

Subchapter D – Underwriting and Loan Policy

§10.301. General Provisions.

(a) **Purpose.** This Subchapter applies to the underwriting, Market Analysis, appraisal, Environmental Site Assessment, Property Condition Assessment, and Direct Loan standards employed by the Department. This Subchapter provides rules for the underwriting review of an affordable housing Development's financial feasibility and economic viability that ensures the most efficient allocation of resources while promoting and preserving the public interest in ensuring the long-term health of the Department's portfolio. In addition, this Subchapter guides staff in making recommendations to the Executive Award and Review Advisory Committee (the "Committee"), Executive Director, and the Board to help ensure procedural consistency in the determination of Development feasibility (Texas Government Code, §§2306.081(c), 2306.185, and 2306.6710(d)). Due to the unique characteristics of each Development, the interpretation of the rules and guidelines described in this Subchapter is subject to the discretion of the Department and final determination by the Board.

(b) **Appeals.** Certain programs contain express appeal options. Where not indicated, §10.902 of this chapter (relating to Appeals Process (§2306.0321; §2306.6715)) includes general appeal procedures. In addition, the Department encourages the use of Alternative Dispute Resolution ("ADR") methods, as outlined in §10.904 of this chapter (relating to Alternative Dispute Resolution (ADR) Policy).

§10.302. Underwriting Rules and Guidelines.

(a) **General Provisions.** Pursuant to Texas Government Code, §2306.148 and §2306.185(b), the Board is authorized to adopt underwriting standards as set forth in this section. Furthermore for Housing Credit Allocation, §42(m)(2) of the Internal Revenue Code of 1986 (the "Code"), requires the tax credits allocated to a Development not to exceed the amount necessary to assure feasibility. The rules adopted pursuant to the Texas Government Code and the Code are developed to result in a Credit Underwriting Analysis Report ("Report") used by the Board in decision making with the goal of assisting as many Texans as possible by providing no more financing than necessary based on an independent analysis of Development feasibility. The Report generated in no way guarantees or purports to warrant the actual performance, feasibility, or viability of the Development.

(b) **Report Contents.** The Report provides a synopsis and reconciliation of the Application information submitted by the Applicant. For the purpose of this Subchapter the term Application includes additional documentation submitted after the initial award of funds that is relevant to any subsequent reevaluation. The Report contents will be based upon information that is provided in accordance with and within the timeframes set forth in the current Qualified Allocation Plan ("QAP") (10 TAC Chapter 11) or a Notice of Funds Availability ("NOFA"), as applicable, and the Uniform Multifamily Rules (10 TAC Chapter 10, Subchapters A – E and G).

(c) **Recommendations in the Report.** The conclusion of the Report includes a recommended award of funds or Housing Credit Allocation Amount and states any feasibility or other conditions to be placed on the award. The award amount is based on the lesser of the following:

- (1) **Program Limit Method.** For Housing Credit Allocations, this method is based upon calculation of Eligible Basis after applying all cost verification measures and program limits as described in this section. The Applicable Percentage used is defined in §10.3 of this chapter (relating to Definitions). For Department programs other than Housing Tax Credits, this method is based upon calculation of the funding limit in current program rules or NOFA at the time of underwriting.
- (2) **Gap Method.** This method evaluates the amount of funds needed to fill the gap created by Total Housing Development Cost less total non-Department-sourced funds or Housing Tax Credits. In making this determination, the Underwriter resizes any anticipated deferred developer fee downward (but not less than zero) before reducing the amount of Department funds or Housing Tax Credits. In the case of Housing Tax Credits, the syndication proceeds needed to fill the gap in permanent funds are divided by the syndication rate to determine the amount of Housing Tax Credits. In making this determination and based upon specific conditions set forth in the Report, the Underwriter may assume adjustments to the financing structure (including treatment of cash flow loans as if fully amortizing over its term) or make adjustments to any Department financing, such that the cumulative Debt Coverage Ratio ("DCR") conforms to the standards

described in this section. For Housing Tax Credit Developments at cost certification, timing adjusters may be considered as a reduction to equity proceeds for this purpose. Timing adjusters must be consistent with and documented in the original partnership agreement (at admission of the equity partner) but relating to causes outside of the Developer's or Owner's control. The equity partner must provide a calculation of the amount of the adjuster to be used by the Underwriter.

- (3) **The Amount Requested.** The amount of funds that is requested by the Applicant. For Housing Tax Credit Developments (exclusive of Tax-Exempt Bond Developments) this amount is limited to the amount requested in the original Application documentation.

(d) **Operating Feasibility.** The operating feasibility of a Development funded by the Department is tested by analyzing its Net Operating Income ("NOI") to determine the Development's ability to pay debt service and meet other financial obligations throughout the Affordability Period. NOI is determined by subtracting operating expenses, including replacement reserves and taxes, from rental and other income sources.

- (1) **Income.** In determining the first year stabilized pro forma, the Underwriter evaluates the reasonableness of the Applicant's income pro forma by determining the appropriate rental rate per unit based on subsidy contracts, program limitations including but not limited to utility allowances, actual rents supported by rent rolls and Market Rents and other market conditions. Miscellaneous income, vacancy and collection loss limits as set forth in subparagraphs (B) and (C) of this paragraph, respectively, are used unless well-documented support is provided and independently verified by the Underwriter.

(A) **Rental Income.** The Underwriter will review the Applicant's proposed rent schedule and determine if it is consistent with the representations made throughout the Application. The Underwriter will independently calculate a Pro Forma Rent for comparison to the Applicant's estimate in the Application.

- (i) **Market Rents.** The Underwriter will use the Market Analyst's conclusion of Market Rent if reasonably justified and supported by the attribute adjustment matrix of Comparable Units as described in §10.303 of this chapter (relating to Market Analysis Rules and Guidelines). Independently determined Market Rents by the Underwriter may be used based on rent information gained from direct contact with comparable properties, whether or not used by the Market Analyst and other market data sources. For a Development that contains less than 15% unrestricted units, the Underwriter will limit the Pro Forma Rents to the lesser of Market Rent or the Gross Program Rent at 60% AMI. As an alternative, if the Applicant submits market rents that are up to 30% higher than the 60% AMI gross rent and the Applicant submits an investor commissioned market study with the application, the Underwriter has the discretion to use the market rents supported by the investor commissioned market study in consideration of the independently determined rents. The Applicant must also provide a statement by the investor indicating that they have reviewed the market study and agree with its conclusions.
- (ii) **Gross Program Rent.** The Underwriter will use the Gross Program Rents for the year that is most current at the time the underwriting begins. When underwriting for a simultaneously funded competitive round, all Applications are underwritten with the Gross Program Rents for the same year. If Gross Program Rents are adjusted by the Department after the close of the Application Acceptance Period, but prior to publication of the Report, the Underwriter may adjust the Effective Gross Income ("EGI") to account for any increase or decrease in Gross Program Rents for the purposes of determining the reasonableness of the Applicant's EGI.
- (iii) **Contract Rents.** The Underwriter will review rental assistance contracts to determine the Contract Rents currently applicable to the Development. Documentation supporting the likelihood of continued rental assistance is also reviewed. The Underwriter will take into consideration the Applicant's intent to request a Contract Rent increase. At the discretion of the Underwriter, the Applicant's proposed rents may be used as the Pro Forma Rent, with the recommendations of the Report conditioned upon receipt of final approval of such an increase.
- (iv) **Utility Allowances.** The Utility Allowances used in underwriting must be in compliance with all applicable federal guidance, and §10.614 of Subchapter F of this Chapter relating to Utility Allowances. Utility allowances must be calculated for individually metered tenant paid utilities.
- (v) **Net Program Rents.** Gross Program Rent less Utility Allowance.
- (vi) **Actual Rents for existing Developments** will be reviewed as supported by a current rent roll. For Unstabilized Developments, actual rents will be based on the most recent units leased with occupancy and leasing velocity considered. Actual rents may be adjusted by the Underwriter to reflect lease-up concessions and other market considerations.

- (vii) **Collected Rent.** Represents the monthly rent amount collected for each Unit Type. For rent-assisted units, the Contract Rent is used. In absence of a Contract Rent, the lesser of the Net Program Rent, Market Rent or actual rent is used.
- (B) **Miscellaneous Income.** All ancillary fees and miscellaneous secondary income, including, but not limited to late fees, storage fees, laundry income, interest on deposits, carport and garage rent, washer and dryer rent, telecommunications fees, and other miscellaneous income, are anticipated to be included in a \$5 to \$20 per Unit per month range. Exceptions may be made at the discretion of the Underwriter and must be supported by either the normalized operating history of the Development or other existing comparable properties within the same market area.
- (i) The Applicant must show that a tenant will not be required to pay the additional fee or charge as a condition of renting a Unit and must show that the tenant has a reasonable alternative.
- (ii) The Applicant's operating expense schedule should reflect an itemized offsetting line-item associated with miscellaneous income derived from pass-through utility payments, pass-through water, sewer and trash payments, and cable fees.
- (iii) Collection rates of exceptional fee items will generally be heavily discounted.
- (iv) If an additional fee is charged for the optional use of an amenity, any cost associated with the construction, acquisition, or development of the hard assets needed to produce the additional fee for such amenity must be excluded from Eligible Basis.
- (C) **Vacancy and Collection Loss.** The Underwriter generally uses a normalized vacancy rate of 7.5 percent (5 percent vacancy plus 2.5 percent for collection loss). The Underwriter may use other assumptions based on conditions in the immediate market area. 100 percent project-based rental subsidy developments and other well documented cases may be underwritten at a combined 5 percent at the discretion of the Underwriter if the immediate market area's historical performance reflected in the Market Analysis is consistently higher than a 95 percent occupancy rate.
- (D) **Effective Gross Income ("EGI").** EGI is the total of Collected Rent for all units plus Miscellaneous Income less Vacancy and Collection Loss. If the Applicant's pro forma EGI is within 5 percent of the EGI independently calculated by the Underwriter, the Applicant's EGI is characterized as reasonable in the Report; however, for purposes of calculating the underwritten DCR the Underwriter's pro forma will be used unless the Applicant's pro forma meets the requirements of paragraph (3) of this subsection.
- (2) **Expenses.** In determining the first year stabilized operating expense pro forma, the Underwriter evaluates the reasonableness of the Applicant's expense estimate based upon the characteristics of each Development, including the location, utility structure, type, the size and number of Units, and the Applicant's management plan. Historical, stabilized and certified financial statements of an existing Development or Third Party quotes specific to a Development will reflect the strongest data points to predict future performance. The Underwriter may review actual operations on the Applicant's other properties monitored by the Department, if any, or review the proposed management company's comparable properties. The Department's Database of properties located in the same market area or region as the proposed Development also provides data points; expense data from the Department's Database is available on the Department's website. Data from the Institute of Real Estate Management's ("IREM") most recent Conventional Apartments-Income/Expense Analysis book for the proposed Development's property type and specific location or region may be referenced. In some cases local or project-specific data such as PHA Utility Allowances and property tax rates are also given significant weight in determining the appropriate line item expense estimate. Estimates of utility savings from green building components, including on-site renewable energy, must be documented by an unrelated contractor or component vendor.
- (A) **General and Administrative Expense ("G&A")**--Accounting fees, legal fees, advertising and marketing expenses, office operation, supplies, and equipment expenses. G&A does not include partnership related expenses such as asset management, accounting or audit fees. Costs of tenant services are not included in G&A.
- (B) **Management Fee.** Fee paid to the property management company to oversee the operation of the Property and is most often based upon a percentage of EGI as documented in an existing property management agreement or proposal. Typically, 5 percent of EGI is used, though higher percentages for rural transactions may be used. Percentages as low as 3 percent may be used if well documented.
- (C) **Payroll Expense.** Compensation, insurance benefits, and payroll taxes for on-site office, leasing and maintenance staff. Payroll does not include Third-Party security or tenant services contracts. Staffing specific to tenant services, security or other staffing not related to customary property operations should be itemized and included in other expenses or tenant services expense.

- (D) **Repairs and Maintenance Expense.** Materials and supplies for the repairs and maintenance of the Development including Third-Party maintenance contracts. This line-item does not include costs that are customarily capitalized that would result from major replacements or renovations.
 - (E) **Utilities Expense.** Gas and electric energy expenses paid by the Development. Estimates of utility savings from green building components, including on-site renewable energy, must be documented by an unrelated contractor or component vendor.
 - (F) **Water, Sewer, and Trash Expense ("WST").** Includes all water, sewer and trash expenses paid by the Development.
 - (G) **Insurance Expense.** Cost of Insurance coverage for the buildings, contents, and general liability, but not health or workman's compensation insurance.
 - (H) **Property Tax.** Includes real property and personal property taxes but not payroll taxes.
 - (i) An assessed value will be calculated based on the capitalization rate published by the county taxing authority. If the county taxing authority does not publish a capitalization rate, a capitalization rate of 10 percent or a comparable assessed value may be used.
 - (ii) If the Applicant proposes a property tax exemption or PILOT agreement the Applicant must provide documentation in accordance with §10.402(d). At the underwriter's discretion, such documentation may be required prior to Commitment if deemed necessary.
 - (I) **Replacement Reserves.** Periodic deposits to a reserve account to pay for the future replacement or major repair of building systems and components (generally items considered capitalized costs). The Underwriter will use a minimum reserve of \$250 per Unit for New Construction and Reconstruction Developments and \$300 per Unit for all other Developments. The Underwriter may require an amount above \$300 for the Development based on information provided in the Property Condition Assessment ("PCA"). The Applicant's assumption for reserves may be adjusted by the Underwriter if the amount provided by the Applicant is insufficient to fund capital needs as documented by the PCA during the first fifteen (15) years of the long term pro forma. Higher reserves may be used if documented by a primary lender or syndicator.
 - (J) **Other Operating Expenses.** The Underwriter will include other reasonable, customary and documented property-level operating expenses such as audit fees, security expense, telecommunication expenses (tenant reimbursements must be reflected in EGI) and TDHCA's compliance fees. This category does not include depreciation, interest expense, lender or syndicator's asset management fees, or other ongoing partnership fees.
 - (K) **Tenant Services.** Tenant services are not included as an operating expense or included in the DCR calculation unless:
 - (i) There is a documented financial obligation on behalf of the Owner with a unit of state or local government to provide tenant supportive services at a specified dollar amount. The financial obligation must be identified by the permanent lender in their term sheet and the dollar amount of the financial obligation must be included in the DCR calculation on the permanent lender's 15-year pro forma at Application. At cost certification and as a minimum, the estimated expenses underwritten at Application will be included in the DCR calculation regardless if actually incurred; or,
 - (ii) The Applicant demonstrates a history of providing comparable supportive services and expenses at existing affiliated properties within the local area. Except for Supportive Housing Developments, the estimated expense of supportive services must be identified by the permanent lender in their term sheet and included in the DCR calculation on the 15-year pro forma. At cost certification and as a minimum, the estimated expenses underwritten at Application will be included in the DCR calculation regardless if actually incurred;
 - (iii) On-site staffing or pro ration of staffing for coordination of services only, not provision of services, can be included as a supportive services expense without permanent lender documentation.
 - (L) **Total Operating Expenses.** The total of expense items described above. If the Applicant's total expense estimate is within 5 percent of the final total expense figure calculated by the Underwriter, the Applicant's figure is characterized as reasonable in the Report; however, for purposes of calculating DCR, the Underwriter's independent calculation will be used unless the Applicant's first year stabilized pro forma meets the requirements of paragraph (3) of this subsection.
- (3) **Net Operating Income ("NOI").** The difference between the EGI and total operating expenses. If the Applicant's first year stabilized NOI figure is within 5 percent of the NOI calculated by the Underwriter, the Applicant's NOI is characterized as reasonable in the Report; however, for purposes of calculating the first year stabilized pro forma DCR, the Underwriter's calculation of NOI will be used unless the Applicant's first year

stabilized EGI, total operating expenses, and NOI are each within 5 percent of the Underwriter's estimates. For Housing Tax Credit Developments at cost certification, actual NOI will be used as adjusted for stabilization of rents and extraordinary lease-up expenses. Permanent lender and equity partner stabilization requirements documented in the loan and partnership agreements will be considered in determining the appropriate adjustments and the NOI used by the Underwriter.

- (4) **Debt Coverage Ratio.** DCR is calculated by dividing NOI by the sum of scheduled loan principal and interest payments for all permanent debt sources of funds. If executed loan documents do not exist, loan terms including principal and/or interest payments are calculated based on the terms indicated in the most current term sheet(s). Otherwise, actual terms indicated in the executed loan documents will be used. Term sheet(s) must indicate the DCR required by the lender for initial underwriting as well as for stabilization purposes. Unusual or non-traditional financing structures may also be considered.

(A) **Interest Rate.** The rate documented in the term sheet(s) or loan document(s) will be used for debt service calculations. Term sheets indicating a variable interest rate must provide a breakdown of the rate index and any component rates comprising an all-in interest rate. The term sheet(s) must state the lender's underwriting interest rate assumption, or the Applicant must submit a separate statement from the lender with an estimate of the interest rate as of the date of such statement. At initial underwriting, the Underwriter may adjust the underwritten interest rate assumption based on market data collected on similarly structured transactions or rate index history. Private Mortgage Insurance premiums and similar fees are not included in the interest rate but calculated on outstanding principal balance and added to the total debt service payment.

(B) **Amortization Period.** For purposes of calculating DCR, the permanent lender's amortization period will be used if not less than thirty (30) years and not more than forty (40) years. Up to fifty (50) years may be used for federally sourced or insured loans. For permanent lender debt with amortization periods less than thirty (30) years, thirty (30) years will be used. For permanent lender debt with amortization periods greater than forty (40) years, forty (40) years will be used. For non-Housing Tax Credit transactions a lesser amortization period may be used if the Department's funds are fully amortized over the same period as the primary senior debt.

(C) **Repayment Period.** For purposes of projecting the DCR over a thirty (30) year period for developments with permanent financing structures with balloon payments in less than thirty (30) years, the Underwriter will carry forward debt service based on a full amortization at the interest rate stated in the term sheet(s).

(D) **Acceptable Debt Coverage Ratio Range.** Except as set forth in clauses (i) or (ii) of this subparagraph, the acceptable first year stabilized pro forma DCR for all priority or foreclosable lien financing plus the Department's proposed financing must be between a minimum of 1.15 and a maximum of 1.35 (maximum of 1.50 for Housing Tax Credit Developments at cost certification).

(i) If the DCR is less than the minimum, the recommendations of the Report may be based on an assumed reduction to debt service and the Underwriter will make adjustments to the assumed financing structure in the order presented in subclauses (I) - (III) of this clause subject to a Direct Loan NOFA and program rules:

(I) a reduction to the principal amount of a Direct Loan, or in the case where no repayable Developer Fee remains available for deferral and the Direct Loan is necessary to balance the sources and uses, a reduction to the interest rate or an increase in the amortization period for Direct Loans;

(II) a reclassification of Direct Loans to reflect grants,

(III) a reduction in the permanent loan amount for non-Department funded loans based upon the rates and terms in the permanent loan term sheet(s) as long as they are within the ranges in subparagraphs (A) and (B) of this paragraph.

(ii) If the DCR is greater than the maximum, the recommendations of the Report may be based on an assumed increase to debt service and the Underwriter will make adjustments to the assumed financing structure in the order presented in subclauses (I) - (III) of this clause subject to a Direct Loan NOFA and program rules:

(I) reclassification of Department funded grants to reflect loans;

(II) an increase in the interest rate or a decrease in the amortization period for Direct Loans;

(III) an increase in the permanent loan amount for non-Department funded loans based upon the rates and terms in the permanent loan term sheet as long as they are within the ranges in subparagraphs (A) and (B) of this paragraph.

- (iii) For Housing Tax Credit Developments, a reduction in the recommended Housing Credit Allocation Amount may be made based on the Gap Method described in subsection (c)(2) of this section as a result of an increased debt assumption, if any.
 - (iv) The Underwriter may limit total debt service that is senior to a Direct Loan to produce an acceptable DCR on the Direct Loan.
- (5) **Long Term Pro forma.** The Underwriter will create a 30-year operating pro forma using the following:
- (A) The Underwriter's or Applicant's first year stabilized pro forma as determined by paragraph (3) of this subsection.
 - (B) A 2 percent annual growth factor is utilized for income and a 3 percent annual growth factor is utilized for operating expenses except for management fees that are calculated based on a percentage of each year's EGI.
 - (C) Adjustments may be made to the long term pro forma if satisfactory support documentation is provided by the Applicant or as independently determined by the Underwriter.

(e) Total Housing Development Costs. The Department's estimate of the Total Housing Development Cost will be based on the Applicant's development cost schedule to the extent that costs can be verified to a reasonable degree of certainty with documentation from the Applicant and tools available to the Underwriter. For New Construction Developments, the Underwriter's total cost estimate will be used unless the Applicant's Total Housing Development Cost is within 5 percent of the Underwriter's estimate. The Department's estimate of the Total Housing Development Cost for Rehabilitation Developments will be based in accordance with the estimated cost provided in the PCA for the scope of work as defined by the Applicant and §10.306(a)(5) of this chapter (relating to PCA Guidelines). If the Applicant's cost estimate is utilized and the Applicant's line item costs are inconsistent with documentation provided in the Application or program rules, the Underwriter may make adjustments to the Applicant's Total Housing Development Cost.

- (1) **Acquisition Costs.** The underwritten acquisition cost is verified with Site Control document(s) for the Property.
- (A) **Excess Land Acquisition.** In cases where more land is to be acquired (by the Applicant or a Related Party) than will be utilized as the Development Site and the remainder acreage is not accessible for use by tenants or dedicated as permanent and maintained green space, the value ascribed to the proposed Development Site will be prorated based on acreage from the total cost reflected in the Site Control document(s). An appraisal containing segregated values for the total acreage, the acreage for the Development Site and the remainder acreage, or tax assessment value may be used by the Underwriter in making a proration determination based on relative value; however, the Underwriter will not utilize a prorated value greater than the total amount in the Site Control document(s).
 - (B) **Identity of Interest Acquisitions.**
 - (i) An acquisition will be considered an identity of interest transaction when the seller is an Affiliate of, a Related Party to, any owner at any level of the Development Team or a Related Party lender; and
 - (I) is the current owner in whole or in part of the Property; or
 - (II) has or had within the prior 36 months, legal or beneficial ownership of the property or any portion thereof or interest therein prior to the first day of the Application Acceptance Period.
 - (ii) In all identity of interest transactions the Applicant is required to provide:
 - (I) the original acquisition cost evidenced by an executed settlement statement or, if a settlement statement is not available, the original asset value listed in the most current financial statement for the identity of interest owner; and
 - (II) if the original acquisition cost evidenced by subclause (I) of this clause is less than the acquisition cost stated in the application:
 - (-a-) an appraisal that meets the requirements of §10.304 of this chapter (relating to Appraisal Rules and Guidelines); and
 - (-b-) any other verifiable costs of owning, holding, or improving the Property, excluding seller financing, that when added to the value from subclause (I) of this clause justifies the Applicant's proposed acquisition amount.
- (-1-) For land-only transactions, documentation of owning, holding or improving costs since the original acquisition date may include property

taxes, interest expense to unrelated Third Party lender(s), capitalized costs of any physical improvements, the cost of zoning, platting, and any off-site costs to provide utilities or improve access to the Property. All allowable holding and improvement costs must directly benefit the proposed Development by a reduction to hard or soft costs. Additionally, an annual return of 10 percent may be applied to the original capital investment and documented holding and improvement costs; this return will be applied from the date the applicable cost is incurred until the date of the Department's Board meeting at which the Grant, Direct Loan and/or Housing Credit Allocation will be considered.

(-2-) For transactions which include existing buildings that will be rehabilitated or otherwise retained as part of the Development, documentation of owning, holding, or improving costs since the original acquisition date may include capitalized costs of improvements to the Property, and in the case of USDA financed Developments the cost of exit taxes not to exceed an amount necessary to allow the sellers to be made whole in the original and subsequent investment in the Property and avoid foreclosure. Additionally, an annual return of 10 percent may be applied to the original capital investment and documented holding and improvement costs; this return will be applied from the date the applicable cost was incurred until the date of the Department's Board meeting at which the Grant, Direct Loan and/or Housing Credit Allocation will be considered. For any period of time during which the existing buildings are occupied or otherwise producing revenue, holding costs may not include capitalized costs, operating expenses, including, but not limited to, property taxes and interest expense.

(iii) In no instance will the acquisition cost utilized by the Underwriter exceed the lesser of the original acquisition cost evidenced by clause (ii)(I) of this subparagraph plus costs identified in clause (ii)(II)(-b-) of this subparagraph, or if applicable the "as-is" value conclusion evidenced by clause (ii)(II)(-a-) of this subparagraph. Acquisition cost is limited to appraised land value for transactions which include existing buildings that will be demolished. The resulting acquisition cost will be referred to as the "Adjusted Acquisition Cost."

(C) **Eligible Basis on Acquisition of Buildings.** Building acquisition cost will be included in the underwritten Eligible Basis if the Applicant provided an appraisal that meets the Department's Appraisal Rules and Guidelines as described in §10.304 of this chapter. The underwritten eligible building cost will be the lowest of the values determined based on clauses (i) - (iii) of this subparagraph:

- (i) the Applicant's stated eligible building acquisition cost;
- (ii) the total acquisition cost reflected in the Site Control document(s), or the Adjusted Acquisition Cost (as defined in subparagraph (B)(iii) of this paragraph), prorated using the relative land and building values indicated by the applicable appraised value;
- (iii) total acquisition cost reflected in the Site Control document(s), or the Adjusted Acquisition Cost (as defined in subparagraph (B)(iii) of this paragraph), less the appraised "as-vacant" land value; or
- (iv) the Underwriter will use the value that best corresponds to the circumstances presently affecting the Development that will continue to affect the Development after transfer to the new owner in determining the building value. These circumstances include but are not limited to operating subsidies, rental assistance and/or property tax exemptions. Any value of existing favorable financing will be attributed prorata to the land and buildings.

(2) **Off-Site Costs.** The Underwriter will only consider costs of Off-Site Construction that are well documented and certified to by a Third Party engineer on the required Application forms with supporting documentation.

(3) **Site Work Costs.** The Underwriter will only consider costs of Site Work that are well documented and certified to by a Third Party engineer on the required Application forms with supporting documentation.

(4) **Building Costs.**

(A) **New Construction and Reconstruction.** The Underwriter will use the Marshall and Swift Residential Cost Handbook, other comparable published Third-Party cost estimating data sources, historical final cost certifications of previous Housing Tax Credit developments and other acceptable cost data available

to the Underwriter to estimate Building Cost. Generally, the "Average Quality" multiple, townhouse, or single family costs, as appropriate, from the Marshall and Swift Residential Cost Handbook or other comparable published Third-Party data source, will be used based upon details provided in the Application and particularly building plans and elevations. The Underwriter will consider amenities, specifications and development types not included in the Average Quality standard. The Underwriter may consider a sales tax exemption for nonprofit General Contractors.

- (B) **Rehabilitation and Adaptive Reuse.**
- (i) The Applicant must provide a detailed narrative description of the scope of work for the proposed rehabilitation.
 - (ii) The Underwriter will use cost data provided on the PCA Cost Schedule Supplement.
- (5) **Contingency.** Total contingency, including any soft cost contingency, will be limited to a maximum of 7 percent of Building Cost plus Site Work and off-sites for New Construction and Reconstruction Developments, and 10 percent of Building Cost plus Site Work and off-sites for Rehabilitation and Adaptive Reuse Developments. For Housing Tax Credit Developments, the percentage is applied to the sum of the eligible Building Cost, eligible Site Work costs and eligible off-site costs in calculating the eligible contingency cost.
- (6) **General Contractor Fee.** General Contractor fees include general requirements, contractor overhead, and contractor profit. General requirements include, but are not limited to, on-site supervision or construction management, off-site supervision and overhead, jobsite security, equipment rental, storage, temporary utilities, and other indirect costs. General Contractor fees are limited to a total of 14 percent on Developments with Hard Costs of \$3 million or greater, the lesser of \$420,000 or 16 percent on Developments with Hard Costs less than \$3 million and greater than \$2 million, and the lesser of \$320,000 or 18 percent on Developments with Hard Costs at \$2 million or less. For tax credit Developments, the percentages are applied to the sum of the Eligible Hard Costs in calculating the eligible contractor fees. For Developments also receiving financing from USDA, the combination of builder's general requirements, builder's overhead, and builder's profit should not exceed the lower of TDHCA or USDA requirements. Additional fees for ineligible costs will be limited to the same percentage of ineligible Hard Costs but will not be included in Eligible Basis.
- (7) **Developer Fee.**
- (A) For Housing Tax Credit Developments, the Developer Fee included in Eligible Basis cannot exceed 15 percent of the project's eligible costs, less Developer fees, for Developments proposing fifty (50) Units or more and 20 percent of the project's eligible costs, less Developer fees, for Developments proposing forty-nine (49) Units or less. For Public Housing Authority Developments for conversion under the HUD Rental Assistance Demonstration ("RAD") program that will be financed using tax-exempt mortgage revenue bonds, the Developer Fee cannot exceed 20 percent of the project's eligible cost less Developer Fee.
 - (B) Any additional Developer fee claimed for ineligible costs will be limited to the same percentage but applied only to ineligible Hard Costs (15 percent for Developments with fifty (50) or more Units, or 20 percent for Developments with forty-nine (49) or fewer Units). Any Developer fee above this limit will be excluded from Total Housing Development Costs. All fees to Affiliates and/or Related Parties for work or guarantees determined by the Underwriter to be typically completed or provided by the Developer or Principal(s) of the Developer will be considered part of Developer fee.
 - (C) In the case of a transaction requesting acquisition Housing Tax Credits:
 - (i) the allocation of eligible Developer fee in calculating Rehabilitation/New Construction Housing Tax Credits will not exceed 15 percent of the Rehabilitation/New Construction eligible costs less Developer fees for Developments proposing fifty (50) Units or more and 20 percent of the Rehabilitation/New Construction eligible costs less Developer fees for Developments proposing forty-nine (49) Units or less; and
 - (ii) no Developer fee attributable to an identity of interest acquisition of the Development will be included.
 - (D) Eligible Developer fee is multiplied by the appropriate Applicable Percentage depending whether it is attributable to acquisition or rehabilitation basis.
 - (E) For non-Housing Tax Credit developments, the percentage can be up to 15 percent, but is based upon Total Housing Development Cost less the sum of the fee itself, land costs, the costs of permanent financing, excessive construction period financing described in paragraph (8) of this subsection, reserves, and any identity of interest acquisition cost.
- (8) **Financing Costs.** All fees required by the construction lender, permanent lender and equity partner must be indicated in the term sheets. Eligible construction period interest is limited to the lesser of actual eligible

construction period interest, or the interest on one (1) year's fully drawn construction period loan funds at the construction period interest rate indicated in the term sheet(s). For tax-exempt bond transactions up to twenty four (24) months of interest may be included. Any excess over this amount will not be included in Eligible Basis. Construction period interest on Related Party construction loans is only included in Eligible Basis with documentation satisfactory to the Underwriter that the loan will be at a market interest rate, fees and loan terms and the Related Party lender can demonstrate that it is routinely engaged in construction financing to unrelated parties.

- (9) **Reserves.** Except for the underwriting of a Housing Tax Credit Development at cost certification, the Underwriter will utilize the amount described in the Applicant's project cost schedule if it is within the range of two (2) to six (6) months of stabilized operating expenses plus debt service. Alternatively, the Underwriter may consider a greater amount proposed by the first lien lender or syndicator if the detail for such greater amount is found by the Underwriter to be both reasonable and well documented. Reserves do not include capitalized asset management fees, guaranty reserves, tenant services reserves or other similar costs. Lease up reserves, exclusive of initial start-up costs, funding of other reserves and interim interest, may be considered with documentation showing sizing assumptions acceptable to the Underwriter. In no instance at initial underwriting will total reserves exceed twelve (12) months of stabilized operating expenses plus debt service (and only for USDA or HUD financed rehabilitation transactions the initial deposits to replacement reserves and transferred replacement reserves for USDA or HUD financed rehabilitation transactions). Pursuant to §10.404(c) and for the underwriting of a Housing Tax Credit Development at cost certification, operating reserves that will be maintained for a minimum period of five years and documented in the Owner's partnership agreement and/or the permanent lender's loan documents will be included as a development cost.
- (10) **Soft Costs.** Eligible soft costs are generally costs that can be capitalized in the basis of the Development for tax purposes. The Underwriter will evaluate and apply the allocation of these soft costs in accordance with the Department's prevailing interpretation of the Code. Generally the Applicant's costs are used however the Underwriter will use comparative data to determine the reasonableness of all soft costs.
- (11) **Additional Tenant Amenities.** For Housing Tax Credit Developments and after submission of the cost certification package, the Underwriter may consider costs of additional building and site amenities (suitable for the tenant population being served) proposed by the Owner in an amount not to exceed 1.5% of the originally underwritten Hard Costs. The additional amenities may be included in the LURA.
- (12) **Special Reserve Account.** For Housing Tax Credit Developments at cost certification, the Underwriter may include a deposit of up to \$2,500 per Unit into a Special Reserve Account [pursuant to §10.404(d)] as a Development Cost.

(f) Development Team Capacity and Development Plan.

- (1) The Underwriter will evaluate and report on the overall capacity of the Development Team by reviewing aspects, including but not limited to those identified in subparagraphs (A) - (D) of this paragraph:
 - (A) personal credit reports for development sponsors, Developer fee recipients and those individuals anticipated to provide guarantee(s) in cases when warranted. The Underwriter may evaluate the credit report and identify any bankruptcy, state or federal tax liens or other relevant credit risks for compliance with eligibility and debarment requirements in this chapter;
 - (B) quality of construction, Rehabilitation, and ongoing maintenance of previously awarded housing developments by review of construction inspection reports, compliance on-site visits, findings of UPCS violations and other information available to the Underwriter;
 - (C) for Housing Tax Credit Developments, repeated or ongoing failure to timely submit cost certifications, requests for and clearance of final inspections, and timely response to deficiencies in the cost certification process;
 - (D) adherence to obligations on existing or prior Department funded developments with respect to program rules and documentation.
- (2) While all components of the development plan may technically meet the other individual requirements of this section, a confluence of serious concerns and unmitigated risks identified during the underwriting process may result in an Application being referred to the Committee by the Director of Real Estate Analysis. The Committee will review any recommendation made under this subsection to deny an Application for a Grant, Direct Loan and/or Housing Credit Allocation prior to completion of the Report and posting to the Department's website.

(g) **Other Underwriting Considerations.** The Underwriter will evaluate additional feasibility elements as described in paragraphs (1) - (3) of this subsection.

- (1) **Floodplains.** The Underwriter evaluates the site plan, floodplain map, survey and other information provided to determine if any of the buildings, drives, or parking areas reside within the 100-year floodplain. If such a determination is made by the Underwriter, the Report will include a condition that:
 - (A) the Applicant must pursue and receive a Letter of Map Amendment ("LOMA") or Letter of Map Revision ("LOMR-F"); or
 - (B) the Applicant must identify the cost of flood insurance for the buildings and for the tenant's contents for buildings within the 100-year floodplain and certify that the flood insurance will be obtained; and
 - (C) the Development must be proposed to be designed to comply with the QAP, NOFA and applicable Federal requirements.
- (2) **Proximity to Other Developments.** The Underwriter will identify in the Report any developments funded or known and anticipated to be eligible for funding within one linear mile of the subject. Distance is measured in a straight line from nearest boundary point to nearest boundary point.
- (3) **Supportive Housing.** The unique development and operating characteristics of Supportive Housing Developments may require special consideration in these areas:
 - (A) **Operating Income.** The extremely-low-income tenant population typically targeted by a Supportive Housing Development may include deep-skewing of rents to well below the 50 percent AMGI level or other maximum rent limits established by the Department. The Underwriter should utilize the Applicant's proposed rents in the Report as long as such rents are at or below the maximum rent limit proposed for the units and equal to any project based rental subsidy rent to be utilized for the Development;
 - (B) **Operating Expenses.** A Supportive Housing Development may have significantly higher expenses for payroll, management fee, security, resident support services, or other items than typical affordable housing developments. The Underwriter will rely heavily upon the historical operating expenses of other Supportive Housing Developments affiliated with the Applicant or otherwise available to the Underwriter. Expense estimates must be categorized as outlined in subsection (d)(2) of this section;
 - (C) **DCR and Long Term Feasibility.** Supportive Housing Developments may be exempted from the DCR requirements of subsection (d)(4)(D) of this section if the Development is anticipated to operate without conventional or "must-pay" debt. Applicants must provide evidence of sufficient financial resources to offset any projected 15-year cumulative negative Cash Flow. Such evidence will be evaluated by the Underwriter on a case-by-case basis to satisfy the Department's long term feasibility requirements and may take the form of one or a combination of: executed subsidy commitment(s); set-aside of Applicant's financial resources to be substantiated by current financial statements evidencing sufficient resources; and/or proof of annual fundraising success sufficient to fill anticipated operating losses. If either a set aside of financial resources or annual fundraising are used to evidence the long term feasibility of a Supportive Housing Development, a resolution from the Applicant's governing board must be provided confirming their irrevocable commitment to the provision of these funds and activities; and/or
 - (D) **Total Housing Development Costs.** For Supportive Housing Developments designed with only Efficiency Units, the Underwriter may use "Average Quality" dormitory costs, or costs of other appropriate design styles from the Marshall & Swift Valuation Service, with adjustments for amenities and/or quality as evidenced in the Application, as a base cost in evaluating the reasonableness of the Applicant's Building Cost estimate for New Construction Developments.

(h) **Work Out Development.** Developments that are underwritten subsequent to Board approval in order to refinance or gain relief from restrictions may be considered infeasible based on the guidelines in this section, but may be characterized as "the best available option" or "acceptable available option" depending on the circumstances and subject to the discretion of the Underwriter as long as the option analyzed and recommended is more likely to achieve a better financial outcome for the property and the Department than the status quo.

(i) **Feasibility Conclusion.** An infeasible Development will not be recommended for a Grant, Direct Loan or Housing Credit Allocation unless the Underwriter can determine an alternative structure and/or conditions the recommendations of the Report upon receipt of documentation supporting an alternative structure. A Development will be characterized as infeasible if paragraph (1) or (2) of this subsection applies. The Development will be

characterized as infeasible if one or more of paragraphs (3) - (5) of this subsection applies unless paragraph (6)(B) of this subsection also applies.

- (1) **Gross Capture Rate and Individual Unit Capture Rate.** The method for determining capture rates for a Development is defined in §10.303 of this chapter. The Underwriter will independently verify all components and conclusions of the capture rates and may, at their discretion, use independently acquired demographic data to calculate demand and may make a determination of the capture rates based upon an analysis of the Sub-market. The Development:
 - (A) is characterized as an Elderly Development and the Gross Capture Rate exceeds 10 percent for the total proposed Units; or
 - (B) is outside a Rural Area and targets the general population, and the Gross Capture Rate exceeds 10 percent for the total proposed Units; or
 - (C) is in a Rural Area and targets the general population, and the Gross Capture Rate exceeds 30 percent; or
 - (D) is Supportive Housing and the Gross Capture Rate exceeds 30 percent; or
 - (E) has an Individual Unit Capture Rate for any Unit Type greater than 75 percent.
 - (F) Developments meeting the requirements of subparagraph (A), (B), (C), (D) or (E) of this paragraph may avoid being characterized as infeasible if clause (i) or (ii) of this subparagraph apply.
 - (i) Replacement Housing. The proposed Development is comprised of affordable housing which replaces previously existing affordable housing within the Primary Market Area as defined in §10.303 of this chapter on a Unit for Unit basis, and gives the displaced tenants of the previously existing affordable housing a leasing preference.
 - (ii) Existing Housing. The proposed Development is comprised of existing affordable housing, whether defined by an existing land use and rent restriction agreement or if the subject rents are at or below 50% AMI rents, which is at least 50 percent occupied and gives displaced existing tenants a leasing preference as stated in a relocation plan.
- (2) **Deferred Developer Fee.** Applicants requesting an allocation of tax credits where the estimated deferred Developer Fee, based on the underwritten capitalization structure, is not repayable from Cash Flow within the first fifteen (15) years of the long term pro forma as described in subsection (d)(5) of this section.
- (3) **Pro Forma Rent.** The Pro Forma Rent for Units with rents restricted at 60 percent of AMGI is less than the Net Program Rent for Units with rents restricted at or below 50 percent of AMGI unless the Applicant accepts the Underwriter's recommendation, if any, that all restricted units have rents and incomes restricted at or below the 50 percent of AMGI level.
- (4) **Initial Feasibility.**
 - (A) Except when underwritten at cost certification, the first year stabilized pro forma operating expense divided by the first year stabilized pro forma Effective Gross Income is greater than 68 percent for Rural Developments 36 Units or less and 65 percent for all other Developments.
 - (B) The first year DCR is below 1.15 (1.00 for USDA Developments).
- (5) **Long Term Feasibility.** The Long Term Pro forma at any time during years two through fifteen, as defined in subsection (d)(5) of this section, reflects:
 - (A) a Debt Coverage Ratio below 1.15; or,
 - (B) negative cash flow (throughout the term of a Direct Loan).
- (6) **Exceptions.** The infeasibility conclusions may be excepted when:
 - (A) Waived by the Executive Director of the Department or by the Committee if documentation is submitted by the Applicant to support unique circumstances that would provide mitigation.
 - (B) Developments not meeting the requirements of one or more of paragraphs (3), (4)(A) or (5) of this subsection will be re-characterized as feasible if one or more of clauses (i) - (v) of this subparagraph apply. A Development financed with a Direct Loan will not be re-characterized as feasible with respect to (5)(B).
 - (i) The Development will receive Project-based Section 8 Rental Assistance or the HUD Rental Assistance Demonstration Program for at least 50 percent of the Units and a firm commitment, with terms including Contract Rent and number of Units, is submitted at Application.
 - (ii) The Development will receive rental assistance for at least 50 percent of the Units in association with USDA financing.
 - (iii) The Development will be characterized as public housing as defined by HUD for at least 50 percent of the Units.

- (iv) The Development will be characterized as Supportive Housing for at least 50 percent of the Units and evidence of adequate financial support for the long term viability of the Development is provided.
- (v) The Development has other long term project based restrictions on rents for at least 50 percent of the Units that allow rents to increase based upon expenses and the Applicant's proposed rents are at least 10 percent lower than both the Net Program Rent and Market Rent.

§10.303. Market Analysis Rules and Guidelines.

(a) **General Provision.** A Market Analysis prepared for the Department must evaluate the need for decent, safe, and sanitary housing at rental rates or sales prices that eligible tenants can afford. The analysis must determine the feasibility of the subject Property rental rates or sales price and state conclusions as to the impact of the Property with respect to the determined housing needs. The Market Analysis must include a statement that the report preparer has read and understood the requirements of this section.

(b) **Self-Contained.** A Market Analysis prepared for the Department must allow the reader to understand the market data presented, the analysis of the data, and the conclusions derived from such data. All data presented should reflect the most current information available and the report must provide a parenthetical (in-text) citation or footnote describing the data source. The analysis must clearly lead the reader to the same or similar conclusions reached by the Market Analyst. All steps leading to a calculated figure must be presented in the body of the report.

(c) **Market Analyst Qualifications.** A Market Analysis submitted to the Department must be prepared and certified by an approved Qualified Market Analyst. (§2306.67055) The Department will maintain an approved Market Analyst list based on the guidelines set forth in paragraphs (1) - (3) of this subsection.

- (1) The approved Qualified Market Analyst list will be updated and published annually on or about October 1st. If not listed as an approved Qualified Market Analyst by the Department, a Market Analyst may request approval by submitting items in subparagraphs (A) - (F) of this paragraph at least thirty (30) days prior to the first day of the competitive tax credit Application Acceptance Period or thirty (30) days prior to submission of any other application for funding for which the Market Analyst must be approved.
 - (A) Franchise Tax Account Status from the Texas Comptroller of Public Accounts (not applicable for sole proprietorships).
 - (B) A current organization chart or list reflecting all members of the firm who may author or sign the Market Analysis. A firm with multiple offices or locations must indicate all members expected to be providing Market Analysis.
 - (C) Resumes for all members of the firm or subcontractors who may author or sign the Market Analysis.
 - (D) General information regarding the firm's experience including references, the number of previous similar assignments and timeframes in which previous assignments were completed.
 - (E) Certification from an authorized representative of the firm that the services to be provided will conform to the Department's Market Analysis Rules and Guidelines, as described in this section, in effect for the Application Round in which each Market Analysis is submitted.
 - (F) A sample Market Analysis that conforms to the Department's Market Analysis Rules and Guidelines, as described in this section, in effect for the year in which the sample Market Analysis is submitted.

An already approved Qualified Market Analyst will remain on the list so long as at least one (1) Market Analysis has been submitted to the Department in the previous 12 months or items (A),(B),(C) and (E) are submitted prior to October 1st. Otherwise, the Market Analyst will automatically be removed from the list.

- (2) 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. Subsequent to the completion of the Application Round and as time permits, staff or a review appraiser will re-review a sample set of submitted market analyses to ensure that the Department's Market Analysis Rules and Guidelines are met. If it is found that a Market Analyst has not conformed to the Department's Market Analysis Rules and Guidelines, as certified to, the Market Analyst will be notified of the discrepancies in the Market Analysis and will be removed from the approved Qualified Market Analyst list.
 - (A) In and of itself, removal from the list of approved Market Analysts will not invalidate a Market Analysis commissioned prior to the removal date and at least ninety (90) days prior to the first day of the applicable Application Acceptance Period.

- (B) To be reinstated as an approved Qualified Market Analyst, the Market Analyst must amend the previous report to remove all discrepancies or submit a new sample Market Analysis that conforms to the Department's Market Analysis Rules and Guidelines, as described in this section, in effect for the year in which the updated or new sample Market Analysis is submitted.
- (3) The list of approved Qualified Market Analysts will be posted on the Department's web site no later than November 1st.

(d) **Market Analysis Contents.** A Market Analysis for a rental Development prepared for the Department must be organized in a format that follows a logical progression and must include, at minimum, items addressed in paragraphs (1) - (13) of this subsection.

- (1) **Title Page.** Include Property address or location, effective date of analysis, date report completed, name and address of person authorizing report, and name and address of Market Analyst.
- (2) **Letter of Transmittal.** The date of the letter must be the date the report was completed. Include Property address or location, description of Property, statement as to purpose and scope of analysis, reference to accompanying Market Analysis report with effective date of analysis and summary of conclusions, date of Property inspection, name of persons inspecting subject Property, and signatures of all Market Analysts authorized to work on the assignment. Include a statement that the report preparer has read and understood the requirements of this section.
- (3) **Table of Contents.** Number the exhibits included with the report for easy reference.
- (4) **Market Analysis Summary.** Include the Department's Market Analysis Summary exhibit.
- (5) **Assumptions and Limiting Conditions.** Include a description of all assumptions, both general and specific, made by the Market Analyst concerning the Property.
- (6) **Identification of the Property.** Provide a statement to acquaint the reader with the Development. Such information includes street address, tax assessor's parcel number(s), and Development characteristics.
- (7) **Statement of Ownership.** Disclose the current owners of record and provide a three (3) year history of ownership for the subject Property.
- (8) **Secondary Market Area.** A geographic area from which the Development may draw limited demand in addition to the PMA. A SMA is not required, but may be defined at the discretion of the Market Analyst to support identified demand. All of the Market Analyst's conclusions specific to the subject Development must be based on only one SMA definition. The entire PMA, as described in this paragraph, must be contained within the SMA boundaries. The Market Analyst must adhere to the methodology described in this paragraph when determining the Secondary Market Area. (§2306.67055)
 - (A) The SMA will be defined by the Market Analyst with:
 - (i) geographic size based on a base year population of no more than 250,000 people inclusive of the PMA; and
 - (ii) boundaries based on U.S. census tracts.
 - (B) The Market Analyst's definition of the SMA must include:
 - (i) a detailed narrative specific to the SMA explaining;
 - (I) how the boundaries of the SMA were determined with respect to census tracts chosen and factors for including or excluding certain census tracts in proximity to the Development;
 - (II) whether a more logical market area within the SMA exists but is not definable by census tracts and how this subsection of the SMA supports the rationale for the defined SMA, and also explains how the SMA relates to the PMA in terms of its qualitative and quantitative aspects;
 - (III) what are the specific attributes of the Development's location within the SMA that would draw prospective tenants currently residing in other areas of the SMA to relocate to the Development;
 - (IV) what are the specific attributes, if known, of the Development itself that would draw prospective tenants currently residing in other areas of the SMA to relocate to the Development; and
 - (V) other housing issues in general, if pertinent.
 - (ii) a complete demographic report for the defined SMA; and

- (iii) a scaled distance map indicating the SMA boundaries showing relevant U.S. census tracts with complete 11-digit identification numbers in numerical order with labels as well as the location of the subject Development and all comparable Developments.
- (9) **Primary Market Area.** A limited geographic area from which the Development is expected to draw most of its demand. The size and shape of the PMA should be reflective of proximity to employment centers, services and amenities and contain the most significant areas from which to draw demand. All of the Market Analyst's conclusions specific to the subject Development must be based on only one PMA definition. The Market Analyst must adhere to the methodology described in this paragraph when determining the market area. (§2306.67055)
- (A) The PMA will be defined by the Market Analyst as:
 - (i) geographic size based on a base year population no larger than necessary to provide sufficient demand but 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.
 - (B) The Market Analyst's definition of the PMA must include:
 - (i) a detailed narrative specific to the PMA explaining:
 - (I) how the boundaries of the PMA were determined with respect to census tracts chosen and factors for including or excluding certain census tracts in proximity to the Development;
 - (II) whether a more logical market area within the PMA exists but is not definable by census tracts and how this subsection of the PMA supports the rationale for the defined PMA ;
 - (III) what are the specific attributes of the Development's location within the PMA that would draw prospective tenants currently residing in other areas of the PMA to relocate to the Development;
 - (IV) what are the specific attributes, if known, of the Development itself that would draw prospective tenants currently residing in other areas of the PMA to relocate to the Development; and
 - (V) other housing issues in general, if pertinent.
 - (ii) a complete demographic report for the defined PMA;
 - (iii) a scaled distance map indicating the PMA boundaries showing relevant U.S. census tracts with complete 11-digit identification numbers in numerical order with labels as well as the location of the subject Development and all comparable Developments. The map must indicate the total square miles of PMA; and,
 - (iv) a proximity table indicating distance from the Development to employment centers, medical facilities, schools, entertainment and any other amenities relevant to the potential residents and include drive time estimates.
 - (C) **Comparable Units.** Identify developments in the PMA with Comparable Units. In PMAs lacking sufficient rent comparables, it may be necessary for the Market Analyst to collect data from markets with similar characteristics and make quantifiable and qualitative location adjustments. Provide a data sheet for each comparable development consisting of:
 - (i) development name;
 - (ii) address;
 - (iii) year of construction and year of Rehabilitation, if applicable;
 - (iv) property condition;
 - (v) Target Population;
 - (vi) unit mix specifying number of Bedrooms, number of baths, Net Rentable Area; and
 - (I) monthly rent and Utility Allowance; or
 - (II) sales price with terms, marketing period and date of sale;
 - (vii) description of concessions;
 - (viii) list of unit amenities;
 - (ix) utility structure;
 - (x) list of common amenities;
 - (xi) narrative comparison of its proximity to employment centers and services relative to targeted tenant population of the subject property; and,
 - (xii) for rental developments only, the occupancy and turnover.

(10) **Market Information.**

- (A) For each of the defined market areas, identify the number of units for each of the categories in clauses (i) - (vi) of this subparagraph; the data must be clearly labeled as relating to either the PMA or the SMA, if applicable:
- (i) total housing;
 - (ii) all multi-family rental developments, including unrestricted developments, whether existing or proposed;
 - (iii) Affordable housing;
 - (iv) Comparable Units;
 - (v) Unstabilized Comparable Units; and
 - (vi) proposed Comparable Units.
- (B) **Occupancy.** The occupancy rate indicated in the Market Analysis may be used to support both the overall demand conclusion for the proposed Development and the vacancy rate assumption used in underwriting the Development described in §10.302(d)(1)(C) of this chapter (relating to Underwriting Rules and Guidelines). State the overall physical occupancy rate for the proposed housing tenure (renter or owner) within the defined market areas by:
- (i) number of Bedrooms;
 - (ii) quality of construction (class);
 - (iii) Target Population; and
 - (iv) Comparable Units.
- (C) **Absorption.** State the absorption trends by quality of construction (class) and absorption rates for Comparable Units.
- (D) **Demographic Reports.**
- (i) All demographic reports must include population and household data for a five (5) year period with the year of Application submission as the base year;
 - (ii) All demographic reports must provide sufficient data to enable calculation of income-eligible, age-, size-, and tenure-appropriate household populations;
 - (iii) For Developments targeting seniors, all demographic reports must provide a detailed breakdown of households by age and by income; and
 - (iv) A complete copy of all demographic reports relied upon for the demand analysis, including the reference index that indicates the census tracts on which the report is based.
- (E) **Demand.** Provide a comprehensive evaluation of the need for the proposed housing for the Development as a whole and each Unit type by number of Bedrooms proposed and rent restriction category within the defined market areas using the most current census and demographic data available. A complete demand and capture rate analysis is required in every Market Study, regardless of the current occupancy level of an existing Development.
- (i) **Demographics.** The Market Analyst should use demographic data specific to the characteristics of the households that will be living in the proposed Development. For example, the Market Analyst should use demographic data specific to elderly population for an Elderly Development, if available, and should avoid making adjustments from more general demographic data. If adjustment rates are used based on more general data for any of the criteria described in subclauses (I) - (V) of this clause, they should be clearly identified and documented as to their source in the report.
 - (I) **Population.** Provide population and household figures, supported by actual demographics, for a five (5) year period with the year of Application submission as the base year.
 - (II) **Target.** If applicable, adjust the household projections for the elderly population targeted by the proposed Development.
 - (III) **Household Size-Appropriate.** Adjust the household projections or target household projections, as applicable, for the appropriate household size for the proposed Unit type by number of Bedrooms proposed and rent restriction category based on 1.5 persons per Bedroom (round up).
 - (IV) **Income Eligible.** Adjust the household size appropriate projections for income eligibility based on the income bands for the proposed Unit Type by number of Bedrooms proposed and rent restriction category with:

- (-a-) the lower end of each income band calculated based on the lowest gross rent proposed divided by 35 percent for the general population and 50 percent for elderly households; and
 - (-b-) the upper end of each income band equal to the applicable gross median income limit for the largest appropriate household size based on 1.5 persons per Bedroom (round up) or one person for Efficiency Units.
 - (V) Tenure-Appropriate. Adjust the income-eligible household projections for tenure (renter or owner). If tenure appropriate income eligible target household data is available, a tenure appropriate adjustment is not necessary.
- (ii) **Gross Demand.** Gross Demand is defined as the sum of Potential Demand from the PMA, Demand from Other Sources, and Potential Demand from a Secondary Market Area (SMA) to the extent that SMA demand does not exceed 25 percent of Gross Demand.
- (iii) **Potential Demand.** Potential Demand is defined as the number of income-eligible, age-, size-, and tenure-appropriate target households in the designated market area at the proposed placed in service date.
 - (I) Maximum eligible income is equal to the applicable gross median income limit for the largest appropriate household size based on 1.5 persons per Bedroom (round up) or one person for Efficiency Units.
 - (II) For Developments targeting the general population:
 - (-a-) minimum eligible income is based on a 35 percent rent to income ratio;
 - (-b-) appropriate household size is defined as 1.5 persons per Bedroom (rounded up); and
 - (-c-) the tenure-appropriate population for a rental Development is limited to the population of renter households.
 - (III) For Developments consisting solely of single family residences on separate lots with all Units having three (3) or more Bedrooms:
 - (-a-) minimum eligible income is based on a 35 percent rent to income ratio;
 - (-b-) appropriate household size is defined as 1.5 persons per Bedroom (rounded up); and
 - (-c-) Gross Demand includes both renter and owner households.
 - (IV) Elderly Developments or Supportive Housing:
 - (-a-) minimum eligible income is based on a 50 percent rent to income ratio; and
 - (-b-) Gross Demand includes all household sizes and both renter and owner households.
- (iv) **Demand from Secondary Market Area:**
 - (I) Potential Demand from an SMA should be calculated in the same way as Potential Demand from the PMA;
 - (II) Potential Demand from an SMA may be included in Gross Demand to the extent that SMA demand does not exceed 25 percent of Gross Demand; and
 - (III) the supply of proposed and unstabilized Comparable Units in the SMA must be included in the calculation of the capture rate at the same proportion that Potential Demand from the SMA is included in Gross Demand.
- (v) **Demand from Other Sources:**
 - (I) the source of additional demand and the methodology used to calculate the additional demand must be clearly stated;
 - (II) consideration of Demand from Other Sources is at the discretion of the Underwriter;
 - (III) Demand from Other Sources must be limited to households that are not included in Potential Demand; and
 - (IV) if households with Section 8 vouchers are identified as a source of demand, the Market Study must include:
 - (-a-) documentation of the number of vouchers administered by the local Housing Authority; and
 - (-b-) a complete demographic report for the area in which the vouchers are distributed.

- (F) **Employment.** Provide a comprehensive analysis of employment trends and forecasts in the Primary Market Area. Analysis must discuss existing or planned employment opportunities with qualifying income ranges.
- (11) **Conclusions.** Include a comprehensive evaluation of the subject Property, separately addressing each housing type and specific population to be served by the Development in terms of items in subparagraphs (A) - (I) of this paragraph. All conclusions must be consistent with the data and analysis presented throughout the Market Analysis.
- (A) **Unit Mix.** Provide a best possible unit mix conclusion based on the occupancy rates by Bedroom type within the PMA and target, income-eligible, size-appropriate and tenure-appropriate household demand by unit type and income type within the PMA.
- (B) **Rents.** Provide a separate Market Rent conclusion for each proposed Unit Type by number of Bedrooms and rent restriction category. Conclusions of Market Rent below the maximum Net Program Rent limit must be well documented as the conclusions may impact the feasibility of the Development under §10.302(i) of this chapter. In support of the Market Rent conclusions, provide a separate attribute adjustment matrix for each proposed Unit Type by number of Bedrooms and rental restriction category.
- (i) The Department recommends use of HUD Form 92273.
 - (ii) A minimum of three developments must be represented on each attribute adjustment matrix.
 - (iii) Adjustments for concessions must be included, if applicable.
 - (iv) Adjustments for proximity and drive times to employment centers and services narrated in the Comparable Unit description must be included.
 - (v) Total adjustments in excess of 15 percent must be supported with additional narrative.
 - (vi) Total adjustments in excess of 25 percent indicate the Units are not comparable for the purposes of determining Market Rent conclusions.
- (C) **Effective Gross Income.** Provide rental income, secondary income, and vacancy and collection loss projections for the subject derived independent of the Applicant's estimates.
- (D) **Demand:**
- (i) state the Gross Demand for each Unit Type by number of Bedrooms proposed and rent restriction category (*e.g.* one-Bedroom Units restricted at 50 percent of AMGI; two-Bedroom Units restricted at 60 percent of AMGI); and
 - (ii) state the Gross Demand for the proposed Development as a whole. If some households are eligible for more than one Unit Type due to overlapping eligible ranges for income or household size, Gross Demand should be adjusted to avoid including households more than once.
- (E) **Relevant Supply.** The Relevant Supply of proposed and unstabilized Comparable Units includes:
- (i) the proposed subject Units;
 - (ii) Comparable Units in an Application with priority over the subject pursuant to §10.201(6) of this chapter.
 - (iii) Comparable Units in previously approved but Unstabilized Developments in the PMA; and
 - (iv) Comparable Units in previously approved but Unstabilized Developments in the SMA, in the same proportion as the proportion of Potential Demand from the SMA that is included in Gross Demand.
- (F) **Gross Capture Rate.** The Gross Capture Rate is defined as the Relevant Supply divided by the Gross Demand. Refer to §10.302(i) of this chapter for feasibility criteria.
- (G) **Individual Unit Capture Rate.** For each Unit Type by number of Bedrooms and rent restriction categories, the individual unit capture rate is defined as the Relevant Supply of proposed and unstabilized Comparable Units divided by the eligible demand for that Unit. [Some households are eligible for multiple Unit Types. In order to calculate individual unit capture rates, the Underwriter will make assumptions such that each household is included in the capture rate for only one Unit Type.]
- (H) **Absorption.** Project an absorption period for the subject Development to achieve Breakeven Occupancy. State the absorption rate.
- (I) **Market Impact.** Provide an assessment of the impact the subject Development, as completed, will have on existing Developments supported by Housing Tax Credits in the Primary Market. (§2306.67055)
- (12) **Photographs.** Provide labeled color photographs of the subject Property, the neighborhood, street scenes, and comparables. An aerial photograph is desirable but not mandatory.
- (13) **Appendices.** Any Third Party reports including demographics relied upon by the Market Analyst must be provided in appendix form. A list of works cited including personal communications also must be provided, and the Modern Language Association (MLA) format is suggested.

(14) **Qualifications.** Current Franchise Tax Account Status from the Texas Comptroller of Public Accounts (not applicable for sole proprietorships) and any changes to items listed in §10.303(c)(1)(B) and (C) of this chapter.

(e) 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.

(f) In the event that the PMA for a subject Development overlaps the PMA's of other proposed or unstabilized comparable Developments, 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; the Gross Capture Rate from such an extended Sub-Market Area analysis may be used as the basis for a feasibility conclusion.

(g) All Applicants shall acknowledge, by virtue of filing an Application, 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.

§10.304. Appraisal Rules and Guidelines.

(a) **General Provision.** An appraisal prepared for the Department must conform to the Uniform Standards of Professional Appraisal Practice (USPAP) as adopted by the Appraisal Standards Board of the Appraisal Foundation. The appraisal must include a statement that the report preparer has read and understood the requirements of this section.

(b) **Self-Contained.** An appraisal prepared for the Department must describe sufficient and adequate data and analyses to support the final opinion of value. The final value(s) must be reasonable, based on the information included. Any Third Party reports relied upon by the appraiser must be verified by the appraiser as to the validity of the data and the conclusions.

(c) **Appraiser Qualifications.** The qualifications of each appraiser are determined on a case-by-case basis by the Director of Real Estate Analysis or review appraiser, based upon the quality of the report itself and the experience and educational background of the appraiser. At minimum, a qualified appraiser must be appropriately certified or licensed by the Texas Appraiser Licensing and Certification Board.

(d) **Appraisal Contents.** An appraisal prepared for the Department must be organized in a format that follows a logical progression. In addition to the contents described in USPAP Standards Rule 2, the appraisal must include items addressed in paragraphs (1) - (12) of this subsection.

- (1) **Title Page.** Include a statement identifying the Department as the client, acknowledging that the Department is granted full authority to rely on the findings of the report, and name and address of person authorizing report.
- (2) **Letter of Transmittal.** Include reference to accompanying appraisal report, reference to all person(s) that provided significant assistance in the preparation of the report, date of report, effective date of appraisal, date of property inspection, name of person(s) inspecting the property, tax assessor's parcel number(s) of the site, estimate of marketing period, and signatures of all appraisers authorized to work on the assignment including the appraiser who inspected the property. Include a statement indicating the report preparer has read and understood the requirements of this section.
- (3) **Table of Contents.** Number the exhibits included with the report for easy reference.
- (4) **Disclosure of Competency.** Include appraiser's qualifications, detailing education and experience.
- (5) **Statement of Ownership of the Subject Property.** Discuss all prior sales of the subject Property which occurred within the past three (3) years. Any pending agreements of sale, options to buy, or listing of the subject Property must be disclosed in the appraisal report.
- (6) **Property Rights Appraised.** Include a statement as to the property rights (e.g., fee simple interest, leased fee interest, leasehold, etc.) being considered. The appropriate interest must be defined in terms of current appraisal terminology with the source cited.

- (7) **Site/Improvement Description.** Discuss the site characteristics including subparagraphs (A) - (E) of this paragraph.
- (A) **Physical Site Characteristics.** Describe dimensions, size (square footage, acreage, etc.), shape, topography, corner influence, frontage, access, ingress-egress, etc. associated with the Development Site. Include a plat map and/or survey.
 - (B) **Floodplain.** Discuss floodplain (including flood map panel number) and include a floodplain map with the subject Property clearly identified.
 - (C) **Zoning.** Report the current zoning and description of the zoning restrictions and/or deed restrictions, where applicable, and type of Development permitted. Any probability of change in zoning should be discussed. A statement as to whether or not the improvements conform to the current zoning should be included. A statement addressing whether or not the improvements could be rebuilt if damaged or destroyed, should be included. If current zoning is not consistent with the highest and best use, and zoning changes are reasonable to expect, time and expense associated with the proposed zoning change should be considered and documented. A zoning map should be included.
 - (D) **Description of Improvements.** Provide a thorough description and analysis of the improvements including size (Net Rentable Area, gross building area, etc.), number of stories, number of buildings, type/quality of construction, condition, actual age, effective age, exterior and interior amenities, items of deferred maintenance, energy efficiency measures, etc. All applicable forms of depreciation should be addressed along with the remaining economic life.
 - (E) **Environmental Hazards.** It is recognized appraisers are not experts in such matters and the impact of such deficiencies may not be quantified; however, the report should disclose any potential environmental hazards (such as discolored vegetation, oil residue, asbestos-containing materials, lead-based paint etc.) noted during the inspection.
- (8) **Highest and Best Use.** Market Analysis and feasibility study is required as part of the highest and best use. The highest and best use analysis should consider paragraph (7)(A) - (E) of this subsection as well as a supply and demand analysis.
- (A) The appraisal must inform the reader of any positive or negative market trends which could influence the value of the appraised Property. Detailed data must be included to support the appraiser's estimate of stabilized income, absorption, and occupancy.
 - (B) The highest and best use section must contain a separate analysis "as if vacant" and "as improved" (or "as proposed to be improved/renovated"). All four elements (legally permissible, physically possible, feasible, and maximally productive) must be considered.
- (9) **Appraisal Process.** It is mandatory that all three approaches, Cost Approach, Sales Comparison Approach and Income Approach, are considered in valuing the Property. If an approach is not applicable to a particular property an adequate explanation must be provided. A land value estimate must be provided if the Cost Approach is not applicable.
- (A) **Cost Approach.** This approach should give a clear and concise estimate of the cost to construct the subject improvements. The source(s) of the cost data should be reported.
 - (i) Cost comparables are desirable; however, alternative cost information may be obtained from Marshall & Swift Valuation Service or similar publications. The section, class, page, etc. should be referenced. All soft costs and entrepreneurial profit must be addressed and documented.
 - (ii) All applicable forms of depreciation must be discussed and analyzed. Such discussion must be consistent with the description of the improvements.
 - (iii) The land value estimate should include a sufficient number of sales which are current, comparable, and similar to the subject in terms of highest and best use. Comparable sales information should include address, legal description, tax assessor's parcel number(s), sales price, date of sale, grantor, grantee, three (3) year sales history, and adequate description of property transferred. The final value estimate should fall within the adjusted and unadjusted value ranges. Consideration and appropriate cash equivalent adjustments to the comparable sales price for subclauses (I) - (VII) of this clause should be made when applicable.
 - (I) Property rights conveyed.
 - (II) Financing terms.
 - (III) Conditions of sale.
 - (IV) Location.
 - (V) Highest and best use.
 - (VI) Physical characteristics (e.g., topography, size, shape, etc.).

- (VII) Other characteristics (e.g., existing/proposed entitlements, special assessments, etc.).
- (B) **Sales Comparison Approach.** This section should contain an adequate number of sales to provide the reader with a description of the current market conditions concerning this property type. Sales data should be recent and specific for the property type being appraised. The sales must be confirmed with buyer, seller, or an individual knowledgeable of the transaction.
- (i) Sales information should include address, legal description, tax assessor's parcel number(s), sales price, financing considerations and adjustment for cash equivalency, date of sale, recordation of the instrument, parties to the transaction, three (3) year sale history, complete description of the Property and property rights conveyed, and discussion of marketing time. A scaled distance map clearly identifying the subject and the comparable sales must be included.
 - (ii) The method(s) used in the Sales Comparison Approach must be reflective of actual market activity and market participants.
 - (I) **Sale Price/Unit of Comparison.** The analysis of the sale comparables must identify, relate, and evaluate the individual adjustments applicable for property rights, terms of sale, conditions of sale, market conditions, and physical features. Sufficient narrative must be included to permit the reader to understand the direction and magnitude of the individual adjustments, as well as a unit of comparison value indicator for each comparable.
 - (II) **Net Operating Income/Unit of Comparison.** The Net Operating Income statistics or the comparables must be calculated in the same manner. It should be disclosed if reserves for replacement have been included in this method of analysis. At least one other method should accompany this method of analysis.
- (C) **Income Approach.** This section must contain an analysis of both the actual historical and projected income and expense aspects of the subject Property.
- (i) **Market Rent Estimate/Comparable Rental Analysis.** This section of the report should include an adequate number of actual market transactions to inform the reader of current market conditions concerning rental Units. The comparables must indicate current research for this specific property type. The comparables must be confirmed with the landlord, tenant or agent and individual data sheets must be included. The individual data sheets should include property address, lease terms, description of the property (e.g., Unit Type, unit size, unit mix, interior amenities, exterior amenities, etc.), physical characteristics of the property, and location of the comparables. Analysis of the Market Rents should be sufficiently detailed to permit the reader to understand the appraiser's logic and rationale. Adjustment for lease rights, condition of the lease, location, physical characteristics of the property, etc. must be considered.
 - (ii) **Comparison of Market Rent to Contract Rent.** Actual income for the subject along with the owner's current budget projections must be reported, summarized, and analyzed. If such data is unavailable, a statement to this effect is required and appropriate assumptions and limiting conditions should be made. The Contract Rents should be compared to the market-derived rents. A determination should be made as to whether the Contract Rents are below, equal to, or in excess of market rates. If there is a difference, its impact on value must be qualified.
 - (iii) **Vacancy/Collection Loss.** Historical occupancy data and current occupancy level for the subject should be reported and compared to occupancy data from the rental comparables and overall occupancy data for the subject's Primary Market.
 - (iv) **Expense Analysis.** Actual expenses for the subject, along with the owner's projected budget, must be reported, summarized, and analyzed. If such data is unavailable, a statement to this effect is required and appropriate assumptions and limiting conditions should be made. Historical expenses should be compared to comparables expenses of similar property types or published survey data (such as IREM, BOMA, etc.). Any expense differences should be reconciled. Include historical data regarding the subject's assessment and tax rates and a statement as to whether or not any delinquent taxes exist.
 - (v) **Capitalization.** The appraiser should present the capitalization method(s) reflective of the subject market and explain the omission of any method not considered in the report.
 - (I) **Direct Capitalization.** The primary method of deriving an overall rate is through market extraction. If a band of investment or mortgage equity technique is utilized, the assumptions must be fully disclosed and discussed.
 - (II) **Yield Capitalization (Discounted Cash Flow Analysis).** This method of analysis should include a detailed and supportive discussion of the projected holding/investment period,

income and income growth projections, occupancy projections, expense and expense growth projections, reversionary value and support for the discount rate.

- (10) **Value Estimates.** Reconciliation of final value estimates is required. The Underwriter may request additional valuation information based on unique existing circumstances that are relevant for deriving the market value of the Property.
- (A) All appraisals shall contain a separate estimate of the "as vacant" market value of the underlying land, based upon current sales comparables. The appraiser should consider the fee simple or leased fee interest as appropriate.
 - (B) For existing Developments with any project-based rental assistance that will remain with the property after the acquisition, the appraisal must include an "as-is as-currently-restricted value". For public housing converting to project-based rental assistance, the appraiser must provide a value based on the future restricted rents. The value used in the analysis may be based on the unrestricted market rents if supported by an appraisal. The Department may require that the appraisal be reviewed by a third-party appraiser acceptable to the Department but selected by the applicant. Use of the restricted rents by the appraiser will not require an appraisal review. Regardless of the rents used in the valuation, the appraiser must consider any other on-going restrictions that will remain in place even if not affecting rents. If the rental assistance has an impact on the value, such as use of a lower capitalization rate due to the lower risk associated with rental rates and/or occupancy rates on project-based developments, this must be fully explained and supported to the satisfaction of the Underwriter.
 - (C) For existing Developments with rent restrictions, the appraisal must include the "as-is as-restricted" value. In particular, the value must be based on the proposed restricted rents when deriving the value based on the income approach.
 - (D) For all other existing Developments, the appraisal must include the "as-is" value.
 - (E) For any Development with favorable financing (generally below market debt) that will remain in place and transfer to the new owner, the appraisal must include a separate value for the existing favorable financing with supporting information.
 - (F) If required the appraiser must include a separate assessment of personal property, furniture, fixtures, and equipment ("FF&E") and/or intangible items. If personal property, FF&E, or intangible items are not part of the transaction or value estimate, a statement to such effect should be included.
- (11) **Marketing Time.** Given property characteristics and current market conditions, the appraiser(s) should employ a reasonable marketing period. The report should detail existing market conditions and assumptions considered relevant.
- (12) **Photographs.** Provide good quality color photographs of the subject Property (front, rear, and side elevations, on-site amenities, interior of typical Units if available). Photographs should be properly labeled. Photographs of the neighborhood, street scenes, and comparables should be included. An aerial photograph is desirable but not mandatory.

(e) **Additional Appraisal Concerns.** The appraiser(s) must be aware of the Department program rules and guidelines and the appraisal must include analysis of any impact to the subject's value.

§10.305. Environmental Site Assessment Rules and Guidelines.

(a) **General Provisions.** The Environmental Site Assessments (ESA) prepared for the Department must be conducted and reported in conformity with the standards of the American Society for Testing and Materials ("ASTM"). The initial report must conform with the Standard Practice for Environmental Site Assessments: Phase I Assessment Process (ASTM Standard Designation: E1527- 13 or any subsequent standards as published). Any subsequent reports should also conform to ASTM standards and such other recognized industry standards as a reasonable person would deem relevant in view of the Property's anticipated use for human habitation. The ESA shall be conducted by a Third Party environmental professional at the expense of the Applicant, and addressed to the Department as a User of the report (as defined by ASTM standards). Copies of reports provided to the Department which were commissioned by other financial institutions must either address Texas Department of Housing and Community Affairs as a co-recipient of the report or letters from both the provider and the recipient of the report may be submitted extending reliance on the report to the Department. The ESA report must also include a statement that the person or company preparing the ESA report will not materially benefit from the Development in any other way than receiving a fee for performing the ESA, and that the fee is in no way contingent upon the outcome of the assessment. The ESA report must contain a statement indicating the report preparer has read and understood the requirements of this section.

(b) In addition to ASTM requirements, the report must:

- (1) state if a noise study is recommended for a property in accordance with current HUD guidelines and identify its proximity to industrial zones, major highways, active rail lines, civil and military airfields, or other potential sources of excessive noise;
- (2) provide a copy of a current survey, if available, or other drawing of the site reflecting the boundaries and adjacent streets, all improvements on the site, and any items of concern described in the body of the ESA or identified during the physical inspection;
- (3) provide a copy of the current FEMA Flood Insurance Rate Map showing the panel number and encompassing the site with the site boundaries precisely identified and superimposed on the map;
- (4) if the subject Development Site includes any improvements or debris from pre-existing improvements, state if testing for Lead Based Paint and/or asbestos containing materials would be required pursuant to local, state, and federal laws, or recommended due to any other consideration;
- (5) state if testing for lead in the drinking water would be required pursuant to local, state, and federal laws, or recommended due to any other consideration such as the age of pipes and solder in existing improvements. For buildings constructed prior to 1980, a report on the quality of the local water supply does not satisfy this requirement;
- (6) assess the potential for the presence of Radon on the Property, and recommend specific testing if necessary;
- (7) identify and assess the presence of oil, gas or chemical pipelines, processing facilities, storage facilities or other potentially hazardous explosive activities on-site or in the general area of the site that could potentially adversely impact the Development. Location of these items must be shown on a drawing or map in relation to the Development Site and all existing or future improvements. The drawing must depict any blast zones (in accordance with HUD guidelines) and include HUD blast zone calculations; and
- (8) include a vapor encroachment screening in accordance with Vapor Intrusion E2600-10.

(c) If the report recommends further studies or establishes that environmental hazards currently exist on the Property, or are originating off-site, but would nonetheless affect the Property, the Development Owner must act on such a recommendation, or provide a plan for either the abatement or elimination of the hazard. Evidence of action or a plan for the abatement or elimination of the hazard must be presented upon Application submittal.

(d) For Developments in programs that allow a waiver of the Phase I ESA such as a USDA funded Development, the Development Owners are hereby notified that it is their responsibility to ensure that the Development is maintained in compliance with all state and federal environmental hazard requirements.

(e) Those Developments which have or are to receive first lien financing from HUD may submit HUD's environmental assessment report, provided that it conforms to the requirements of this section.

§10.306. Property Condition Assessment Guidelines.

(a) **General Provisions.** The objective of the Property Condition Assessment (PCA) for Rehabilitation Developments is to provide cost estimates for repairs and replacements, and new construction of additional buildings or amenities, which are: immediately necessary repairs and replacements; improvements proposed by the Applicant as outlined in a scope of work narrative submitted by the Applicant to the PCA provider that is consistent with the scope of work provided in the Application; and expected to be required throughout the term of the Affordability Period and not less than thirty (30) years. The PCA prepared for the Department should be conducted and reported in conformity with the American Society for Testing and Materials "Standard Guide for Property Condition Assessments. Baseline Property Condition Assessment Process (ASTM Standard Designation: E 2018") except as provided for in subsections (b) and (c) of this section. The PCA report must contain a statement indicating the report preparer has read and understood the requirements of this section. The PCA must include the Department's PCA Cost Schedule Supplement which details all Rehabilitation costs and projected repairs and replacements through at least thirty (30) years. The PCA must also include discussion and analysis of:

- (1) **Useful Life Estimates.** For each system and component of the property the PCA should assess the condition of the system or component, and estimate its remaining useful life, citing the basis or the source from which such estimate is derived;

- (2) **Code Compliance.** The PCA should review and document any known violations of any applicable federal, state, or local codes. In developing the cost estimates specified herein, it is the responsibility of the Applicant to ensure that the PCA adequately considers any and all applicable federal, state, and local laws and regulations which may govern any work performed to the subject Property. For transactions with Direct Loan funding from the Department, the PCA provider must also evaluate cost estimates to meet the International Existing Building Code and other property standards;
- (3) **Program Rules.** The PCA should assess the extent to which any systems or components must be modified, repaired, or replaced in order to comply with any specific requirements of the housing program under which the Development is proposed to be financed, the Department's Uniform Physical Condition Standards, and any scoring criteria for which the Applicant may claim points;
- (4) **Accessibility Requirements.** The PCA report must include an analysis of compliance with the Department's accessibility requirements pursuant to Chapter 1, Subchapter B and Section 10.101 (B)(8) and include the specific scope of work and costs needed to ensure that the Development will meet these requirements upon Rehabilitation (including conversion and Adaptive Reuse).
- (5) **Reconciliation of Scope of Work and Costs.** The PCA report must include the Department's PCA Cost Schedule Supplement with the signature of the PCA provider; the costs presented on the PCA Cost Schedule Supplement are expected to be consistent with both the scope of work and immediate costs identified in the body of the PCA report, and with the Applicant's scope of work and Hard Costs as presented on the Applicant's development cost schedule; any significant variation between the costs listed on the PCA Cost Schedule Supplement and the costs listed in the body of the PCA report or on the Applicant's development cost schedule must be reconciled in a narrative analysis from the PCA provider; and
- (6) **Cost Estimates for Repair and Replacement.** It is the responsibility of the Applicant to ensure that the PCA provider is apprised of all development activities associated with the proposed transaction and consistency of the total immediately necessary and proposed repair and replacement cost estimates with the Total Housing Development Cost schedule and scope of work submitted as an exhibit of the Application.
 - (A) **Immediately Necessary Repairs and Replacement.** Systems or components which are expected to have a remaining useful life of less than one (1) year, which are found to be in violation of any applicable codes, which must be modified, repaired or replaced in order to satisfy program rules, or which are otherwise in a state of deferred maintenance or pose health and safety hazards should be considered immediately necessary repair and replacement. The PCA must provide a separate estimate of the costs associated with the repair, replacement, or maintenance of each system or component which is identified as being an immediate need, citing the basis or the source from which such cost estimate is derived.
 - (B) **Proposed Repair, Replacement, or New Construction.** If the development plan calls for additional repair, replacement, or New Construction above and beyond the immediate repair and replacement described in subparagraph (A) of this paragraph, such items must be identified and the nature or source of obsolescence or improvement to the operations of the Property discussed. The PCA must provide a separate estimate of the costs associated with the repair, replacement, or new construction which is identified as being above and beyond the immediate need, citing the basis or the source from which such cost estimate is derived.
 - (C) **Reconciliation of Costs.** The combined costs described in subparagraphs (A) and (B) of this paragraph should be consistent with the Hard Costs presented on the Applicant's development cost schedule.
 - (D) **Expected Repair and Replacement Over Time.** The term during which the PCA should estimate the cost of expected repair and replacement over time must equal the lesser of thirty (30) years or the longest term of any land use or regulatory restrictions which are, or will be, associated with the provision of housing on the Property. The PCA must estimate the periodic costs which are expected to arise for repairing or replacing each system or component or the property, based on the estimated remaining useful life of such system or component as described in paragraph (1) of this subsection adjusted for completion of repair and replacement immediately necessary and proposed as described in subparagraphs (A) and (B) of this paragraph. The PCA must include a separate table of the estimated long term costs which identifies in each line the individual component of the property being examined, and in each column the year during the term in which the costs are estimated to be incurred and no less than thirty (30) years. The estimated costs for future years should be given in both present dollar values and anticipated future dollar values assuming a reasonable inflation factor of not less than 2.5 percent per annum.

(b) Any costs not identified and discussed in the PCA as part of subsection (a)(4), (5)(A) and (5)(B) of this section will not be included in the underwritten Total Development Cost in the Report.

(c) If a copy of such standards or a sample report have been provided for the Department's review, if such standards are widely used, and if all other criteria and requirements described in this section are satisfied, the Department will also accept copies of reports commissioned or required by the primary lender for a proposed transaction, which have been prepared in accordance with:

- (1) Fannie Mae's criteria for Physical Needs Assessments;
- (2) Federal Housing Administration's criteria for Project Capital Needs Assessments;
- (3) Freddie Mac's guidelines for Engineering and Property Condition Reports;
- (4) USDA guidelines for Capital Needs Assessment.

(d) The Department may consider for acceptance reports prepared according to other standards which are not specifically named in subsection (b) of this section, if a copy of such standards or a sample report have been provided for the Department's review, if such standards are widely used, and if all other criteria and requirements described in this section are satisfied.

(e) The PCA shall be conducted by a Third Party at the expense of the Applicant, and addressed to Texas Department of Housing and Community Affairs as the client. Copies of reports provided to the Department which were commissioned by other financial institutions should address Texas Department of Housing and Community Affairs as a co-recipient of the report, or letters from both the provider and the recipient of the report should be submitted extending reliance on the report to Texas Department of Housing and Community Affairs. The PCA report should also include a statement that the person or company preparing the PCA report will not materially benefit from the Development in any other way than receiving a fee for performing the PCA. The PCA report must contain a statement indicating the report preparer has read and understood the requirements of this section.