

# **Multifamily Underwriting Template Webinar**

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- **Presenters**

Anker Heegaard, Compass

Les Warner, ICF



# Agenda

- Quick review of key HOME Underwriting Requirements
- Function of the sample underwriting template
- Demonstration of the template utilizing a case study
- Explorations of sound underwriting principles supported by the template



# Purpose of Underwriting and Subsidy Layering

- HOME underwriting is the analysis of project assumptions and risks to ensure the project will remain sustainable while meeting the affordability requirements
- 92.250(b) requires the PJ to examine:
  - Project sources and uses
  - Cost and profit reasonableness
  - Market demand
  - Developer experience and capacity
  - Financial commitments



# Related HOME Requirements

*Cost Allocation*



*Maximum per  
Unit Subsidy  
Limits*



*Commitments*



*Written  
Agreements*



*Project  
Completion  
Deadlines*



# Related HOME Requirements (cont.)

*Property  
Standards*



*Affordability  
Period*



*Acquisition/Demolition:  
construction and/or demolition  
expected to start within 12 months*

*Rents/Utility  
Allowance*



# Applicability

- Applies to all rental and homebuyer development projects, direct homebuyer assistance, and amortized homeowner rehabilitation assistance loans for which funds are committed on or after August 23, 2013
- 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



# PJ Responsibility for Underwriting

- 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



# Sustainable Projects

- HUD encourages PJs to employ underwriting principles that promote long-term financial viability
- Underwriting to establish viability over the HOME affordability period
- Viability ensures that reserves are adequate for projected capital replacements, based on a CNA
- PJ has a liability to ensure the project can survive moderate losses or revenue or increased costs and complete the affordability period



# Documenting Compliance

- PJ must develop and follow procedures to document all elements of underwriting and subsidy analysis
- File must identify who submitted documentation and when it was submitted
- PJ must document its review and approval following standards and procedures
- Changes made during development will require updated review and written agreement provisions



# PJ Uses for Template

- Provides a format the PJ can adapt to complete a portion of the required HOME underwriting
- The completed template will provide documentation of these required steps
- The template can be customized to incorporate PJ's adopted underwriting standards
- Developers can be required to complete and submit the template for PJ review



# Functions of the Template

- Facilitates the review of project costs by the PJ to determine if reasonable and eligible
- Compares the sources of financing for the project to the total use or costs
- Project the cash flow and financial health throughout the HOME affordability period
- Document financing and operating terms for the HOME funding



# Function Not Included in Template

- Market Analysis
- Cost Allocation – follow the guidance provided in CPD Notice 16-15
- Developer Capacity
- Cost Reasonableness – the template documents the costs but the PJ will need to complete an evaluation of reasonableness
- Underwriting requires the PJ to analyze the results of the template and make changes as needed



# Guided Tour – Underwriting Wildflower Apartments

- New construction – 10 units, 100% HOME, no LIHTC
- Application has been submitted in-full; and underwriter is going to populate the model
- Once populated with all the basic information, key underwriting determinations and decisions can be made



# Tabs of the Underwriting Template

- Introduction
- HOME/Other Affordability Requirements
- Rents and Income
- Development Costs
- Operating Expenses
- Financing Sources
- Custom Loans
- Operating Pro-Forma
- Gap Analysis
- Summary Page



# Introduction

## Key Function

- Identifies the project with name and basic information
- Provides an overview of the sections and general instructions on the use of the template

## Tips

- Make sure to name and save each project as a separate file
- Do not overwrite the calculation formulas within the spreadsheet
- Cells with green coloring are for data entry



# HOME & Other Affordability Requirements

## Key Function

- Captures all rent and occupancy restrictions that will apply to the project

## Tips

- Rent structure may need to be updated based on changes during underwriting



# Rent and Income

## Key Function

- Designates the number of units by size
- Sets utility rates based on utility allowance established by PJ
- Sets a vacancy loss rate based on the PJs underwriting standards

## Tips

- Make sure you are using the current utility allowances
- Vacancy loss rate may vary based on the type of project - variances with the PJ standard will need to be noted



# Development Costs

## Key Function

- This tab captures the total cost of development
- Costs ineligible for HOME funding are presented separately

## Tips

- PJ will need to require developer to break out cost categories that include both eligible and ineligible costs



# Replacement Reserves

## Key Function

- Function allows the PJ to estimate the level of replacement reserves needed for the project over time
- PJ may also have standards for a minimum replacement reserve per unit per year

## Tips

- HOME funds cannot be used to capitalize replacement reserves as part of the development costs
- Annual contribution levels are set to ensure adequate reserves to meet the projected needs over the life of the project



# Construction Schedule

## Key Function

- HOME funds impose a four-year project completion deadline from the date of commitment of funds
- Construction schedule allows the PJ to check for compliance with HOME and PJ-required deadlines

## Tips

- Inclusion of milestones within the construction schedule allows PJ to track the progress of each project toward the projected completion date
- PJ can request a one-year extension if needed but must track the status of projects to identify at risk projects



# LIHTC Basis

## Key Function

- Provides a very basic framework for incorporating LIHTC equity
- This framework is sufficient for reflecting the essential terms of the equity investment (including the credits allocated, and the equity invested)

## Tips

- For the calculation to work properly, units subject to the LIHTC use restriction must be designated as such on the 'Rents and Income' Worksheet
- Obtain the other inputs from the developer, supported by the equity commitment letter



# Operating Expenses

## Key Function

- This information is used to estimate operating costs during the affordability period

## Tips

- Monitoring fees to be paid by the project can be included but must be based on actual costs. Escalation of monitoring costs can be projected but the fees charged will need to be based on actual costs.



# First Mortgage Sizing

## Key Function

- Allows for key inputs around value (typically a limitation of 1st mortgage size) and debt coverage
- These inputs will establish whether the proposed 1st mortgage is supportable by the Net Operating Income of the property

## Tips

- This information will come from the lending commitment provided by the applicant's proposed lender
- This is where key inputs about both hard and soft loans are made



# Sources and Uses

## Key Function

- All prior inputs come together here to establish whether the proposed Sources are adequate to pay for the estimated costs (Uses)''
- This is a key output, illustrating whether the deal has a 'viable' Development Proforma

## Tips

- When the Sources are less than the Uses, either increase the HOME funds, increase another source, or look for ways to reduce the Uses



# Sources and Uses by Month

## Key Function

- Development happens over time, so sources must be equal to or greater than uses at each point in time
- This worksheet can help you determine the timing of when HOME funds are invested

## Tips

- Early money reduces construction interest and reduces development costs, but early money is at higher risk than later investments



# Pro Forma Assumption

## Key Function

- Sets the period over which viability is analyzed in the Operating Proforma
- Typically, income and expenses increase at different rates
- This can reveal a likely future issue which must be addressed up-front in the structure of the transaction

## Tips

- Look at the long-term history of FMRs for your area to determine how to trend income
- Look at the long-term operating expense increase rates in your portfolio to determine the trending rate for expenses



# Operating Proforma

## Key Function

- Illustrates the effects of trending rates on the property's performance over the period
- Establishes whether the property is reasonably likely to succeed or fail over time, when accounting for the tendency of income to rise more slowly than expenses

## Tips

- Smaller properties need more cushion (as a percentage) than larger properties
- If the property goes to negative cash flow during the period of affordability, the proposed 1st mortgage is probably too high



# Administrative Record

## Key Function

- Demonstrates compliance with certain key HOME requirements related to investing HOME funds.
- Summary documentation on this worksheet refers to more comprehensive information in the files

## Tips

- Consider whether a HUD reviewer would find your notes on this page to reveal careful consideration of key issues.



**Questions?**

