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Multiple Subsidy Deal Structuring & Compliance

January 9, 2024



MRBs and Other Federal Homeownership Programs
JANUARY 10 – 12







Housing Credit
JANUARY 9 – 11

Section 8 and Other Federal Multifamily Programs
JANUARY 10 – 12







HOME and Housing Trust Fund
JANUARY 7 – 9

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Welcome & Introductions

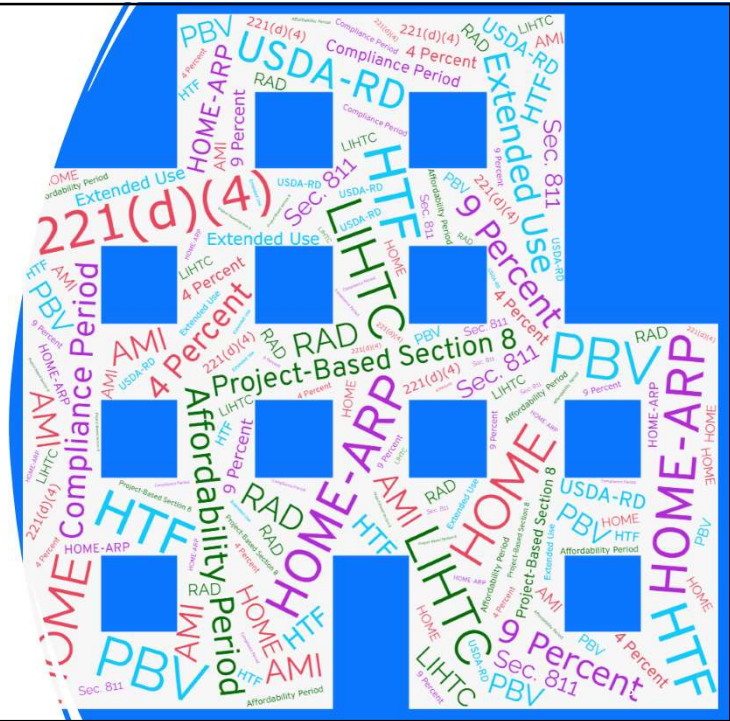
- Sponsored by
 - NCSHA &
 - HUD’s Office of Affordable Housing Programs (OAHP)
- Presenter
 - Steve Lathom
 - TDA Consulting 
 - slathom@tdainc.org




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You were told...

- Explore the intricacies of structuring deals that rely on Housing Credit equity as well as HOME or HTF.
- Learn how to reconcile differing compliance requirements across subsidies.



Really?

Describe the history of western philosophy from Socrates to John Rawls. Be comprehensive but concise.

You have 75 minutes.

BLUE BOOK
Examination Book

Name _____
 Student ID _____
 Instructor _____
 Course/Section _____
 Class _____
 Date _____

Notes

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Topics for Today

- Recognize fundamental difference between allocations role and gap lender role
- Get funds into the deal the right way
- Compare/contrast requirements esp. for HOME-ARP
 - At project and unit levels

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What's Your Role


LIHTC Allocator



- Want to make good allocations...
 - Maximize production at reasonable cost
 - Respond to state's housing needs & priorities
- Responsible for regulatory oversight
- But if things go wrong...
 - You don't repay Treasury, owners do

HOME/HOME-ARP/HTF Lender

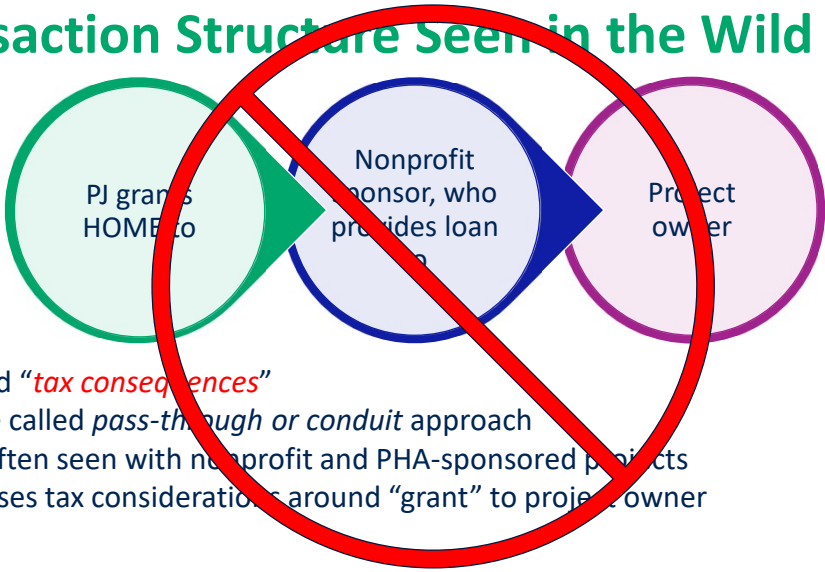
-  all that...
 - Award good projects
 - Respond to needs/priorities
-  that too...
 - Compliance & performance monitoring
- But if things go wrong...
 - You repay HUD, even if you can't collect from the owner




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Transaction Structure Seen in the Wild



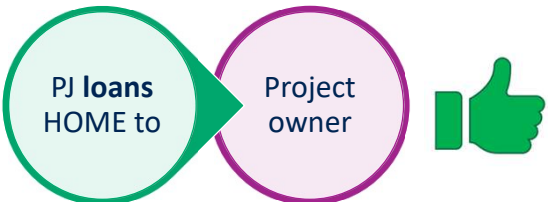
- To avoid “*tax consequences*”
- May be called *pass-through or conduit* approach
- Most often seen with nonprofit and PHA-sponsored projects
- Addresses tax considerations around “grant” to project owner


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HOMEfires – Volume 16, No. 1

- Grant/Loan structure **not permissible** in **HOME**
 - Nor in **HTF** or **HOME-ARP**
- It **never** was, but we know this structure was used frequently in HOME
- Agreement and provision of funds **must** be between PJ & **owner**
 - In addition to being a statutory & regulatory requirement, absent contractual relationship with owner, PJ has less control, fewer enforcement mechanisms, increased risk of noncompliance and requirement to repay HOME
- HOME can be a loan; there was **never** a requirement funds be granted
 - PJ can lend on amortizing, cash-flow, deferred terms; interest bearing or 0%





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HOMEFires – Volume 16, No. 1 continued...



- Forward looking
 - If you’ve been doing this, **stop now!**
 - Same statutory/regulatory provisions apply to HOME-ARP
 - Different statute, but same result for HTF



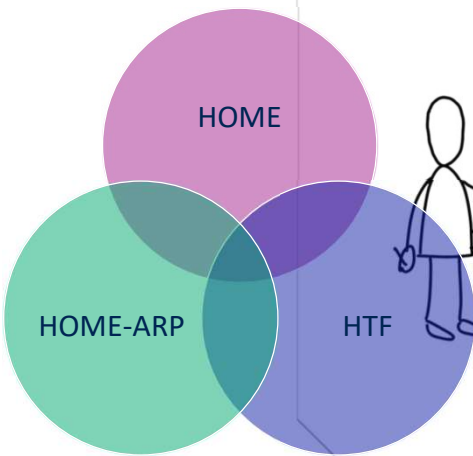



- Past projects
 - HUD applying discretion in enforcement, but... clean up where you can
 - Any payments on HOME loan paid to 3rd party (e.g., nonprofit sponsor) should be Program Income returned to PJ for additional projects
 - Consider amending/restating agreements, requiring assignment of receivable loans to PJ, etc.
 - Review prior agreements for broad “corrective” provisions
 - Consider conditioning new funds on clean up of prior projects

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Can These Overlap?





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At the PROJECT Level

- Layered finance is what we do
 - *Sometimes (maybe even often) to our own detriment*
- Relative to cross-cutting req. HOME/HOME-ARP largely identical
 - Minor distinctions vs. HTF around DBRA, Env. Review, 1:1 replacement
- Affordability and Compliance periods measured from same “project completion” threshold but durations vary
 - HOME: 5, 10, 15 years for rehab; or 20 years for new construction
 - HOME-ARP: 15 years no matter \$ amount or new v. rehab
 - HTF: 30 years no matter \$ amount or new v. rehab

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At the UNIT Level

- Many (maybe most) times you cannot, but occasionally you must
- Things get messy, *strongly recommend avoiding where you can*
 - Identify distinct tranches of HOME units, HOME-ARP units, and HTF units
 - Also remember, two types of HOME-ARP units – QP and Low Income (LI) units
- Also *recommend designating fixed units* when combining HOME-ARP with HOME or HTF
 - If not, at least clearly specify that any given unit may not be designated by both programs (*unless some units must be both, then say so)
 - If you must, where possible overlap regular HOME with HOME-ARP Low-Income (not QP) units

When You Cannot Double-Designate

- Cost allocation is independently required for HOME, HOME-ARP, and HTF
- Process is materially the same for each, except:
 - Max per-unit subsidy in HTF is state defined and does not apply to HOME-ARP
 - Also, some very deep in the weeds differences between HOME/HOME-ARP and HTF re: projects involving public housing units could impact cost allocation *methodology*
- In practice, PJs/Grantees ***most often*** designate minimum number of required units
 - In that approach, the idea is HOME paid for (*nearly*) all eligible costs of the designated HOME units
 - Basic cost principles prohibit charging the same expense to two different sources



- Project is a side-by-side duplex
 - Two comparable units
- Total *eligible* project costs = \$500,000
 - HOME award of \$250,000
 - HTF award of \$250,000
- HOME & HTF each independently require cost allocation
 - Ignoring HTF, cost allocation for HOME requires 1 HOME unit
 - Ignoring HOME, 1 HTF unit required
- ***Can we designate one unit as both HOME & HTF, letting the other be an unassisted market rate unit?***
 - *Why not?*

Cost Allocation Thought Experiment

(Massively Oversimplified)



- Same duplex project, **but**
- Total *eligible* project costs = \$500,000
 - HOME award of **\$400,000**
 - HTF award of **\$100,000**
- HOME & HTF each independently require cost allocation
 - Ignore HTF, cost allocation for HOME requires **2** HOME units
 - Ignore HOME, 1 HTF unit required
- **Result**
 - One unit **must** be both HOME & HTF
 - Other unit **must** be HOME
 - *Could* also be HTF, but only if “over designating”

Cost Allocation Thought Experiment

(Massively Oversimplified – But Different)

Why Not Combine at Unit Level?


- It adds unnecessarily complexity
 - *Did you just follow cost allocation? ٩(ツ)٩*
- Complexity increases compliance risk & admin. burden for PJs, owners, management
 - Initial eligibility may vary, income is not part of eligibility for HOME-ARP QP units
 - But still applies for units w/LIHTC, PBVs, etc.
 - Over-income rules between programs vary
 - HOME-ARP even different btw QP & LI units
- Lose regulatory flexibility afforded to HOME-ARP
 - **Tenant-based** voucher, HOME & HTF still **restrict rent to published rent limit**
 - HOME-ARP allows (higher) voucher rent
 - HOME **doesn't allow local PHA's utility allowance**,
 - HOME-ARP & HTF do



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Brief Foray Into Coordinated Entry

- HOME projects may **NOT** use coordinated entry to select tenants from waiting list. 
 - HOME **statutory** requirement for *project-specific* waiting list and selection in *chronological order*, even when there are preferences or limitations
 - CE places households across a *portfolio* of projects and prioritizes based on *vulnerability*
- Same is true for **HTF**, requirements are regulatory, not statutory
 - HUD could waiver for good cause (*but the bar would be high*)

Coordinated Entry & HOME-ARP

- Project-specific waitlist is always acceptable; **it's the default**
- HOME-ARP **allows** but **does not require** CE
 - Only for QP units, low-income units **must** use project-specific waitlist
- However, to use with HOME-ARP, CE system **must** meet specific conditions or be changed, revised, updated...
 - Must include all QPs
 - Geography must align (e.g., project market area and CoC geography)
- If not, project-specific waitlist is required
 - CE system, and others, can refer applicants to project for placement on waitlist



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What We Know about Deep Affordability

- Deep targeted units require rent or operating subsidies to be viable
 - Whether units are formally for ELI at/below 30%* AMI or
 - For QPs who will overwhelmingly be ELI at intake
- Making ELI/QP units viable requires:
 - PBVs or other project-based rent assistance
 - But supply is limited, coordination can be difficult
 - “Internal subsidy” from other units, e.g., units at 60% to 80% AMI
 - Still requires deep capital subsidies
 - Doesn’t work in every project
 - When it does, need still outpaces number of ELI/QP units supported
 - **OR... operating subsidies from HOME-ARP itself**

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Operating Cost Assistance

- **HOME-ARP gets this right(er)**
 - Still doesn’t mean it will work for everyone everywhere or be easy.
- Allows PJ to either provide ongoing operating cost assistance or **capitalize an operating cost assistance reserve**
 - Only applicable to HOME-ARP QP units, not “just” HOME-ARP LI units
 - Cannot be used for units with PBVs or other PBRA (e.g., Sec. 8, USDA-RA, etc.)
 - Must be sized relative to required 15-year compliance period, cannot be sized for PJ-imposed extended compliance period

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Operating Cost Assistance continued...

- Definition of operating costs aligns with industry norms, includes standard OpEx and Replacement Reserve deposits
 - Note: HTF regulation does not and therefore may not work in practice
- Operating Deficit =
 - Actual Revenue from HOME-ARP units (tenant contributions + any tenant-based voucher assistance)
 - Less allocable OpEx less allocable RR deposits*
 - But **does not** include debt service – presumption is HOME-ARP funded (nearly) entire cost of HOME-ARP units

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Another *(over-simplified)* Example

	# of Units	Monthly/Unit	Annual/Unit	Annual Gross
LIHTC Units	40	700	8,400	336,000
HOME-ARP Tenant Contributions	10	100	1,200	12,000
HOME-ARP Balance of QP Rent		300	3,600	36,000
Other/Misc Revenue		8	100	5,000
<i>Subtotal</i>			13,300	389,000
Vacancy (7%)			(931)	(27,230)
Net Revenue			12,369	361,770
Operating Expenses			4,500	225,000
Replacement Reserve Deposits			300	15,000
Net Operating Income			7,569	121,770
Debt Service (at 1.15 DCR)			2,118	105,887
Cash Flow			318	15,883

- Projected OpEx+RR = \$4,800/unit
 - Excludes debt service
- Less Projected Tenant Contributions to Rent (after UA)= \$1,200/unit
- Yields HOME-ARP Operating Deficit \$3,600 x 10 units = \$36,000/year
- 15 years x \$36K = **\$540,000**

▪ *Note: Project cash flow is attributable to non-HOME-ARP units & reasonable w/in PJ underwriting standards*

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Taking It a Few Steps Further

- **Capitalized reserve preferred** vs. ongoing operating cost assistance
 - Ongoing operating assistance only available within “budget period” for HOME-ARP (i.e., before expenditure deadline of 9/30/2030); it would expire years before project’s compliance period
 - Reserve protects PJ against project failure requiring repayment
 - Other market participants will expect/require it (i.e., LIHTC investors)
- **Critical assumption: “typical” tenant contribution to rent**
 - PJ sets standard for “affordable” tenant contribution (e.g., 30% of adjusted income)
 - Tenant rent contribution determined for each QP household, for many segments of overall QP, this could be very little or even \$0
 - Underwriting balance: Be cautious, hedging a bit conservative; but don’t be unrealistically pessimistic either

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Deeper Still

- PJ **must**
 - Require operating assistance reserve be in separate interest-bearing account
 - *Steve Says: Some of you have the capacity to hold the reserve, consider that*
 - Require owner to request written approval for any withdrawals and review documentation supporting any withdrawals
 - *Steve Says: If not holding the reserve, require a deposit account control agreement*
 - At least annually review balance, burn rate, and projected depletion
 - *Steve Says: Expect to reconcile periodic withdrawals w/actual year-end performance*
- Remaining balance in reserve at the end of Compliance Period...
 - May be retained if project will continue to serve QP tenants in accordance with HOME-ARP requirements via “enforceable restrictions imposed by PJ” (what we often refer to as a local “extended use” period)
 - Otherwise, must be returned to PJ, receipted as HOME Program Income

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Final Thoughts

- It's already complicated, keep it simple(r) when and where we can...
 - Think of the sources you control in a holistic framework; you decide "best fit" resource for each project
 - Don't layer sources unnecessarily, avoid doing so at the unit level
 - Consider fixing units to limit confusion or unintended complexity
- Plan for surprises & shifts. Something will change, probably many things
 - Some already have – where are you on your Allocation Plan?

