QUESTIONS AND ANSWERS FROM THE 111-12-20 WEBINAR ON USING

HUD's SECTION 108 PROGRAM WITH LIHTCS

1. QUESTION: How much of the development entity does the CHDO have to own? Typically, I see CHDO's with only 1% interest as GP with the other 99% owned by the investor (LP interest).

ANSWER: First, note that the rules for CDBG funds refer to a Community Based Development Organization (CBDO) not a Community Housing Development Organization (CHDO). They are different in terms of how the ownership entity is approved and the service area of the organization as further described in Section 2.2.5 of the link below:

https://www.hud.gov/sites/documents/DOC_16471.PDF

The answer to the question depends on how the rental housing development is being financed. For a LIHTC property that is syndicated, it is customary that a general partner owns a 1% interest in the property and limited partners own a 99% interest in the partnership. A non-profit sponsor may own the 1% interest in the partnership, or if there is also a for-profit co-general partner, then the 1% ownership interest would be negotiated between the co-general partners. HUD would evaluate who has controlling stake in the general partnership entity, and if the non-profit entity could be taken out of the partnership by the for-profit entity without the agreement of the non-profit entity, HUD likely would conclude that the rental housing development is not properly categorized as CHDO owned.

For a newly constructed rental housing property that is not syndicated and that is financed using the proceeds from a private lender loan and/or CDBG or Section 108 funds, and that is to be owned by a Community Based Development Organization (CBD0), depending on the circumstances of the transaction a CBDO could own 100% of the interest in the property.

2. QUESTION: When you state the grantee must pledge CDBG funds to secure the section 108, do you mean that they forgo funding for other items that year? So essentially, you would not be able to grant funds out to multiple organizations for that CDBG calendar year and would rather have to use CDBG funds strictly towards the repayment of the sect 108 loan use for the development?

ANSWER: No, that is not what we mean. Under the Section 108 Program, the Grantee is entering into a loan agreement with HUD based on future CDBG allocations and therefore the Grantee pledges its CDBG funds as collateral, but this will not impact the ability to use the allocation to fund other projects. When the cash flow of a project is insufficient to pay the annual obligation on the Section 108 note, and no other resources are available, the grantee may have to use the pledged CDBG funds to make the payment. In such a circumstance the amount of CDBG funds used to pay the Section 108 note would not be available for other purposes. The Section 108 Note outlines an annual payment obligation, and the Grantee will know in advance how much of its CDBG allocation would be subject to the specific year's debt service payment but that does not mean CDBG funds would have to be used. For example, if the Section 108 project generates program income, the CDBG allocation would not have to be used at all. CDBG funds would only be used if the grantee plans to use its allocation for debt service or, more unlikely, other payment sources fail to materialize. In the Sacramento case study the grantee is choosing to pay debt service with its CDBG allocation rather than another source or project revenue – the annual amount of future CDBG allocations pledged to repay the loan obligation was between 9-23% annually, with an average of 16% of the future allocations, leaving funds for other purposes.

3. QUESTION: Can the Section 108 loan amortization period extend beyond 20 years?

ANSWER: If the question refers to the Section 108 loan from HUD to an eligible grantee, the Section 108 regulations limit the repayment period to 20 years. HUD does allow for some years of interest-only payments depending on project needs.

4. QUESTION: Can we use Section 108 for environmental cleanup of a future LIHTC/HOME multifamily project?

ANSWER: On the assumption that the environmental clean-up is for a specific project with a provided timeline, if properly structured in a manner similar to the examples discussed in the webinar (city ownership of land and negotiated contract with the contractor performing the site work) it is possible that this would be permissible. It is suggested that the details of such a proposal be discussed with your HUD Field Office representatives.

5. QUESTION: When interest payments are due, what LIBOR date is used? For example, if the payment is due 2/1/2021, what LIBOR date was used to calculate interest? As you know, LIBOR changes daily.

ANSWER: The interest rate is based on the 3-month LIBOR rate reset on the 1st day of each month and paid quarterly.

6. QUESTION: I have seen Section 108 used in a LIHTC project for acquisition of property for conversion to affordable housing, where the developer was a non-profit and the funding was passed through from the Grantee. Is that not allowed now?

ANSWER: Section 108 funds can be loaned from the Grantee to a nonprofit general partner of a LIHTC deal for the acquisition of an existing building to be rehabbed under the LIHTC program. That is allowed under the CDBG rules. If this was a New Construction LIHTC project, then the rules are more stringent. The Grantee would have to purchase the property, as per the case-studies for the new construction developments.

The limited circumstances where Section 108 funds can be used directly for new construction would be by a HUD designated Community Based Development Organization (CBDO)in support of an economic development project.

7. QUESTION: In my experience, HUD requires full collateralization outside of the CDBG pledge. Is this no longer the case?

ANSWER: It is still the case that a community will have to pledge another source of collateral beyond the CDBG allocation. The collateralization for each development project is based on the financial structure of the transaction and is determined by HUD based on their review of the proposed project.

8. QUESTION: Can property be acquired by a non-profit for a future housing project with Sec 108 funds?

ANSWER: Each proposal must demonstrate financial feasibility at the time of application. Projects that depend on a sponsor receiving other resources in the future would not be approved by HUD for a Section 108 loan. Additionally, land banking is not an eligible activity.

9. QUESTION: These are only for non-entitlement communities, correct?

ANSWER: No – both entitlement and non-entitlement communities can apply for a Section 108 loan. Non-entitlement communities would access the program through the state.

10. QUESTION: You may get into the business terms later, but will HUD entertain amortization periods for 30-35 years?

ANSWER: No – The Section 108 program will only provide for a 20 -year note with the Grantee.

11. QUESTION: Since Section 108 loans must be repaid to the note holder/HUD, how can gap financing loans be structured if the loan must be ultimately repaid?

ANSWER: Gap financing in a LIHTC deal is typically structured to be paid only from cashflow (see Sacramento example). Therefore, it is most likely that the project cashflow will not be the source of the repayment of the Section 108 Loan. There would be separate loan terms between the project and the Grantee and the Grantee and HUD. The repayment of the Section 108 note to the HUD Note Holder will be from a combination of the cash flow of a project; other resources available to a grantee; and from future CDBG allocation provided to the Grantee.

12. QUESTION: May an entitlement have loan terms beyond 20 years?

ANSWER: No – 20 years is the maximum term of a Section 108 loan.

13. QUESTION: Can rent restrictions have a term beyond 20 years?

ANSWER: Rent restriction imposed at the property level which are longer than 20 years may be acceptable and sometimes are required by the state agency providing the LIHTCs. However, note that regardless of the terms of the note between the Lender or as required as part of the allocation of LIHTCs for a project, the Section 108 loan between the Grantee and HUD/the Note Holder must be repaid within the 20 year term of the loan.

14. QUESTION: You had said that the Grantee must own the property earlier, hence the question re: non-profit ownership.

ANSWER: See the above response re: non-profit ownership

15. QUESTION: In my experience, HUD requires full collateralization outside of the CDBG pledge. Is this no longer the case?

ANSWER: **See question above, t**he collateral required for a transaction is negotiated based on the HUD review of the financial strength of the project.

16. QUESTION: What is the City of High Point's source of repayment of their Section 108 loan? Will it be repaid from property cash flow or when the property is refinanced?

ANSWER: First out of project cash flow; second, the pledge of CDBG funds; third best faith efforts to use the general fund of the city to repay the loan.

17. QUESTION: In a similar situation to what was described by the City of High Point, where the tax Credits were coming in slower than anticipated to take out the Section 108 note, HUD considered refinancing the 108 loan with a new Section 108 loan. Luckily, that was not needed, but would that work?

ANSWER: Refinancing an existing Section 108 loan may be possible, but HUD's discretion is limited by other legislation. Any such proposal should be shared with the local HUD office and the Section 108 office.

18. QUESTION: What will the interest rate be based on now that LIBOR is going away?

ANSWER: A similar short-term index acceptable in the financial markets likely will be used. Information about such a change will be shared at a future date.

19. QUESTION: I saw there was a conventional loan in the capital stack. Did the 108 loan share a first lien with the conventional lender?

ANSWER: No, for the Avondale Trace development – the conventional lender was in first lien position in the loan structure. The Loan from the City (funded with Section 108 funds) was in a subordinate position.

20. QUESTION: Loan term of 20 years with interest only with no amortization? - this seem unusual. Would HUD agree to this for all LIHTC deals?

ANSWER: This was the structure agreed to by the City with the developer. The financial feasibility of each project is subject to review by the Section 108 staff in the central office of HUD. For two of the case studies the city loans (funded with Section 108 funds) were in a subordinate position due to the permanent lender and state financing requirements. For the third case study the city section 108 loan was amortized. How its structured is dependent on the project and discussions with HUD.

21. QUESTION: When used for Low Income housing, the Section 108 "loan" seems more like a grant.

ANSWER: It is not unusual for City financing in a LIHTC deal to be in a subordinate position, with payment subject to available cashflow. These are still structured as loans that must be repaid at the end of the loan term. As noted earlier, the cash flow in each transaction is subject to review and approval by HUD staff. In many LIHTC deals cash flow is limited due to providing very low rents.

22. QUESTION. What are the advantages and disadvantages of using 108 funds for construction financing (some to be left in the project)?

ANSWER: Using Section 108 funding during a construction phase requires proper loan structuring. One means discussed as part of the webinar included the city of High Point, NC using Section 108 resources to acquire the land and pay for site improvements prior to transferring the property to the limited partnership. CDBG funds can only be used for hard construction costs if the project is a rehabilitation of an existing building, not new construction. See the Section 4.3 of the below link for a detailed description of eligible uses of CDBG funds for both rehabilitation and new construction initiatives:

https://www.hud.gov/sites/documents/DOC_16473.PDF

FROM HUD: Remember, every Section 108 project must satisfy program requirements - national objective, eligible activity, and public benefit standards (if applicable). CDBG regulations can be found here.

FROM HUD: HUD does allow for refinancing Section 108 loans, but borrowers cannot simply take out a new loan to pay off an existing loan. There would have to be an eligible activity before a new Section 108 loan could be used.

23. QUESTION: Regarding construction financing... could it be structured as a jobs activity. What I meant is that instead of treating a project as "new construction" could it alternately be seen as a project creating jobs and meeting Section 3 obligations too?

ANSWER: Section 108 funds cannot be provided to a for-profit developer to construct new residential housing and have that treated as an economic development project.

24. QUESTION: Was the City of Sacramento or High Point required to establish a loan loss reserve for HUD?

ANSWER: No – the financial feasibility of the projects discussed during the webinar did not include a loan loss reserve.

25. QUESTION: Given the timing sensitivity, I really wondered what percent of attempted projects relying on Section 108 fall apart altogether. Is chance of success mostly dependent on a savvy developer?

ANSWER: A competent developer was very helpful to the success of all the projects discussed in the webinar. Discussions with the developer about the timeline for obtaining the LIHTCs while also discussing timing and requirements for obtaining the Section 108 loan should be had upfront to ensure a successful project. Success depends on the communication between the developer, the Grantee and HUD as the project is structured. In the case studies, the successful Section 108 Loans were the result of discussions between the grantees and HUD about what was possible. Having an experienced developer for these transactions is also helpful.

26. QUESTION: The idea of using a new Section 108 to take out the old one came from HUD the existing loan was still in the temporary facility at the time.

ANSWER: HUD does allow for refinancing Section 108 loans, but borrowers cannot simply take out a new loan to pay off an existing loan. There would have to be an eligible activity before a new Section 108 loan could be used.

27. QUESTION: When interest payments are due, what LIBOR date is used? For example, if the payment is due 2/1/2021, what LIBOR date was used to calculate interest. As you know, LIBOR changes daily.

ANSWER: As discussed above, the calculation of the amount of the quarterly payment due to HUD during the variable rate phase of a Section 108 loan execution is based on the 3-month LIBOR rate (plus 20 bp) as of the first day of each of the prior three months.