

THE HFA INSTITUTE 2020

Written Agreements

January 13, 2020



**HOME and
Housing Trust
Fund**
JANUARY 12 – 14



Housing Credit
JANUARY 14 – 16



**MRBs and
Other Federal
Homeownership
Programs**
JANUARY 15 – 17



**Section 8 and
Other Federally
Assisted
Multifamily
Housing**
JANUARY 15 – 17



Welcome & Introductions

- Sponsored by:
 - HUD's Office of Affordable Housing Programs
 - NCSHA
- Trainers:
 - Steve Lathom, TDA Consulting – Diane Thompson, OAHP
slathom@tdainc.org
(517) 203-4130

Goals

- Importance of the written agreement
- Things to avoid & best practices to consider
- Much of our focus will be on HOME/HTF rental transactions
- Strategic consideration of “business terms” that support compliance with regulatory obligations

Centrality of the Written Agreement

- HUD has the statute, regulation, and formal guidance
- PJs required to develop and follow policies and procedures
 - Making choices within program's block grant nature
- Lower-tier participants (e.g. developers and owners) experience HOME through their written agreement(s)
 - Outlines specific policy choices
 - Defines day-to-day mechanics (e.g. draws, reporting, etc.)
 - May be more restrictive

Why Written Agreements

- (Not just) because HUD says so
- Also, because
 - HOME brings with it a complex and (usually) long-term relationship between the PJ and its partners
 - Clarity is important for all concerned
 - What do I (PJ) expect?
 - What am I (developer/owner) signing up for?
 - Public interest in accountability

Who Gets One?



- State recipient/subrecipient running a program for you
- Developer receiving financing for rental or homebuyer
- Low income recipients of DPA, TBRA, owner-occupied rehab

WARNING

- Not all agreements are the same, dependent on program role
 - Esp. State/subrecipient v. owner/developer v. LI beneficiary
 - Requirements vary – esp., applicability of 2 CFR 200
- There will be other docs, but agreement is always required
 - Note/mortgage are NOT the written agreement
 - Deed restrictions are NOT the written agreement

WARNING

- If you don't mean it, don't include it
 - PJ must “{ensure} that HOME funds are used in accordance with all program requirements **and written agreements**” [§92.504(a)]
 - Failure to enforce written agreement – even if provision is not per se a minimum HOME requirement – can be grounds for HUD findings and corrective actions

Making it Count

Ineffective Written Agreements

- One-sizes fit all
- Written for other programs
- Overly vague... “comply with 24 CFR Part 92”
- Lawyers too involved/not involved enough
- Poorly written, hard to follow

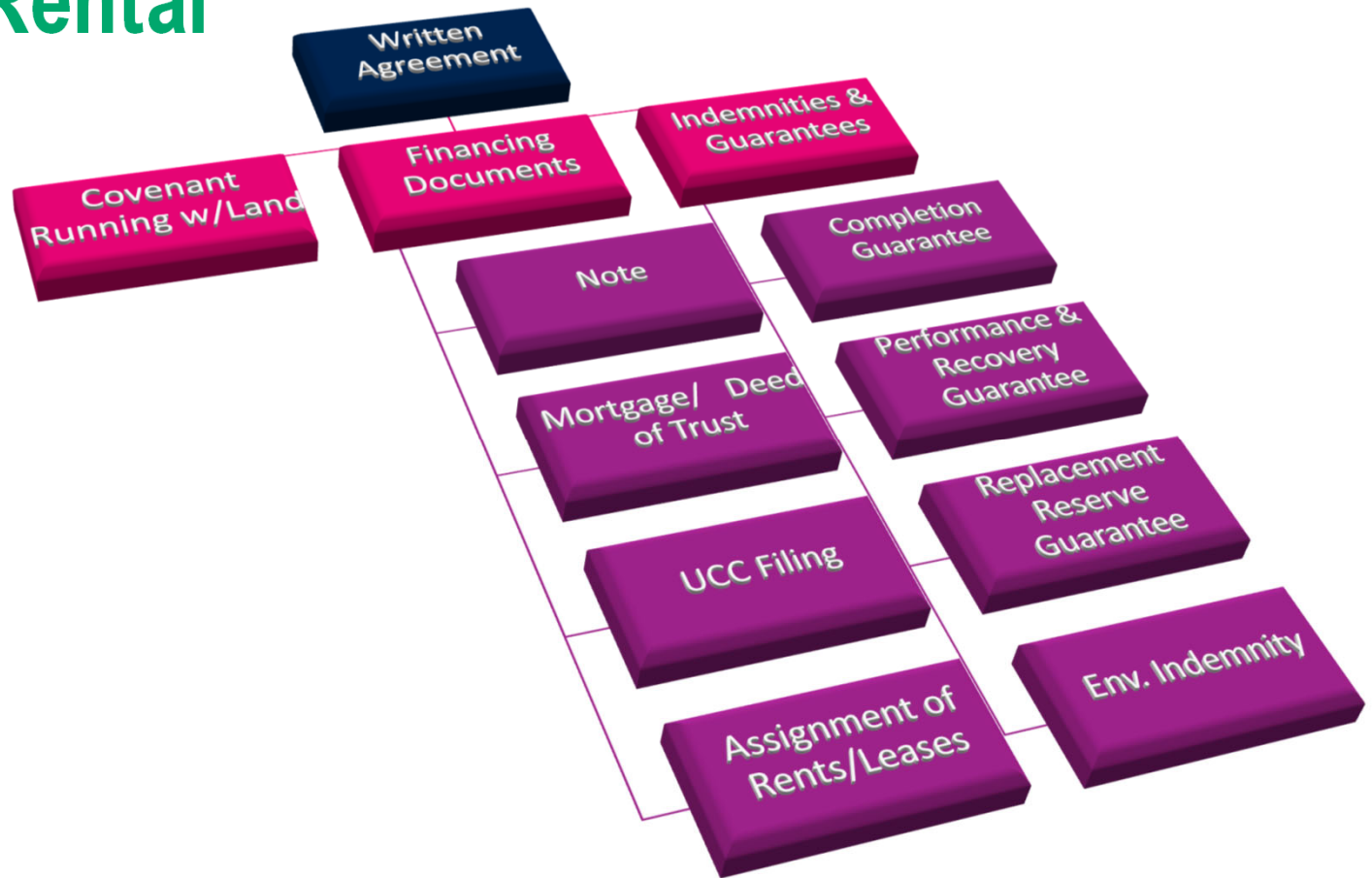
Effective Agreements

- Different forms by role & project type
- HOME specific templates
- Provide concise and understandable summary not just citations
- Program staff and lawyers work together
- Consider your audience – written agreement as narrative

Brief Detour Before We Talk Rental

- Often two agreements – state/subrecipients will enter into agreements with LI households or even developers
 - PJ ultimately responsible for performance no matter how many layers
 - Agreements used by state/subrecipients should be
 - At minimum, reviewed (provide templates?) by PJ & provide PJ w/enforcement rights
 - May be multi-party agreement – owner, subrecipient, PJ
 - May be in PJ's name (e.g. agreement with LI buyer)
 - Same for agreements between developer (e.g. CHDO) and LI buyer
- Common finding – no “written agreement” with buyers of HOME-assisted units, PJs have relied exclusively on note/mortgage or deed restriction

Let's Talk Rental



Negotiating the Agreement: Lessons from the Field

- Regulatory provisions tend to be “easy”
 - Mostly technical; sometimes we quibble, but it is what it is
 - Remember, provide plain language description of requirements, not just citations
 - I should understand most of what’s needed WITHOUT reading the CFR
- “Business” terms are where we argue
 - ***Repayment for failed projects is critical context***
 - Specific points may not be “required” by regulation, but ARE informed by it

Key Business Points

- Budget changes, change order(s), and disbursement issues
- Control over reserves – funding level, withdrawals
- Definition of surplus cash/cash flow and waterfall
- Sale/transfer of underlying ownership interests
- Relative priority of deed restriction/covenant
- Indemnities & Guarantees

Budget/Contract Changes & Disbursement

- PJ responsible for
 - Underwriting, including all sources/uses and cost reasonableness
 - Prior to commitment and “in response to any changes that may occur in the project budget”
 - Property standards, including review/approval of plans/specs
 - Change orders may affect both cost (is it reasonable, is the budget still balanced) AND compliance with property standards (does change remove essential element, e.g. broadband)

Best Practice

- Reserve rights to review/approve budget or contract change
 - Acknowledge mutual approvals likely needed from all funders
- Reserve right to review/approve all disbursements, regardless of source
 - Often draws show unannounced budget changes
 - May need to manage good cost/bad cost issues

Reserves

- Primary regulatory obligation – ongoing HOME compliance
 - Project cannot comply if it doesn't survive
 - Reserves support ongoing viability of the project
 - But generally cannot be directly funded with HOME
- Regulation requires
 - Ongoing property standards
 - Ongoing financial oversight (10+ HOME units)
 - Significant discussion of reserves in CPD 15-11 underwriting considerations

Best Practices

- Control disbursements from reserves
 - Range of options: hold reserves v. joint signatory account v. ongoing reporting
 - May requires mutual consent of all permanent funders
- Require reserves be replenished if used
- Allow for periodic Capital Needs Assessments to reset replacement reserve requirements

Definition & Disbursements of Surplus Cash

- Regulatory context largely the same as reserves
 - Ensure ongoing viability by limiting excessive disbursements
 - Relates esp. to underwriting and subsidy layering considerations
 - Strong interaction with common “cash flow contingent” payment terms

Best Practices

- Clearly define surplus cash
 - Use uniform definition across programs and transactions
- Establish waterfall expectations
 - No distributions if
 - Reserves underfunded
 - Unresolved compliance issues
 - Payment to underlying owners exclusively from surplus cash

Transfers – Title or Ownership Interests

- PJs required to underwrite capacity of owner/developer prior to commitment
 - Why allow later change in counterparty without permission and similar review?
- In CHDO projects, expectation of continued CHDO control

Best Practices

- Only allow transfer of title with approval of PJ
 - “in its sole discretion”
- Require pre-approval of any change in underlying ownership interests, including
 - General or limited partners; members
 - Designation of managing general partner or managing member
- Anticipate and plan for orderly investor exit
 - Preapproved transfers to underlying sponsor
 - Sale to other parties in PJ’s sole discretion?

A Word on Deed Restrictions

- Distinct from written agreement
 - Separately required by regulation
 - Provide independent means of enforcing for ongoing requirements
- *Far too many (most) HOME/HTF restrictions are inadequate to accomplish this purpose!*

Effective Restrictions

- Remember, runs with the land, provides constructive notice to any future title holder of ongoing requirements
 - Restriction matters most following foreclosure, involuntary transfer, or other removal of original owner (*more in a minute*)
- Restriction should stand alone – provide adequate detail of **ALL** ongoing expectations
 - Not merely cite the written agreement (or high level CFR citations)
 - Agreement not in the public record, and by time restriction is needed (e.g. post-foreclosure), agreement no longer exists in practice

Priority of Restrictions

- Regulation allows (but does not require) deed restriction (covenant, etc.) to be removed via foreclosure/deed in lieu
- **BUT**, removal of ongoing restrictions will require repayment of HOME/HTF
 - Whether or not PJ/State can collect on any loan documents

Best Practice

- Require deed restrictions be recorded senior to all **financing**
 - Do not give up seniority via subordination
 - Include both regulatory imperatives **AND** business expectations in support of compliance
- Relative priority of HOME/HTF v. LIHTC LURA not material
 - Neither can remove the other
- HOME/HTF financing documents typically subordinate

Indemnities & Guarantees

- Most projects held by single-purpose/single-asset entities
 - Both for general liability reasons and for LIHTC reasons, as applicable
 - HOME/HTF loans are generally non-recourse, enforceable only against the real estate
- Much more complicated than this, but in LIHTC recourse loans mess everything up
- But, PJ is left holding the bag in the event of project failure
 - Repayment required whether or not PJ collects on loan

Practices to Consider

- Various indemnities and performance guarantees **can** be required by underlying individuals/corporations that own the owner
 - Critically, these are not guarantees of loan payment
- These can include:
 - Completion of construction
 - Replacement reserve deposits
 - Recovery of PJ's obligations to HUD for failure to maintain compliance
 - Environmental liabilities

Wrap-Up & Next Steps

- Questions, additional comments, your experiences/ideas
- HUD developing written agreement checklists and CPD Notice
 - Watch for eventual publication