

THE HFA INSTITUTE 2021

Mixed Financing, Part 1: Underwriting

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National Council of
State Housing Agencies



**MRBs and
Other Federal
Homeownership
Programs**
FEBRUARY 1 – 3



Housing Credit
FEBRUARY 3 – 5



**Section 8 and
Other Federally
Assisted
Multifamily
Housing**
FEBRUARY 8 – 10



**HOME and
Housing Trust
Fund**
FEBRUARY 10 – 12



Welcome

- Sponsored by:
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 - NCSHA
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Agenda

- Leveraging Other Funds
- Impact of mixing resources with HOME Underwriting
- Overview of funding specific requirements
- Potential Underwriting Implications
- Wrap Up and Questions

Leveraging Other Funds

Advantages

- Leveraging multiple funding sources stretches limited funding
- Additional sources allow deeper affordability targeting
- Ineligible costs under one funding may be allowable under another

Challenges

- Multiple sets of regulations to meet
- May trigger federal requirements otherwise not applicable
- Complicates the rules for long term compliance

Examples of Potential Affordable Housing Funding Sources

HUD Sources

- HTF
- CDBG
- HUD Project based subsidies

Non-HUD Sources

- Low Income Housing Tax Credits (LIHTC)
- Tax Exempt Bonds
- Opportunity Zone Investment Fund
- Local, HFA, or Foundation Generated Resources

Low Income Housing Tax Credit (LIHTC) Considerations

- Excellent source of leverage
- Source of credits include:
 - Annual allocation to state (Currently \$2.70 per capita)
 - “4%” LIHTCs if state tax exempt bond cap is available
 - Separate allocation from congress sometimes available
 - Hurricane Katrina / Rita “GO Zone” LIHTCs
 - Additional disaster recovery tax-exempt bond cap if allocated
- Tax credits translate into equity proceeds; pay for project costs
 - Pricing based on local market conditions; project structure
 - Current average price is approximately 90 cents+ per LIHTC credit
 - Price adjusted based on market and risk characteristics

HTF

- HTF beneficiaries must have incomes less than the greater of ELI limit or (below 30% of AMI) or Federal poverty line
- Up to 10% of each annual grant may be spent on administrative and planning costs
- At least 80% of each annual grant must be spent on rental housing
- Up to 10% of each annual grant may be spent for homeownership (direct assistance or rehab/construction).

Project Based Subsidies

- Project based subsidies fund the difference between an affordable rent for a specific household versus the project rent
- For example – provide a rent subsidy for the difference between the 30% an eligible household can afford to pay and the rent at 60% AMI
- Depending on availability of resources a PHA may enter into a Annual Contribution Contract (ACC) for a period of fifteen (15) years

Evaluation of Risk

- The PJ must evaluate the risk of potential non-compliance throughout the affordability period – the PJ risks repayment of total HOME investment if project fails to complete affordability period
- HOME non-compliance will cause the PJ to enforce their written agreement provisions, but they are typically in a second or third lien position
- LIHTC projects that fail to maintain compliance can trigger the Equity investors to not be able to recognize tax credits
- LIHTC projects owned as single-asset entities (Limited Partnership)(LLC)
- Equity investors typically include “flow down” provisions in the partnership agreement that reduces the developer fee

HOME Underwriting Requirements

- §92.250(b) requires a PJ to adopt and evaluate HOME projects according to written underwriting and subsidy layering guidelines
- HOME underwriting is the analysis of project assumptions and risks to ensure the project will meet affordability requirements
- Section 212(f) requires PJ to certify that it will not invest more HOME funds in a project than is necessary and reasonable
- Analysis of Market assessment and Developer Capacity ensure viable and sustainable projects
- CPD Notice 15-11 HOME Underwriting and Subsidy Layering Guidelines published on December 22, 2015

HOME Underwriting Requirements (cont'd)

- A PJ must evaluate a project against its HOME underwriting standards and cannot simply accept underwriting done for LIHTC or other lenders
- A PJ can review other lenders' underwriting but the PJ must make and document its own determination that the project meets HOME requirements
- The PJ must certify in IDIS to the use of its underwriting guidelines.

Applicability

- Applies to projects funded in part or in whole with HOME funds
- CPD Notice 15-11 HOME Underwriting and Subsidy Layering Guidelines published on December 22, 2015
- <https://www.hudexchange.info/trainings/courses/home-underwriting-and-subsidy-layering-guidelines-hud-notice-cpd-15-11-webinar/1062/>

Reviewing Sources and Uses

- PJs must determine all project costs are **eligible, customary and reasonable**
- Sources and Uses must include all funds and costs to complete the project
 - All sources must be firmly committed
- Budget must be in sufficient detail to determine: total cost, per unit cost, and line item percentages
 - Ensure all HOME costs eligible per 92.206
 - Ensure HOME investment does not exceed max per unit subsidy limits
 - Perform cost allocation to ensure only costs of assisted units may be charged to HOME

Eligible and Ineligible Project Costs

- Projects may include costs that are deemed ineligible for HOME funding. These include:
 - off-site infrastructure
 - stand alone community buildings for a mixed funded projects
 - luxury items not eligible for HOME
- The PJ needs to designate the use of all HOME funds to expenses eligible for HOME investment
- Other project funding would be identified in the line-item budget for those HOME ineligible expenses

Subsidy Layering

- Subsidy layering is the “gap analysis” to determine the level of HOME funds needed to make the project feasible
- It is a comparison of the approved costs, available financing, and other sources of funding
- Gap analysis cannot be finalized until all sources have been confirmed
- PJs analysis includes the project capacity to support debt – versus just determining the projected gap in sources

Cost Allocation

- HOME funds may only be used to pay eligible costs for HOME-assisted units
- A PJ must perform cost allocation for a project where less than 100% of the units are HOME-assisted.
- Cost allocation results dictate:
 - The maximum HOME investment (capped by subsidy limits), or
 - The minimum number of HOME units
 - See Notice CPD-16-15
- Final Cost allocation cannot be completed until all sources confirmed

Underwriting Process for Multiple Funds

- Underwriting can be completed simultaneously but must be completed to standards of each funding source
- HOME cannot defer to underwriting completed for another funding source
- HOME underwriting cannot be finalized until all sources have been committed – final commitment of HOME cannot be determined until commitment of all sources
- HOME will require evidence of LIHTC credit award and initial letter of interest and valuation from equity investor
- LIHTC will need to determine equity gap – will require a conditional HOME award

Project Reserves

- Reserves are needed to ensure stability for projects in periods when maintenance or operational costs exceed current cash flow
- HOME/HTF funds cannot be used to capitalize operating or maintenance reserves but can be used to fund an initial operating reserve to cover shortfalls during the initial 18 months rent up period
- HOME/HTF does allow annual contributions from net cash flow to build reserves over time
- Best practice – Equity resources can fund up front capital reserves

Reserves for Replacement

- Deposits for future capital expenditures
- Approaches to capital budgeting:
 - Future cash flow
 - Regular deposits to a reserve account escrow
- After the first year of the project, HOME cannot invest HOME \$ during affordability period without HUD waiver
- Must rely on reserve for replacement, owner investment, or other funding sources
- Standards for reserves part of Underwriting policies

Standards for Reserves

- PJ underwriting policies and procedures must establish a process to determine adequate ongoing project reserves.
- HOME reserves standards may be set program wide based on unit size or set based on a project specific evaluation
- The HOME multifamily underwriting template can be utilized to calculate needed project reserves.
- LIHTC project may have standards set within the QAP

Designate Fixed or Floating Units

- Only units receiving HOME \$ are subject to HOME requirements
- For properties with HOME and non-HOME units, must select “fixed” or “floating” HOME units
 - Fixed = HOME units for duration of affordability period
 - Floating = unit numbers change but always have same portion of HOME units
- Fixed or floating is designated in written agreement

Deed and Use Restrictions

- HOME rental affordability restrictions must be imposed by deed or other restrictions on the property that run with the title to the land for at least the minimum period of affordability
- Must apply without regard to any loan, repayment, or transfer
- Rights of purchase and other methods may supplement

Ineligible Activities for HOME

- Projects that require program participation requirements such as clean and sober programs
- Public housing development or rehabilitation under Section 9 of the 1937 Public Housing Act
- Facilities such as dormitories or nursing homes
- Projects previously funded with HOME funds after initial 12 months following project completion but still within the affordability period

Combining Project Based Subsidies and HOME

- HOME allows the project to exceed the HOME rent up to the subsidy contract level when the subsidy is in combination with a Low-HOME unit. The household must have an income at or below 50% AMI and pay no more than 30% of their household income for the tenant portion of rent and utilities.
- PJ may need to designate additional Low-HOME units to utilize available subsidies

Timing of Funding Investments

- HOME funds can be invested for acquisition and construction which lowers the cost of construction financing
- Equity investments typically are not available until the unit has been placed in service
 - Price per LIHTC credit impacted by timing of equity investment
- PJs can be placed at greater risk during initial period if other investors have yet to put funding into the deal
- Underwriting needs to track not only the sources and uses but also when the sources become available
- Gaps in availability may require construction financing or bridge funding

Affordability Periods

- HOME rehabilitation requires 5-15 years based on average HOME investment per unit; New construction is an automatic 20 years.
- LIHTC allows equity investors to exit at the end of year 10 of the 15-year compliance period: HFA may exercise provisions of 30-year LIHTC affordability period. LIHTC underwriting covers this period and includes exit strategy
- HTF requires an affordability period of at least 30 years
- Underwriting must document the project can remain viable throughout the affordability period

Income Targeting

- LIHTC: 50% or 60% AMI
 - QAP often requires deeper targeting
 - 2018 Appropriation Act permits “Income Averaging” permitting LIHTCs to be taken for units up to 80% of AMI
- HOME: 50%, 60%, and 80%
 - Program rule 90% of units at 60% at initial occupancy
 - Project rule requires 20% of units at 50% AMI if 5 or more HOME units
 - Further targeting may be required
- HTF: 30% AMI(or poverty)
 - Some units allowed at 50% if HTF funding over \$1B

Combining Funds and Lower Income Targeting

- 100% HTF projects with rents at 30% may not generate adequate revenue to cover ongoing costs.
- Combining HTF units within larger LIHTC can provide financial stability needed – this may be a critical combination in the absence of ongoing subsidies
- Allows for more diversity within affordable housing communities

Other Federal Requirements

- LIHTC is considered a non-federal source of funds and does not trigger many of the “other federal” requirements such as ER, Davis Bacon wage rates, and URA
- HFA may have adopted similar policies but have more flexibility
- HOME/HTF or other federal funding federalizes the project and triggers a list of federal requirements
- This may have impact timelines, administrative burden, and the total project cost
- Funders may strategically choose to utilize non-federal funding for specific projects such as state HTF when available

Level of Assistance

HOME

- Cost Allocation and Maximum per unit subsidy limits apply
- PJ often have maximum loan amounts

LIHTC

- Equity investment based on eligible basis
- Size of investment based on the equity gap
- Credit provided based on financial feasibility for a minimum 15- year compliance period
- Value per credit may vary over time

Project Timetable

HOME

- HOME 24-month commitment deadline currently waived
- PJ has four-year project completion deadline from commitment of funds to the project meeting activity specific definition of completion
- Failure to meet four-year completion deadline triggers repayment
- HOME units must be occupied within 18 months or repay funds

LIHTC

- 10% test for Carryover Allocations
- Project must be placed in service by the close of 2nd calendar year following carryover allocation or return funds
- Beginning of the 10-Year Credit Investment Period

Start of the Affordability Period

- HOME affordability begins at project completion as defined for rental or homeownership rules
- LIHTC 10-year credit period begins when the placed in service requirement has been met
- LIHTC new construction placed in service when certification of occupancy in place
- LIHTC substantial rehabilitation considered placed in service at the close of any 24-month period after meeting the substantial rehabilitation test

Written Agreement: Unit Designation

- HOME projects with other affordable housing funding require detailed unit designation to identify HOME units and HOME in combination with other sources such as LIHTC
- Number and type of HOME assisted units
 - Bedroom distribution
 - Low HOME/High HOME
 - Fixed and Floating
 - Rent limits
- Income and Rent standards for mixed funded units will require calculation of the more restrictive standard

Resources

- Notice CPD-16-15: Allocating Eligible Costs and Identifying HOME-Assisted Units in Multi-Unit HOME Rental and Homeownership Development Projects
<https://www.hudexchange.info/resource/5137/notice-cpd-16-15-allocating-eligible-costs-and-identifying-home-assisted-units-in-multiunit-home-rental-and-homeownership-development-projects/>
- 2020 HOME Multifamily Underwriting Template Webinar
<https://www.hudexchange.info/trainings/courses/2020-home-multifamily-underwriting-template-webinar/3682/>
- IRC 42 https://www.irs.gov/pub/irs-utl/IRC_42.pdf
- <https://www.novoco.com/notes-from-novogradac/implementation-lihtc-income-averaging>
- <https://www.ncsha.org/resource/housing-credit-income-averaging-frequently-asked-questions/>