Retroactive Revocation of Tax Treatment

Sections 8 and 9 of the Proposed Ordinance permit retroactive revocation of the tax stabilization if certain benchmarks are not met or the property is transferred to a tax exempt entity. These provisions do not fairly account for the challenges inherent to affordable housing projects, which frequently rely on a mix of funding sources and require enhanced cooperation between public and private entities. The Proposed Ordinance makes the tax stabilization plan provisional upon meetin milestones that are in many cases out of a sponsor's control. Loss of tax stabilization in the middle of a development's affordability term would be financially devastating.

Although the City is right to be concerned about foregone revenue in the event of a transfer to a tax-exempt owner, the penalty could yield undesirable results. Because of the potentially high dollar amount of a multi-year (potentially multi-decade) retroactive assessment, the City could be in the position of owning and operating a property outright following an unsuccessful tax sale. Also Section 9 appears to apply to a property that a private tax-exempt or public lending agency acquires by foreclosure under the terms of its security documents. These lenders, including Rhode Island Housing, could evaluate this type of penalty unfavorably in making credit decisions.

3. First Lien Position and Other Practical Considerations

The Proposed Ordinance contemplates that the City will enjoy a first lien position in consideration of its agreement to stabilize the tax payments. This provision is likely to have a fatal effect on a project's ability to attract financing, since lenders as a condition of making development loans require first lien positions and other liens to be subordinated.

Briefly, the Proposed Ordinance also raises the following additional practical concerns for funders:

- The contracting requirements established in the Proposed Ordinance, (as well as the related enforcement provision) could increase construction costs. The general contractor for the Sankofa project would need to assess the financial impact of these requirements, and WEHDC may need to modify its 2014 funding application with a plan for addressing any cost difference before the application could be considered.
- The Proposed Ordinance establishes a tax stabilization term that is shorter than the affordability period that WEHDC anticipates for Sankofa. Many of the federal and state funding sources for affordable housing development require affordability periods longer than the terms of the related mortgages; Building Homes Rhode Island (the state's bond funding program), for example, requires a thirty year affordability restriction. The tax stabilization period should be coterminous with the land use restrictions for the project (as provided in the eight percent statute), or risk a comparatively unfavorable rating for financial feasibility.
- The Proposed Ordinance is not consistent with the income limits under the HTC program. Section 8(d) should be revised to reflect the federal HTC guidelines, which permit tenant income to rise above 60% subsequent to initial lease-up, up to a maximum of 115% percent of Area Median Income.

We urge the City Council to adopt an ordinance re-affirming the application of the eight percent law to affordable housing developments, whether new construction or substantial rehabilitation, just as the City applied the law from its adoption in 1994 through 2012. This would give developments like Sankofa the best possible advantage in the 2014 competition for HTC funding, in which the Providence applications are being weighed against those from other communities that have already acknowledged the applicability of the eight percent law.

Moreover, if Sankofa or any of the other Providence applications receives an allocation of HTC, we would be pleased to join with the City in exploring, during the pre-development period, the impact of the proposed construction contracting requirements. It should also be noted, that while this letter specifically discusses the Sankofa proposal, its statements can be generally applied to any other proposed HTC applicant in Providence and the letter in no way implies any preference in the 2014 HTC process for any applicant, or that Rhode Island Housing has in any way scored or ranked any applicants except as mentioned in actions taken by the Board of Commissioners at its meeting on December 19, 2013.

Rhode Island Housing and the City of Pr vidence have had an incredibly productive partnership over the past 20 years and together we have rebuilt and revitalized many of Providence's hardest hit neighborhoods. The Sankofa proposal, if approved, will turn blighted, contaminated, tax-exempt, vacant properties into beautiful tax-paying homes in Providence's West End with no City investment required. The other Providence applications, if approved, would also enhance the City with new or rehabilitated homes. With so many cuts in federal funding, neighborhood revitalization opportunities are being severely curtailed. I hope that we can resolve the tax issues discussed here and our work together can continue.

Sincerely,

Carol Ventura
Director of Development

cc: Mayor Angel Taveras
Councilman Michael Solomon
Mr. Michael D'Amico
Other 2014 Providence HTC Applicants