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MEMORANDUM

TO: House Committee on General, Housing and Military Affairs

FROM: Gus Seelig and Jen Hollar

DATE: February 18, 2016

RE: VHCB Policies and Loan Portfolio

To complement our testimony on the impacts of the state's investment through VHCB, we would like to offer background on our loan portfolio and lending policies. If you would like further detail, we would be happy to provide information, as examples, on projects we have considered recently for refinancing.

This memo will outline the key factors incorporated into our review of requests for housing projects and the reasons we typically provide VHCB funding in the form of loans. These include the following four considerations for our Board as directed by Vermont statutes and our policies:

- Serving the lowest income Vermonters;
- Conducting our mission without causing displacement;
- Leveraging our funds as effectively as possible; and
- Seeking permanent affordability from the Board's investments.

The Board has reviewed the question of using very low or no-interest and deferred loans rather than grants on a number of occasions. Our current lending policy best meets the above goals given our experience with projects and the structure of federal housing programs.

Vermont, like most cities and states, relies heavily on the federal low-income housing tax credit program to build affordable rental housing and generate private investment in that housing. Due to the structure of this program, the practice of providing deferred debt is utilized nationally to maximize affordability as well as the amount of equity available to projects while meeting federal requirements. VHCB's loans and portfolio are consistent with this approach.

We have made some modifications in our lending practices over time. For instance, early on some loans with state funds were made with interest rates. Further, all federal funds administered by the Board required (until about ten years ago) that we charge the applicable federal interest rate. Sometimes loans had deferred debt with compound interest above 8%. The result has been high accumulation of principle and interest on some properties.

As you know, we are often serving a very low-income clientele. As a result, there is limited ability to increase rents to cover debt service. Rents are also strictly regulated and limited by the federal government. Further, increasing rents too much would have the negative consequence of displacing Vermonters in contradiction with our guiding statute. There was an assumption in the late 80's and early 90's that the incomes of low-income households would increase at least at the rate of the consumer price index (CPI). This has proven not to be true. The percentage of extremely low income Vermonters we are housing has increased over time further hampering the potential for debt repayment.

Now, when we fund new projects, deferred debt always carries a 0% interest rate. This enhances the future potential for repayment when refinancing occurs.

Projects funded in the late 80's and early 90's were developed in an era without fully considering the capital replacement needs of a property. Affordable housing developments, like all housing, have components that wear out over time. As we will explain in our testimony, VHCB hired national experts ten years ago to make recommendations on capital planning. It changed our thinking and practices both in requiring capital needs assessments, which are updated every five years, and increasing the amount property owners put into replacement reserves. As a result, we expect that the next generation of properties refinancing 25 years from now will be in a far better position than the first generation.

Fuel prices and energy costs have undergone dramatic shifts since initial projects were funded. Most of our properties outside of Chittenden County are heated with oil or propane. Both as a result of enhanced state energy standards and to protect the properties, we think it useful to make investments in energy efficiency and renewables. This has the added benefit of helping a large number of low income Vermonters avoid the need to use the LIHEAP program.

VHCB is occasionally asked why we make loans under such dire economic circumstances especially when we have the authority to make grants. The answers include the following:

1. Loans offer the opportunity to re-visit a project's finances and a community's need for a project when circumstances change or primary debt is retired and to recapture the public's investment if a property no longer needs such financing to be deferred.

2. Loans provide a security position in a project in case the project has problems or a project sponsor has problems. This loan position allows the Board, on behalf of taxpayers, to step in if it chooses should there be a problem either with a project or project sponsor (owner).

3. Making funds available as loans rather than grants helps to raise more equity from the private sector than would be the case if funds were provided as grants. Although the tax credit program is complex and exact numbers difficult to determine, there is no question loans in these projects leverage more non-state resources than grants. A

review of four projects several years ago in which VHCB provided $4 million indicated that equity investments would have been reduced by $2 million had those funds been provided as grants rather than loans. Looking at it in another way, if the Board had made all awards as grants Vermont would have built and rehabilitated approximately 30% fewer apartments over the preceding 20 years. This would have reduced housing by approximately 1,500 apartments along with the related benefits of community renewal, construction jobs and more.

4. If the Board chooses to extend the deferral of the loan when a project needs additional capital investment and there is a new syndication (tax credit partnership), the loan is again calculated as part of a qualified basis bringing another round of private sector equity to the property. This allows the Board to provide an additional 15-30 years of affordability. It is generally far less expensive than the cost of replacement housing.

VHCB's policy of using loans is not unique. Other federal programs use deferred debt including CDBG, the Federal Home Loan Banks' Affordable Housing Program and other HUD funding. Our practice is for the Board to review any requests for extensions or modifications on a case-by-case basis. It has been reviewed by the Vermont Office of the Attorney General and the Vermont State Auditor of Accounts.

A quick look at VHCB's audit or annual report might suggest that our loan portfolio could be a source of funding for housing development. However, a more in depth review of our loan portfolio and lending policies will illustrate how these public dollars have, continue and will provide maximum benefit to Vermonters far into the future.