SUPPLEMENTAL BOARD BOOK OF AUGUST 25, 2016

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CONSENT AGENDA
BACKGROUND

Application #16057, Silverleaf at Mason, presented several significant and challenging issues, both substantive and procedural. The Applicant was advised of concerns about the gross capture rate and the breadth of the primary market area in TDHCA’s underwriting report dated July 6, 2016. By this report, underwriting did not recommend the proposed development for award, despite the market analysis provided by an approved market analyst, and the developer appealed this determination by letter dated July 13, 2016. In its appeal, the developer challenged whether TDHCA adhered to its underwriting rules, particularly 10 TAC §10.303, and whether the developer had been given the opportunity to communicate with TDHCA staff about its concerns in satisfying the rule requirements regarding the market area and capture rate. The Executive Director reviewed the relevant information, and on July 19, 2016, issued a determination denying the appeal based on the market analysts failure to provide “a detailed description of why the subject Development is expected to draw a majority of its prospective tenants or homebuyers from the defined PMA,” as required by 10 TAC §10.303(d)(9)(B)(i), and that the later submission of materials by the developer should not be accepted in light of the timing of submitting documents on appeal under 10 TAC §10.902(c). In light of further considerations, discussed below, the Executive Director withdrew his July 19, 2016, appeal determination during the July 28, 2016, board meeting, and the application was given an award of tax credits conditional on the satisfaction of underwriting.

Following an earlier internal audit finding regarding the expectation that all underwriting be completed by late July board meeting, Real Estate Analysis (“REA”) redoubled its efforts to complete underwriting on all priority applications, including this application, prior to awards. Once REA believed it had all the Applicant was going to provide it issued its report, finding the application to be not feasible based on concerns over the market analysis. The Applicant, through its counsel, took the position that the Applicant had not been afforded the opportunity to resolve inconsistencies as specifically provided in 10 TAC §10.303(c)(2). It was on that basis that staff recommended the change to a conditional award recommendation, allowing for the opportunity to engage with the Applicant’s market analyst and see if inconsistencies could be resolved.

There was a meeting of staff and the Applicant’s representative, the Applicant’s market analyst, and the Applicant’s counsel on August 9, 2016, and the discussion focused on the large primary market area (“PMA”) spanning Mason, Mennard, and McCullough counties, but not Brady.
Staff could not see how an elderly household would be attracted from the far northern reaches of McCullough County (north of Brady), bypassing Brady, which is larger and has medical facilities, to live in Mason. The market analyst, from Novogradac, explained the analysis she had performed and indicated that the configuration of the PMA was driven by rule-based requirements to use census tracts, census tracts in rural areas frequently being quite large.

Staff emphasized the need for a satisfactory narrative, as provided for in 10 TAC §10.303(d)(9), explaining why it was reasonable to conclude the majority of the tenants could be attracted from the PMA. As required by the rules, the narrative should lead a reader to the same conclusion as the market analyst reached or a similar conclusion (10 TAC §10.303(b)). The market analyst explained that the majority of the tenants (at least 25 households for this 49 unit, elderly limitation development) would be attracted from areas largely in Mason County but spilling into Mennard and McCullough counties. She provided a drive-time analysis showing how a twenty-five minute drive time would encompass the needed demand. While the drive-time analysis extended partially into Llano and Gillespie counties, the population in these areas is roughly equivalent to the balance of population outside of the drive-time area but within the original three county PMA. Indeed, she explained that although this had not been made clear in the narrative aspect of the market study, it had always been contemplated that the development would draw chiefly on the area around Mason, mainly in Mason County but reaching into McCullough and Mennard counties. She referred to the following two paragraphs in her report:

The Primary Market Area (PMA) encompasses Menard, Mason and McCulloch Counties. According to our interviews with local stakeholders and property managers of the surveyed properties, participants from this general region would consider relocating to the Subject property given the lack of affordable senior housing in the area, the significant population over the age of 55, coupled with the aging housing stock, much of which was constructed prior to 1939. (Page 18)

This area is comprised of Mason, McCulloch, and Menard Counties, and was defined based upon conversations with local property managers, city officials, commuting patterns, major roadways, and overall similarities in market characteristics observed during the field inspection. It is assumed that more than 90 percent of the income-qualified and size-eligible household demand for the Subject will be generated from within the PMA. (Page 15)

Although staff accepts this rationale and sees how it supports a conclusion that the market analysis was compliant and did not lead to a conclusion of unfeasibility, it is noted that on the issue of capture rate, the calculations are based on the full three county PMA (limited in definition to census tracts by rule) and because this drive-time area is not readily supported by household data that would enable a localized calculation of capture rates, the capture rate conclusions supported by the full area may not align perfectly with the circumscribed drive-time portion of the PMA. However because staff agreed with the market analyst that the drive-time PMA is most logical and practical as a subset of the PMA that is based on census tracts pursuant to the rule, staff concluded...
that further defining the PMA based on drive-time was appropriate and therefore was used by staff in the capture rate calculations.

Staff received a letter dated August 17, 2016, from John Shackelford on behalf of the next applicant in line, State Street Housing, querying the process that has led to Mason receiving a conditional award (attached). The letter expresses concern over the Applicant being given in effect “multiple bites at the apple.” Staff understands this concern and believes the process would have not taken this irregular course had the Applicant engaged in a more significant effort up-front to address the requirements of the underwriting rules, and/or if REA had fully set out each of its concerns with the market analysis in time to have received an explanation prior to issuing its underwriting report. However, staff agrees with the applicant that the rule in effect for this tax credit round did provide for engagement with the market analyst to address and resolve inconsistencies and it was appropriate to afford them this opportunity. In point of fact it is not unusual for REA to have extensive back and forth with market analysts, but this particular analysis presented a multitude of concerns and was addressed by REA late in the round, and in order to meet the award deadline and in the face of what initially appeared to be too many problems to overcome it may have been prematurely concluded that further dialogue with the market analyst would not be fruitful.

10 TAC §10.303(c)(2) requires that, during the underwriting process, each market analysis “will be reviewed and any discrepancies with the rules and guidelines set forth in this section may be identified and require timely correction.” Accordingly, before underwriting finds a market analysis to be unacceptable for failure to satisfy underwriting rules or guidelines, it must afford both notice (i.e., identify the discrepancy) and the ability to make a timely correction (i.e., before rejection of the market analysis by underwriting). As, in this instance, the discrepancies were not fully identified and correction of the identified discrepancy was not sought until after the negative underwriting report was issued, the process afforded by this rule had not been fully provided. Having now provided the process required by the rules, underwriting accepts the market analysis and additional materials submitted by the applicant and market analyst. Staff will draw on this example as it fashions new rules and procedures regarding market analyses and underwriting priority applications in the next round.¹

¹ In Mr. Shackelford’s letter he also raises the issue of “gerrymandering” of market areas. Staff acknowledges that the drive time analysis may appear as gerrymandering, but it can also be viewed as an explanation of market dynamics within these larger census tracts where significant portions of the covered area are ranch land or other undeveloped land. Underwriting has accepted the latter use of the drive-time analysis.
Via Email: tim.irvine@tdhca.state.tx.us
Tim Irvine, Esq.
Executive Director
Texas Department of Housing and Community Affairs
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RE: Silverleaf at Mason; TDHCA File No. 16057

Dear Mr. Irvine:

This law firm represents State Street Housing Development, LP ("State Street"), and I have been requested by Jeff Spicer and Kelly Garrett, principals of State Street, to write this letter on their behalf. They have an application for tax credits for the project known as Stonebridge of Lamesa, having TDHCA File No. 16234, which is the second highest scoring application in Region 12, Rural, behind Silverleaf at Mason.

The purpose of this letter is to express concern over the process involving Silverleaf at Mason and the apparent multiple bites at the apple the Department appears to be giving this Applicant to provide a Market Analysis satisfactory to the Real Estate Analysis Division, including permitting the applicant’s Market Analyst to bifurcate/gerrymander the census tract north of the census tract in which this project is located in violation of 10 TAC §10.303(d)(9).

As you know, initially the Applicant for the Silverleaf at Mason project claimed that the Underwriter had not followed the rules pursuant to 10 TAC §10.303(d)(9) and such Applicant appealed your decision to the Board for action at the July 28, 2016 Board meeting. I am in complete agreement with both the Department’s write up to the Board, and with your letter to the Applicant and to his consultant, Robbye Meyer, dated July 19, 2016, in which you stated that 10 TAC §10.303(g) specifically states that “the Department shall not be bound by any such opinion or Market Analysis and may substitute its own analysis and underwriting conclusions for those submitted by the Market Analyst.” In my opinion, the Applicant’s argument that the Underwriter does not have the authority to exercise his or her independent judgment in evaluating a Market Analyst’s opinions is completely without merit.

It is clear from an entire reading of 10 TAC §10.303 that the law gives the Department through its Real Estate Analysis Division, the discretion and authority in making determinations about a Market Analysis submitted by an applicant’s Market Analyst. For instance, 10 TAC §10.303(d)(10)(E)(v)(II) states that “consideration of Demand from Other Sources is at the
discretion of the Underwriter.” Also, in 10 TAC §10.303(d)(11)(G) it states “in order to calculate individual unit capture rates, the Underwriter will make assumptions that each household is included in the capture rate for only one Unit type.” Further, 10 TAC §10.303(e) states, “The Department reserves the right to require the Market Analyst to address such other issues as may be relevant to the Department’s evaluation of the need for the subject development and the provisions of the particular program guidelines.” And finally, 10 TAC §10.303(f) states “…the Underwriter may perform an extended Sub-Market analysis considering the combined PMA’s and all proposed and unstabilized Units in the extended Sub-Market Area...” It is therefore clear and unambiguous that 10 TAC §10.303 is replete with provisions which expressly reflect that the Department and the Underwriter has the discretion to exercise his or her own independent judgment in determining whether a Market Analysis and its conclusions accurately reflect whether a project is economically feasible or not in a particular area.

Furthermore, it is clear to me that the Applicant for Silverleaf at Mason is mistakenly and conveniently taking a portion of the language in 10 TAC §10.303(d)(9) and using it out of context. Although this applicant may be accurate when he says that the rule provides that the PMA will be defined by the Market Analyst, he, as you very well know, fails to go on to say that such language is only part of the overall text and that the entire sentence is as follows:

(A) The PMA will be defined by the Market Analyst as:

   (i) size based on a base year population of no more than 100,000 people;

   (ii) boundaries based on U.S. census tracts; and

   (iii) the population of the PMA may exceed 100,000 if the amount over the limit is contained within a single census tract.”

An entire reading of this section makes it obvious that this rule is not as limited as the Applicant claims. A common sense reading of the entire sentence reasonably informs the reader that the Market Analyst in defining a PMA must identify aspects that the Market Analyst needs to take into account in arriving at a PMA such as population thresholds and boundary methodology. To suggest that this very limited language cited by this Applicant is conclusive and supercedes the clear language in several places in 10 TAC §10.303 cited above, and, in particular 10 TAC §10.303(g), is a tortured interpretation based solely on the Applicant’s desperate attempt to obtain an allocation of tax credits. I am confident this Applicant would be on the other side of this issue if a competitor were making the same claim against him.

I am hopeful that your decision has not changed and that the position you took in your letter to this Applicant and Ms. Meyer, dated July 19, 2016 remains your position with respect to this issue.
It has come to my attention, however, that following the removal of this particular agenda item from last month’s Board meeting that the Department has given this Applicant another opportunity to have its Market Analyst redefine the PMA for this project. As noted in the write-up for the Board meeting, the Department stated “Novogradac performed the original Market Study dated March 28, 2016. After discussions with the Applicant about the market concerns and prior to publication of the underwriting report, the Underwriter requested the Applicant to provide any information that they believe would support the PMA used by their Market Analyst. On June 29, 2016, the Market Analyst provided a revised PMA. The revision to the PMA itself was not specifically requested by the Underwriter as part of an administrative deficiency; however, staff did evaluate and consider this information.”

From the above quoted language used by the Department, it is clear this Applicant provided an initial Market Study dated March 28, 2016, and was given an opportunity to correct any deficiencies when the Applicant’s Market Analyst provided a revised PMA on June 29, 2016. Although it was not requested by the Underwriter, in effect this Applicant was given an opportunity by the Department to have the discrepancies in its initial Market Study be identified and timely corrected, which is provided for in 10 TAC §10.303(c)(2). Accordingly, the Applicant was given a second bite at the apple, which is fine because it is contemplated in 10 TAC §10.303(c)(2). However, as the Department further stated in the write up for the Board, this Applicant provided “yet more unsolicited market information from Novogradac dated July 12, 2016. This information introduced the addition of an SMA encompassing the three counties making up the original PMA.” The Department then further states, “Even if the appeal response information were to be accepted outside of the administrative deficiency process, it is insufficient to replace or supersede the original Market Study because key components such as individual unit capture rates are not addressed.” So, effectively, this Applicant was given a third bite at the apple and yet the Underwriter determined that even with the additional unsolicited market information from Novogradac dated July 12, 2016, the information was unacceptable, the Underwriter did not change his position that the project’s capture rate exceeded the 10% limit, and therefore, for this reason, the Department determined Silverleaf at Mason should not be recommended for an award of tax credits.

The Applicant is now being given a fourth bite at the apple by being given an opportunity to have its Market Analyst provide additional information to the Underwriter regarding the size of the PMA. Contrary to the clear and unambiguous language of 10 TAC §10.303(d)(8)(A)(ii) and 10 TAC §10.303(d)(9)(A)(ii) and historically how the Real Estate Analysis Division has required Market Studies to be based on entire census tracts, this Applicant is now being permitted to bifurcate the census tract north of the census tract in which this project would be located and using only the southern portion of such northern census tract to make questionable and unreasonable assumptions about the re-location of prospective tenants residing in the southern portion of such northern census tract. Bifurcate is just another way of saying gerrymandered. I take issue with the Department giving this Applicant a fourth bite of the apple in violation of the administrative deficiency process set forth in 10 TAC §10.201(7), and in violation of 10 TAC §10.303(c)(2), 10 TAC §10.303(d)(8)(A)(ii), 10 TAC §10.303(d)(9)(A)(ii), and 10 TAC §10.902(c).
First, as the Department correctly pointed out in the write-up for the Board, "the Underwriter is unable to use this information in responding to the appeal." The information referenced by the Department was the additionally revised market information received after publication of the underwriting report. Clearly and unquestionably, it is a violation of 10 TAC §10.201(7), 10 TAC §10.303(c)(2) and 10 TAC §10.902(c) for this Applicant to be given a fourth opportunity to supplement and revise its Market Study at this time. As the Department clearly stated in the write-up for the Board, "The Department is unable to consider new documentation related to the Application that is provided after publication of the report..."

Second, I am not aware of the Real Estate Analysis Division allowing an applicant at any time to bifurcate (gerrymander) a census tract. To my knowledge, there is no precedent for this to be permitted. Please correct me if I am mistaken. It is understandable why the Real Estate Analysis Division would not permit an applicant to have its Market Analyst take portions of a census tract, which in effect means gerrymandering a census tract, to achieve a capture rate that does not exceed the 10% limit. If this practice was permitted, then in the future every applicant will play games with and manipulate a census tract in a way that allows the project to be economically feasible and to achieve a capture rate that does not exceed the 10% limit. To permit this Applicant to do that which has never been done before would set a terrible precedent for the tax credit application process in the future.

Specifically, this Applicant should not be allowed to use only the southern portion of the census tract to the north of the census tract in which the project will be located in violation of 10 TAC §10.303(d)(9)(A)(ii) because such gerrymandering requires the Market Analyst to assume potential residents of Silverleaf at Mason would relocate to the south in Mason with severely limited services and amenities for seniors instead of relocating to the north in Brady where an abundant number of services and amenities are available to seniors. This defies common sense and logic. 10 TAC §10.303(d)(9)(A)(ii) requires the Market Analyst to define a PMA by using "boundaries based on U.S. census tracts..." This language does not say "or any portion thereof" or some other language which permits only a limited or reduced segment of a census tract to be used. I therefore ask the question when has the Real Estate Analysis Division permitted an applicant to do what this Applicant is attempting to do?

I strongly urge you to (i) maintain the same positions with respect to the issues as set forth in your July 19th letter and as expressed in the Department's write-up for last month's Board meeting, (ii) have this item be placed on the Board's agenda for the August 25, 2016 Board meeting, and (iii) to have staff recommend denial of the appeal for the same reasons cited in your letter to the Applicant and Ms. Meyer dated July 19, 2016 and as later re-affirmed in the Department's write-up to the Board for last month's Board Meeting.

One of the hallmarks of your tenure as Executive Director has been instituting a policy of transparency and for applying the rules on the same basis to all applicants. Every applicant for low-income affordable housing tax credits in the State of Texas has had the rules work against them from time to time. If you recall, last December I appealed a decision to the Board on behalf of Mr. Garrett and Mr. Spicer which appeal was denied. At that Board Meeting, Dr. Munoz
expressed concern about deviating from the rules and their enforcement despite the extenuating circumstances that I was urging the Board to take into consideration. Following Dr. Munoz’ statements, Mr. Oxer then stated, and I am paraphrasing, rules must have sharp edges because without sharp edges they become merely guidelines.

I am hopeful that in this instance, the rules will be applied to this Applicant consistent with your history of enforcing the rules and that this Applicant is denied the opportunity to receive an allocation of tax credits for Silverleaf at Mason because the Underwriter has determined that the capture rate exceeds the 10% limit and despite all of the machinations and manipulations with the Applicant’s Market Study, the fact remains that this project is not economically feasible.

Very truly yours,

[Signature]

John C. Shackelford

JCS/klm

cc: **Via Email:**
   Beau Echols, Esq.
   Tom Gouris
   Marnie Holloway
   Brent Stewart
   Kelly Garrett
   Jeff Spicer
   Michelle Snedden, Esq.
   Lauren Osterman, Esq.
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THIS ITEM HAS BEEN PULLED FROM THE AGENDA