



Leveling the Playing Field for Small Scale Developers and Non-Profits

BY MARK HENDRICKSON

Having a dedicated revenue source for affordable housing has drawn market rate developers to expand their businesses to include and even be dominated by the development of affordable product. Having large scale experienced developers in the business of delivering affordable housing is an important asset for Florida. But when the open door for large scale, profit-motivated developers slams shut in the face of smaller scale developers and mission-based nonprofits, Florida is placed in a vulnerable position—one that compromises the interests of the public.



paper, including (1) effective elimination of the lottery by creating scoring items (including leveraging) which will eliminate ties, and (2) by elimination of shell applications.

EVOLUTION OF SYSTEM: BEST OF OLD AND NEW SYSTEMS

This article is not trying to present an argument that the system in place prior to the series of changes that lead to the current crisis was perfect. It was not. It was flawed in that it encouraged cross appeals related to irrelevant or minor issues that had no bearing on the public purpose of a proposed development. The lack of cures for any issue also did not serve any valid public purpose.

The solution is a new system that combines the best of the old and new approaches. Restoration of meaningful scoring items, elimination of wholesale cures without penalty, but retention of cures for minor or irrelevant errors will create a truly level playing field that funds applicants—regardless of their size or type—based upon valid public purpose criteria, without a return to wholesale abuse of cross appeals.

WHY? Because when profit-motivated housing developers find better ways to make a profit, they logically leave the affordable housing industry. And if the system continues to provide little welcome for the small developers and the mission-based nonprofit developers they are unable to find within affordable housing a viable line of business. The human infrastructure needed to run an effective nonprofit will justifiably find other work. Ultimately, the delivery system fails, but not before public funds are wasted in an effort to keep the for-profit sector engaged. Florida is on the road to that failure now.

EXECUTIVE SUMMARY

The current system of allocating Housing Credits and SAIL by the Florida Housing Finance Corporation is broken. This is not because of FHFC Board or staff intent—instead it is the result of a series of seemingly rational decisions that, taken in their entirety, have resulted in a system that is skewed in favor of a few large developers. The system can be fixed by adopting the series of changes detailed in this

BACKGROUND

A decade ago, the allocation system had a wide variety of point driven criteria, and ties between applicants were rare. An applicant could control their own destiny in the process by turning in a complete application that achieved the public policy goals of the state as reflected in the scoring system.

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Important scoring factors that drove the system were leveraging of public funds, local government contributions, and turning in a complete application. Applicants that used the least amount of public subsidy per set-aside unit produced and received significant support from the local government where the development was located were most often winners. A small for-profit or not-for-profit developer could thrive within the system because they could focus upon their single (or few) applications and achieve a score high enough to win. Applicants could not flood the system with mediocre applications and win because of the volume of applications submitted.

An important part of scoring was to minimize the amount of items classified as “threshold” (requiring rejection if an error was made), and instead have most items as point scoring (where a minor mistake on one part of an application would lead only to a slight point reduction which could be offset by high scores on items such as leveraging).

With the best of intentions, certain items were reclassified as “threshold”—setting off a plethora of cross appeals designed to eliminate otherwise good applications. The aversion to the overwhelming number of cross appeals lead FHFC to attempt to change the system to make cross appeals less appealing (unlimited cures without penalty). Unfortunately, this well intentioned goal actually generated a system that tipped the playing field advantage to large scale for-profit developers who could overwhelm the system with massive amounts of applications.

THE PROBLEMS AND THEIR GENESIS

The most significant changes to the application process were the “dumbing down” of the application so that virtually every applicant would end up with the same score and the introduction of virtually unlimited cures.

FHFC was lobbied with the concept that rewarding leveraging caused a “race to the bottom”, wherein applications with unrealistically low amounts of subsidies became winners—later causing a return of the Housing Credits or SAIL because the deal would not work. While a few developments did turn back their allocations (primarily

during the period where land prices rapidly escalated earlier this decade), this can be more likely traced to a period where developers were able to flip the land for a significant profit (why go through the headache and financial risk of building and operating a rent restricted property for an extended period when a developer could make \$1-2 million by simply selling the land?). This is not to say that no developer ever underestimated their needed subsidy and returned an allocation—but it was not a major problem.

FHFC eliminated leveraging either altogether or as a meaningful scoring item. This resulted in a loss of any competitive controls on subsidy requests—meaning that there was no longer any self-regulation by developers. To the contrary, many deals seemed to be inflating costs to justify excess subsidy. Where leveraging had been the ultimate tie-breaker, it became a meaningless or non-existent scoring item. This in itself was the key to creating the “everyone ties” system that now prevails.

Simultaneously, an argument was made that the contribution levels needed for maximizing a score on local government contributions were too high, and drove deals away from areas that needed housing but where the local government did not want affordable housing. While the argument related to contribution levels was legitimate, with the a few isolated locations, the argument related to local

governments utilizing this item to keep affordable housing out of their jurisdiction was not the case. The system was changed so that minimal local contributions that virtually every applicant could receive resulted in maximum points. Additionally, local contribution was eliminated entirely as a scoring item for Bond-SAIL applications. More importantly, the application eliminated the requirement for applicants to provide documentation of the contribution other than a signed form from a local government. As local governments are not experts on the system, this opened up the system to abuse, wherein the claimed contribution is not what is really being given. This was adopted because local contributions were the source of many cross appeals—and they often should have been.



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At the same time, the aversion to cross appeals made an argument that unlimited cures were needed—to avoid litigation and allow “the best” applicants to prevail. The argument was made and sold that minor application errors were driving who won rather than rational public purpose scoring. This was only true because the two most meaningful scoring items—leveraging and local government contribution—were effectively eliminated from the process. It is ironic that the advantage gained from cross appeals was only possible because of the “everyone ties” system and the large number of threshold scoring items.

Most ironic was the argument that an application driven system was unfair to small and non-profit developers—who it was argued could not afford the assistance necessary to fill out an application correctly. The irony was that the changes made to “fix” this problem directly resulted in a new system that made it almost impossible for the small developer to win in the general competition for allocation.

The final change made to the system was the addition of a lottery, wherein ties were broken by the random drawing of numbers. With meaningful scoring items, a lottery would rarely (if ever) determine who receives allocation. However, with the combination of changes noted above, it became the main determinant of who receives FHFC funding.

Of course, the more applications submitted by a developer, the more lottery numbers that developer receives. With virtually unlimited cures, a large developer can submit “shell” applications, where much of the application is not even completed, but can later be cured. This allows the large developers to overwhelm the system with shell applications, pull a lottery number, and then cure only the applications with potential winning numbers. The “real” application deadline became the cure date—and developers had full knowledge of everyone else’s application and where they stood in the funding process before that time.

Therefore, a large developer might pull 20-40 lottery numbers, and a small developer 1-3. Some non-profits only

do one deal every few years, putting them at an even more extreme disadvantage.

An ancillary problem that developed with this system was the push for an increase in various set-asides, which became the only way small developers could compete. When you face a 50-1 competitive disadvantage in the general competition, the only solution within the flawed system is to carve out a small piece of the pie that only a few developers wanted.

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THE BROKEN SYSTEM

By 2008, the system had become irretrievably broken. Developers that turn in massive amounts of shell applications are given great competitive advantage, and the small developer is left with little chance of winning an allocation unless they literally hit the lottery against great odds. Turning in complete applications has no meaning, and developers cannot control their own destiny by planning efficient transactions that produce more units for less public money.

In 2008 an additional abuse of the system began—“carpet-bombing” the system with applications designed to give one developer effective control of the SAUL system. Combined with the ability to withdraw applications before scoring is complete, this can give a developer de facto control over the process—wherein they determine what will be funded rather than FHFC public policy. Like the other problems, this gaming of the system is only possible because the unlimited cure available to applicants allows shell

applications to be submitted.

Some of the large developers still argue that leveraging will discourage “hard to do” deals, or deals from higher cost counties. The argument related to county location is spurious, as allocation is distributed by a per county unit system (SAUL), where the competition is really between deals within any given county. The hard to do deal argument can best be addressed by the legitimate use of set-asides, such as the homeless set-aside, the requirement for funding of a high-rise every year, or some type of urban redevelopment set-aside—not by eliminating leveraging as the basic method of breaking ties.

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THE NEEDED REFORMS

1. Add leveraging as a meaningful scoring item. This was already done for SAIL in the 2008 cycle, and preliminary analysis shows that more than twice as many set-aside units will be produced per SAIL dollar as compared to 2007. Leveraging scoring, where the allocation per set-aside unit is the measurement, will break ties in virtually all circumstances. This works simply by giving the application with the best leveraging full points, the applicant with the worst no points, and everyone else in between pro rata points. Additionally, only like-developments (new construction, rehabilitation) should be compared for leveraging purposes). To avoid gaming of this system, subsidy requests that are outside of a mathematically calculated range should be eliminated from this calculation—to keep a developer from submitting a request solely designed to compress the difference in scores between the “real” applications.

2. Eliminate shell applications by removing the penalty free ability for unlimited cures. Cures of minor errors such as numerical transpositions, failure to put a zip code on a form that is signed and otherwise identifies a property, and other such errors can and should still be permitted without penalty. However, curing substantive errors such as missing forms, unsigned forms, and meaningful mistakes (leaving exhibits to a document out of the submission, for example) should only be allowed with point penalties.



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- 3. Threshold items should be highly limited—so that errors do not lead to rejection of applications.
- 4. The lottery will effectively be eliminated as the driving factor in allocation simply by adding back scoring items that prevent ties and elimination of shell applications. As an aside, if all other factors between two deals are equal, what is better public policy—giving the allocation to the applicant who fills out their application completely or the one who gains a competitive advantage by “buying” lottery numbers?
- 5. Backup material “proving up” the local contribution should be added back to the application. At present, contribution points are given solely based upon a local government official signing a form, without really showing any documentation to prove that the contribution is real. While the contribution level required for receiving maximum points may remain low, the application system should make sure that the contribution is real.

With these reforms, small developers, both for-profit, and not-for-profit, can control their own destiny within a fair system with a truly level playing field.



MARK HENDRICKSON, president of *The Hendrickson Company*, is the immediate past Chair and serves as an Executive Committee member for the Florida Housing Coalition. He served as Executive Director of the Florida Housing Finance Agency from its inception in 1981 to 1994. As its first Chief Executive Officer, he led the way in creation of the Sadowski Act.

The vision of the Florida Housing Coalition includes that “at least one active, viable community-based organization plays an important role in delivering affordable housing and related services in each community”. To that end, the Florida Housing Coalition Board of Directors has been undertaking a study of policy changes needed to increase the capacity of



nonprofit developers throughout the state. The Coalition will have a workshop on September 16th “Designing a New Environment for Nonprofit Developers” at the statewide annual conference which addresses these issues as well as models that work in other states to support the development of small and large scale nonprofits.