Les Warner: (In progress) – things here. First off, I want to introduce or mention I've got Kris Richmond who is going to assist me with working with the questions and answers on this. We also have Chantel Key who is kind of at the controls for the webinar itself and will respond back if you are experiencing technical difficulties at some point during this webinar.

I think for the presentation today, what we will generally stick to is I think we'll go through the majority of the material and then open it up for questions and answers, but I would also encourage you if there are clarifications that you need on a specific slide or item that's being covered, go ahead and input that, Chantel will explain a little bit about inputting questions in just a moment and Kris may interject and will stop and deal with things if there's some confusion as we're moving forward. Chantel, you want to fill folks in how to submit a question for this webinar?

Chantel Key: Sure thing, Les. So on your GoToWebinar toolbar, you will see an area that says questions. If you – you can expand that questions textbox by clicking on the plus sign to the left of the word that says – of the word questions. So again, on your GoToWebinar toolbar, there is an area for questions and if you expand that area, you will see a questions textbox and like Les was mentioning, that anytime during the webinar, you can enter in your questions and at the end of the webinar, we will provide the question and the answers at that time. Les.

Les Warner: Great. Thank you. So just a couple of the notes here, there will be a second presentation of this same webinar, the same materials just providing two offerings that'll be July 28th at 1:30. I expect that the listserv for registration on that will go out in the next day or so. So if you've got colleagues that wanted to attend today and weren't able to, you might let them know about that.

Also, the slides and a transcript of this session will be posted probably sometime later next week on the HUD Exchange. And so that's also an opportunity to go back to those materials, if needed. So I think we'll go ahead and get moving. We've got a lot of ground to cover as part of this, if I can get my slide to move.

So I guess I didn't introduce myself, I'm Les Warner. I'm from ICF International, been with ICF for over nine years at this point and spent about 20 years working for the State of Ohio with the HOME program.

So I've kind of experienced the program from both sides at this point. So today's agenda, we're going to be walking through the notice itself talking about what the notice is about, what it applies to, talking a little bit rather quickly about some of the other HOME requirements that have implications either for on how you're going to do the underwriting or things you have to take into consideration as you're working on that.
We'll talk through some of the requirements that you have now in place on having policies and procedures and standards in place for how you will do both your underwriting and your subsidy layering. We'll talk at some depth about a market assessment looking at our developers on both capacity and their financial position on this and then kind of put that into the context of how do we process through reviewing specific projects.

We'll follow that with a little more in-depth talking about subsidy layering, which is now required for all projects and then the issue about because we have a long-term affordability period, this concern about having self-sustaining projects. So we're really making sure that if we fund it, that based on the best information we can gather that that project will be able to be sustainable through that entire affordability period so that you won't have potentially a risk of repayment, which obviously is one of our goals here. And then we'll finish up talking just a little bit about how to document your compliance with this requirement. One of the things I would say up front is that depending on your agency's operation and in some cases, sort of the scale of your annual funding and the level of projects that you are doing, I would guess a lot of you have pretty good underwriting and subsidy layering systems in place.

And so this may be a matter of thinking through what does the new notice specifically call for in making sure that you have met that within your policies and procedures and really what you're capturing in sort of documentation of your due diligence that you're completing as part of your underwriting and subsidy layering? For others, you may recognize that gee, I have not really – I don't have some of the systems in place that I need to meet these requirements and you'll have more work to make sure that you're within compliance on this. So the purpose of underwriting and subsidy layering is really to complete an analysis of a project, look at the assumptions and the risks that are part of that to determine is this a project that I should be funding?

Is this a risk that is too great whether this project will be successful, whether I've got a developer that can complete this, is there really a market for this, do the numbers work so that this project will be self-sustaining during that affordability period? The second part of this, the subsidy layering, is really then looking at what's the level of HOME assistance that's needed in this project? The underwriting itself is looking at the overall project itself, but really sizing that level of assistance from HOME is really our subsidy layering process as part of that.

And one thing I'll note on that is under the old HOME rule, we would've talked about subsidy layering as being something that was required when we had more than one government or public funding source in a project, but under the new HOME rule and under this new notice, subsidy layering is going to be part of every project that you are undertaking, because really it's, again, sizing that level of HOME assistance to make sure we're putting in enough for it to be stable, but not over-subsidizing it. And then the other leg of our underwriting and subsidy layering is trying to figure out is this the right project, is it in the right location, will it be affordable for the target market, is it the right size, can this market actually absorb and support these units?

We'll talk in a minute or two about some of the timelines that have now been clarified under the new rule and thinking about is this the right number of units, can this market absorb these units within the prescribed timeline on this and then of course, this issue about will this be sustainable as this project that will be able to complete that affordability period serving the target population.
without need for additional funding to be provided and we, of course, know we cannot put additional HOME dollars into a project during that affordability period. So when does this apply? Well, this has been in place under the new rule for any project that were funded and we look at that as when funds are committed.

So this went into effect on August 23, 2013 for any projects where we committed funds to a new project. So this covers rental housing. It also would be for development projects for homebuyer, but also includes direct homebuyer assistance. So we're providing down payment assistance, closing costs, even though there's no development as part of this, we're going to have requirements that will apply. And in the case under homeowner rehab where we are providing our assistance in the form of an amortized loan, then we're going to be using some of these requirements, because it's looking at what's the affordability for this household as part of that.

This also applies for projects that they don't have to be 100 percent HOME and of course, a lot of our projects are layered together and oftentimes the HOME funds are really a small percentage of the overall funds in that project, but these, because you are putting HOME funds into that project, the requirements on underwriting and subsidy layering will apply to that entire project. We need the entire project to be sustainable to make sure that our HOME units will be successful as part of that. So the notice, as I mentioned on CPD Notice 15-11 was published on December 22, 2015. So it is in place.

It was a nice little Christmas gift that we all got this last Christmas. It is in effect and we want to make sure that folks understand and have thought through their systems and policies and procedures to make sure that you'll be able to demonstrate that you actually are in compliance with the requirements. So let's talk a little bit about direct homebuyer assistance. So because we are not in that case – so if we're only providing, let's say, down payment assistance and closing costs, we're not part of a larger development project. So we're not underwriting the development and we don't have to then do a market analysis, because we're not trying to figure out is this going to be a unit that somebody's going to want to rent or in this case, to buy.

We also don't have to do a developer's capacity analysis, because we don't have a developer in this case, but we must follow these requirements, specifically at 92254A, which require you as the PJ to underwrite to determine what the level of assistance would be for that individual homebuyer and under the regulations, you've had to have had policies and procedures in place for a homebuyer program. So you would be following those policies and procedures on what process, what standards are going to be utilized in determining the level of assistance that you would be providing. We used to have programs across the country that were trying to run a homebuyer program with a standard amount.

So every homebuyer got $10,000, essentially, whether that was more than what they needed or less than what they needed. So the requirement very specifically is that you need to complete underwriting and size that level of assistance for each individual homebuyer based on your standards, based on the procedures that you've put in place. So hopefully there's nobody out there that's still running a program where everyone gets the same amount of funding. If so, stop and rework your program to make sure that you're going to be in compliance.
Keep in mind that if you are doing a project where you are providing direct homebuyer assistance, but it's in conjunction with a project that you also are putting HOME funds in for development you're essentially going to have two levels of underwriting/subsidy layering, one, looking at that development project and making sure that you have an appropriate market in developer capacity and looking at all of the issues on actually building or creating these units, but then this second level of actually sizing the assistance for that homebuyer and making sure that these will be long-term affordable, sustainable units for those individuals and making sure that we provide them the appropriate level of assistance.

Other subset that we mentioned here was under homeowner rehab. when we are providing the assistance in the form of an amortized loan. I would – I know there are lots of programs out there that have a deferred forgivable loan and in those cases, there's no financial impact on that household on the sizing of payments. And so in that case, we don't have to do underwriting, but in the case where we have an amortized loan, we're going to collect payments from that household, then you would need to have your underwriting and subsidy layering in place to make sure that these are going to be affordable payments for that household.

So we have our regulatory requirements in a couple of separate places. So under 92250B, this is where it lays out the requirements that you are, as the PJ, required to have policies and procedures, standards that you will have in place and that you will use for conducting your underwriting and subsidy layering process. And as we'll talk about later, these may be different based on the type of projects. So it may be a tiered system where you're – depending on the type of project, the size and scale of a project, you might have some different standards, but this would be clearly laid out in a process, which then you would be able to document that you have followed those standards, followed those – that process.

And so that would be part of your documenting compliance with the notice and with the regulations themselves. We also have requirements – now I need 254F, which requires you to have underwriting standards for homebuyers. So two separate categories and regulatory references. So we're going to very briefly visit the fact that not only are we following the underwriting/subsidy layering requirements, but we're working with projects that have applicable other HOME requirements, quite a list of them. So things like we have a maximum subsidy limit and we'll talk in a minute about the cost allocation process and that becomes part of a cost allocation process is looking at what's our per-home unit subsidy that we're providing and making sure that we're going to be within those provisions?

We have a separate slide on cost allocation, we'll talk a little bit more length on that. Your written agreements, so at the point that you've completed all of your underwriting process or subsidy layering, all of your eligibility review, you're then capturing in that written agreement all of this information. That's going to be your enforcement tool, it becomes one of your key communication documents that a property manager, a developer, an owner is going to be referring back to that written agreement on what was essentially negotiated as the terms and conditions that went with that provision of HOME funding. Keep in mind that that can be a living document.
So if there are changes that were to occur, that written agreement needs to be revised and updated and as we'll mention, if there's a change to maybe costs on this projects or number of units or whatever that would be, you also may need to go back through your underwriting/subsidy layering, any of these other requirements to make sure that this project is still going to be in compliance with all of these requirements and then that written agreement gets updated to make sure that you reflect that. We're going to be talking about commitments. Remember, we've got a 24-month commitment deadline and we now have, under the new HOME rule, some more specific language about the requirements of what it takes to have met that threshold on committing your HOME funds.

We'll also be talking a little bit about the HOME deadlines. So we know that we have a commitment deadline and an expenditure deadline, but we also now have an 18-month rent-up or occupancy requirement for our HOME units. So that becomes part of our upfront review of this project or market analysis to determine will this project, if we build it – will we be able to rent it, will we be able to sell it within those time provisions? Of course, our property standards, we'll talk a little bit about our rent and utility allowance.

It's obviously part of our underwriting, it's going to be based on what are the applicable rent requirements, what was our calculation for our utilities and making sure that our operating performance that we are basing our underwriting on is also in compliance with what those rent limits would be, utility allowances and of course, also makes sense within that particular market is not only being affordable for our target buyer, but is this actually going to be a marketable unit based on the other compensation within that market. And then of course, all of our HOME funds for our homebuyer/rental are going to come automatically with an affordability period.

So when we're going through our underwriting and subsidy layering process, we're not only looking just at the point that we are funding that project, but thinking about what's the affordability period for this particular project and reviewing what our projections are through the affordability period to make sure that we have a sustainable project. So a little bit of that – we're doing a little bit of sort of a crystal ball trying to project what we think will happen in that market, what will happen with incomes and rent levels and those sorts of things, but that becomes part of our process to limit the risk of committing HOME dollars to a project and making sure that we're going to be confident that that project will be not only completed as far as the construction or the rehab on this project, but also that it's going to be sustainable and be able to complete its affordability period within that timeline.

So as part of that process in staying within those regulations, one of the things that we want to include, which hasn't necessarily formerly been part of that process would be having a construction schedule, a timeline for that project and we're going to be reviewing that proposed project against those timelines so we make sure that all of our HOME deadlines, if we fund this project, that we will be on schedule to meet those. That gets captured in our written agreement and then also becomes as tool for you as the PJ to be able to track the progress of these projects to make sure that if we were expecting construction to begin within 3 months and be completed in let's say 14 months, that would trigger the start of our rent-up period, being able to, from time to time, track those projects, see where you are in standing with that and be able to get some
early indicators of whether that project might be experiencing some difficulties that you as the PJ will need to step in and try to address that.

So let's talk about some of these specifics in just a little bit more level of detail. So our cost allocation process is essentially looking to make sure that for our HOME investment that we put into a project, that we're essentially getting a fair share of long-term affordable HOME-assisted units that we're going to designate as part of that process and making sure that it's going to be in compliance with our cap on our subsidy limit per unit.

So you are always required to complete a cost allocation for any project that is not 100 percent HOME funded. If it's 100 percent HOME funded, then we know that all of the units in that project are going to be designated as HOME-assisted units. So in going through that cost allocation process, we are coming up with the number of HOME-assisted units in that project or essentially capping the amount of money that we're able to put in that project based on the number of HOME units that that developer has offered to you.

So there may be some negotiation as part of this, but that becomes part of your process to be able to then do your underwriting for this project. We need to know what the amount of funding is that you're proposing to put into this project and also the number of HOME units so we're able to then look at what are long-term rent restrictions, be able to make sure we have eligible costs for those specific HOME units, those sorts of things. So cost allocation becomes an important precursor essentially on being able to complete our project. So this gives us our unit mix on that project, helps us double check on our maximum subsidy limits and this may be where you see changes in numbers from what the original proposal was from that developer based on your cost allocation process.

So one of the changes under the new HOME rule was some additional clarification on what it means to have a valid commitment of HOME funds. So before you can actually count your HOME funds as being committed, you have to not only have the project identified, but have gone through all of your underwriting process, subsidy layering, the budget production schedule is in place that we were just talking about, making sure that all of the project financing is in place and you will have to have completed your underwriting and subsidy layering. That includes when we're talking about market assessment, developer capacity, all of that has to be completed before you're able to set this project up, complete a written agreement and show this project as a committed project.

Now, the second bullet point here I wanted to specifically mention. It's saying here that it's not committed under the environmental review requirements have been met. If you look at the commitment notice, which is 15-09, there is a clause in that notice that allows you to have a conditional commitment and the only condition would be this completion of the environmental review requirement. So there are many folks who, in doing a HOME project, particularly HOME multifamily projects, will complete their funding process, identify who the projects of it are going to receive funding and then begin the environmental review requirements. This does allow you to execute a written agreement, show that project as a committed project so that those funds count towards meeting your commitment deadline.
That is the only conditional clause that's really allowed under this protocol. Keep in mind, construction has to start within 12 months, you will have looked through your timelines to make sure also that construction can be completed on time, be able to get these units marketed within the available time periods. If you have not taken a look at it, the CPD Notice 15-09 is the updated notice for commitment of HOME funds. There was a webinar that was provided, I think the first one was done in May, I'm not sure if there'll be a second one that may be provided. I think in the near future, you will find that that webinar that has the slides and the transcripts will be posted to the HUD Exchange. So if you were not able to participate in that webinar, I do encourage you to look back, keep an eye on the HUD exchange and take a look at not only the notice, but also the webinar materials would be helpful for you.

So because of this clarification on the commitment of HOME funds, some of you may need to think about your procedures on how you work with applicants. You may need to have some kind of a preliminary award that you are providing, some kind of notification that you're doing that maybe falls short of what HOME is going to count as a commitment and will allow you to count that with an IDIS, but allow you to make a commitment to that project as part of some kind of preliminary award notice. I think a number of folks have used something like that in the past and that may be more important for you to be able to do on this. One of the things I'll note on this since a lot of our projects include the low-income housing tax credits, keep in mind that when we talk about making sure that all of the financing has been secured, that also includes your tax credit award on that.

And what we're looking for to designate that commitment would be the notification to show that the credits had been committed to that particular project by the housing finance agency and then having at least an initial offering letter from an equity provider. So that would essentially put a dollar value on those funds to allow you to be able to move forward with your underwriting knowing what the projected revenue that would be available based on the provision of the tax credits on that project that allow you to essentially determine what's the gap on my project. So that becomes one of the essential parts of this process is making sure that you have been able to designate what the actual other dollar figures coming into this, the other sources into this project and those numbers had been finalized.

You might be doing some preliminary underwriting on this project, but until you have been able to finalize the commitment of the other funds and be able to finalize those numbers, you're essentially not able to complete your underwriting/subsidy layering and would only have some of the working number until all the rest of the funds have been committed to that project. So again, the deadlines that we're dealing with with our HOME funds we have two years to commit our funds to activities that includes our CHDO funds. We have five years to extend all of our funds and that's – and it also includes CHDO funds and then a number of regulations that we've been mentioning before, construction has to start within 12 months and if you're doing acquisition or you're doing demolition, we have to see – since we're not a demolition or clearance program, we're a housing program, we have to see that acquisition and demolition are going to start within a 12-month time period.

So looking at those project timelines to make sure that we're going to be in compliance. Part of that we have a four-year project completion deadline and keep in mind that on the front end,
you're going to want to, as part of your project review, probably buy yourself a little bit of room on this. So if the rule is that you've got four years, you probably only want to fund projects that you feel confident can be completed well before that. So you've bought yourself a little bit of space in case there's some kind of a delay on that. The 18-month lease-up, and we're going to spend quite a bit of time talking about market analysis requirements as part of your underwritings, but this becomes really key, because we have an 18-month lease-up rule for our rental housing project.

So at the point that we are showing our rental housing project as being completed, which means that the construction has been completed, meets all of our applicable standards and that the HOME funds have been drawn for that project, we're going to mark that project is IDIS as being completed. That begins our time period for our 18-month lease-up and that's the lease-up of our HOME units.

So if we have a project that we have oversaturated the market and we've built too many HOME units for that local market to be able to absorb or we've been wrong on the kind of unit that those tenants are looking for, maybe the neighborhood that they are willing to live in, if we experience difficulties and we're not able to rent those units within that 18-month time period, you will have to repay the funds that are attributable to those unleased units. So it becomes really key as part of our underwriting to really look at our market analysis and be really confident that the number, that the type, that the location for those units that we really are on target for that or we could be setting ourselves up essentially to have to make repayment on that.

For our homebuyer units, we have nine months from the point that construction has been completed to sell that unit or have a ratified sales contract in place. A lease purchase agreement does count as meeting this requirement. If you fail to meet that nine-month requirement, then those units are required to be converted to a rental unit and then we have, of course, long-term affordability, all sorts of rent requirements and this project essentially has to be re-set up as a rental project. So really important on the front end that we properly vet the projects to make sure that we're going to be in compliance. So as part of this, you are now required to have underwriting and subsidy layering guidelines. I would think many of you either have them already formerly laid out or have had a well put together process that you've been using for some period of time.

But what you're specifically being required is to have written guidelines and procedures in place on what you will do with each project. So walking through how will that market analysis be completed for the project? It might be different, depending on the kind of project that you're doing, but a specific protocol and you'll be monitored against these guidelines also. So if I say in my underwriting guidelines that I will review a market study and make a conclusion about whether the number of units can be supported by this project and maybe you have some specifics about what you consider to be an acceptable market information for your project, that's the kind of documentation that we'll need to see to show that yes, I have these guidelines, but I'm also following them, I have some consistent process I'm going to use.

Same thing with developer experience and financial capacity, we'll be talking in more length about that. Cost reasonableness also has to be part of that process. So cost reasonableness is
going to be documented either through a procurement process where we have bids and an evaluation on the cost for this project or in many of the cases that we're going to be dealing with, we may be working with a developer that is not triggering the federal procurement requirements. So in those cases, if we don't have procurement that is part of our determining cost reasonableness, there would also have to be a process as part of your underwriting and subsidy layering guidelines on how you will collect and evaluate the cost for projects and make a determination that these appear to be reasonable.

Oftentimes, that's going to be based on looking at comparable projects within your own portfolio, but there needs to be a process in place and that will be described within the guidelines that you put together. As part of this, we're sizing the level of assistance, we're making sure that we're not over subsidizing on these projects, but we're striking that balance of making sure we're not over subsidizing, but also we want to make sure that these projects are going to remain financially viable throughout that affordability period. So trying to strike that sort of middle ground, being a little conservative, making sure that if the project itself experiences some kind of unexpected bump in the road, a change in the market, whatever that might be that this project will have sufficient reserves, sufficient room in its projected net operating income to be sustainable.

So as part of that, we're then also looking at what's a reasonable level of profit or return that's going to come back to that owner or developer? And some of that's going to be based on the – what their role is, what's their risk, the size and complexity of that project and this might be offset by the term that you put in place for the financing. So if it would appear that the owner is going to be – they're going to need your money up front, but they, in the longer run, would be receiving too much of a return, you could structure your HOME assistance in the form of a loan so that they are not essentially going to receive that level of profit at the end of that project. So that becomes part of your guidelines of what's my process going to be, what are my standards going to be on this?

And that would be something that would be implemented on each of your projects through your funding process and you'd essentially have a paper trail to be able to show that. We'll be talking, as we go through this, about insuring the financial viability for that entire affordability period. So one of the things that we're doing up front is we'd have a standard that we are always going to have pro formas that go for at least our affordability period, have some standards about how those projections are made and some of the standards on how we think costs are going to escalate or how we believe rents are going to go up over time, those sorts of things, things like vacancy losses all become part of your guidelines that then you will use as part of your review process.

And then as we mentioned, we are talking about commitments, we have to be able to verify that all of the dollars that are projected as part of this financial package are real, that they are committed and that those are the final dollar amounts. And so in some cases, you may be delayed in being able to do your final underwriting/subsidy layering until there's verification and we have some of the other funds locked in. So as far as coordination with other funders, you – and this notice is laying out you have a responsibility as the administrator of the HOME funds to complete your own evaluation, complete your own underwriting and subsidy layering based on the standards and guidelines that you have in place.
The fact that it's also going through tax credit review or other lenders have made decisions about this project, that's fine and there may be some useful information within that, but your basis for your decision has to be based on your own guidelines and your own standards in place. You know, lenders, the tax credit, underwriting is based on their own program or risk guidelines, which may well be different than your own. So it's always encouraged to collect and review what the other lenders have done on these projects and of course, we need to verify that we have a firm commitment of their funds then, but you must be able to document that you are following your own guidelines. As part of setting up a project and committing those funds, you will be certifying in IDIS that you have completed that process and that those funds have been committed following these specific requirements.

So in developing guidelines, your written guidelines will describe how you're going to collect and review, talk about what your standard will be for the information that's submitted to you. So part of this becomes what am I going to ask for within my application format? And based on these underwriting requirements, some of you may choose to go back and update or upgrade some of those requirements since the level that's needed to be completed to be able to count these projects as committed has been raised or clarified a little bit may be that you need a little bit more up front as part of your application process where you need a clear process on how some of this will get updated as some of these things are clarified.

So what your standards, what your policies would be as part of that, things like your key ratios that you're going to use as part of underwriting. So whether it's multifamily or single family, some of those ratios might be things like, for instance, if we were talking about single family, we might be talking about a front end or a back end ratio. So we might be looking at specifically what their tax – their principle, interest, taxes and insurance might be for that homebuyer and comparing that to what percentage of their household income that represents. We might also use what we call a back end ratio, which would also include the rest of household debt. So those would be standards that we would determine up front on what do we consider to be an affordable percentage for this household to have to commit to their housing expenses?

For multifamily, our ratios that we might have in place might be standards on things like how quickly do we expect rent to escalate over time? So keep in mind, our home rents are based on income. And so depending on where the economy goes in the service area that you're working, it might be that rent levels are very stagnant and in some cases, we've seen rent levels actually go down over time. So we're trying to make an appropriate projection, but be a little conservative. We're also protecting how we think expenses for operating and utilities will go up over time and those ratios need to be projected based on something that you've determined is a reasonable escalation rate. Also, things like the vacancy rate for a project. I used to have folks that would say, this is a senior project and I've got a waiting list. So I will have – I don't need – I'm going to project zero vacancy for this project, I don't believe I'll ever have a vacant unit.

Our minimum standards is essentially 5 percent and some projects we may need to project a higher vacancy rate either because of turnover, because of the local market for that particular project. So having those standards, having those ratios in place and then when we are reviewing
that pro forma, we're going to look at what was their projection versus what we consider to be a reasonable projection.

For those of you that have not done as much underwriting, the reason that this is so important, if I am – let's say I'm projecting that rents are going to go up at a very nice pace, let's say I'm going to say they're going to go up 4 or 5 percent every year, my expenses are only going to go up by 3 percent and I'm going to have a very low vacancy rate, that's going to make your cash flow look really healthy, make it look like this project can support quite a bit of debt.

It'll make it look more sustainable than if in truth, the rents are probably not going to go up at quite that fast of a rate, but my expenses may go up quite a bit faster and I'm going to have some higher levels of vacancy. The reality will not be nearly as rosy. So we're always trying to make sure that when we are looking at pro formas and we are making projections about the future financial stability of that project, that the projections are based on realistic ratios for that. Also, your guidelines, as I mentioned, would include some guidance or protocol on how you will look at cost reasonableness, whether that is if I have a procurement that's been completed, the steps that I would use in evaluating that information versus I may be looking at some review of the cost for that project and doing an analysis to determine does this appear to be what it should cost me in this area with this type of construction and this size of unit?

But that would need to be laid out within those guidelines. That would also include sizing your level of home subsidy on that and the terms and conditions that you would be putting in place. And part of that you would also be calling out what am I going to expect to see from the developer, from the applicant for this project? What kind of documentation? What's my standard on this before I'm willing to complete my process and sign off on the particular project? So we keep talking about market assessment and being so critical. In the past, some of the failed HOME projects was really because we completed projects, we built units or rehab units, but we guessed wrong about what the demand was, what the market was for those units and of course, to have a successful HOME project, we not only have to complete the project, but it has to be occupied by income eligible tenants through that affordability period.

So really critical if we want to avoid having to repay money, if we want to avoid having to convert a homebuyer unit to a rental unit, we want to make sure that up front we've really done a very thorough assessment and we sized that project and placed that project in a way that we are very confident is going to be successful and that would all be completed before you make a commitment for that project. I mentioned a couple of times that the sizing on the scale of the projects is probably going to determine what's reasonable to ask for on a project. So if I'm doing a – let's say I'm funding a CHDO that's going to purchase and rehab a three or four-unit existing rental property within their service area, you're not going to need the same level –

We don't have the same level of risk as you would if you were doing let's say a new construction of 200 units somewhere. So as part of your guidelines and your procedures, think about what is going to be an acceptable level of market information for you as the PJ to be able to complete your assessment of the project and make a determination of is this an appropriate risk, is this the right place, is this the right kind of unit, are there income eligible tenants, can they afford these units as part of that. So you have a number of options on how you might do that. You might be
doing that based on the knowledge and experience of your own staff. Particularly for smaller projects, you may be collecting information yourself on what you know about that particular local market about comparable projects within that area and making that determination.

In that case, not only would your guideline lay that out, so you're going to be following what your protocol is, but that paper trail, the documentation you would have in place would be some kind of narrative within your files that would show the way we completed this market assessment was based on this criteria and here's what we had to work with, here's how we made our conclusion. In many cases, PJs are going to have a market assessment done themselves. So they will independently contract for a market assessment to be done. There's some PJs that have done market assessments for their entire territory and then made some decisions in their program design on saying, these are the kinds of projects that we want to fund because of what we're seeing as market demand and need within our market.

You also might have a developer who you are requiring to have a professional assessment to be completed and they're going to submit that as part of their application process for HOME funds. That's fine, but as part of that, you will need to review that market information that's provided and make a determination on whether you think the conclusion that they have documented within their reports are sound and whether you agree with those assessments. So setting within those guidelines some protocol of what you're going to collect, when you will have it and being able to document that you went through that process and made an informed decision as part of choosing to not only fund the project, but fund it for a particular number of units.

So you may be thinking in terms of I have an 18-month time period to achieve occupancy on this project, thinking about what do I know about this specific market and making a determination of what you believe is a somewhat conservative ability for that local market to absorb these specific units and that would be not only your basis on yes, I think this is a project I should fund, but also, this is the number of units that I think I should be funding for that project. You know, your financials might support many more HOME units being developed, but if you aren't confident that they're going to be able to be rented and occupied or sold, depending on what our project is, you're not going to want to make that commitment of funds, because you're risking having to repay funding.

So some of the market assessment things that you would want to think about will be looking at the demographics of that area, what do you know about the area, the neighborhood, the city? Are we seeing population growing? Maybe it's shrinking. What's the general age on that population? What are the trends that we're seeing in that particular market? What's the LMI population in that area? What are essentially the competition in that area for other units to really think about not only for now when I'm funding this, but where do the demographics seem to be going? If I need this project to be viable and marketable for the next 20 years, if I'm seeing population shrink, maybe I'm not going to have that market within a number of years if those trends continue. So some of the demographics would play into some of my decisions.

So looking not only at that project and neighborhood, but maybe thinking about the overall metropolitan area, whatever we see our broader market as being on this. Also looking at what our actual demand is for housing, not just what the numbers seem to show, but what the market
seems to show as far as absorption for those units, what the affordability is going to be for the
target market that we believe that we're going to be able to get to occupy these units and what's
the competition in that market? One of the things that I experienced years ago in doing some
early HOME projects was that we had market assessments that came back and said that the
market would absorb the units, but what was happening in some of those markets was we had
folks moving out of older affordable housing projects into the brand new units.

So our new units rented up, but then our older housing projects were at risk. So making sure that
we look at what the competition is, what other construction is happening or trends in that area
and then looking at overall vacancy rates. So these become some of the things that you're going
to need to call out and ask for as part of the information that you're either going to collect
yourself or you're going to ask to be submitted with applications for projects. So part of your
review process then begins looking at that information if you're going a market study, looking at
the assumptions that that's been based on to try to determine whether you believe that that is
valid or not, really trying to look has the case been made that for the particular type of unit and
the numbers that are being proposed as part of this application, has the case really been made that
there is a demand for these particular units?

There were times in some markets where we kind of thought as long as I build affordable
housing, I don't have to ever worry about this on there being a demand and units renting out.
Even in senior housing we are finding in some markets that the demand has changed even just
for the type of units. So our elderly population is more mobile and we're seeing in some markets,
they want more cottage style housing as opposed to high-rise, almost like a dormitory sort of
setting and if you build the wrong kind of unit or you build it in the wrong place, you may find
that even though we have the population, we have the income levels, if I build the wrong unit,
we may find that we can't actually rent these. Also, looking at the proposed HOME rents or
affordable rents versus what's in the market.

In some cases, our HOME rents are not dramatically different than what those market rents are.
And so we may have some competition there with our market units. As I mentioned before,
thinking about our program timelines, thinking about that 18-month time period and being really
confident that our project can actually absorb those units. I think we probably will see, in some
markets, where folks will now say, let's do this as a phased development, let's enter a smaller
number of units into a market and then if that is successful, come back with the second phase on
this. Another key element is looking at your partners. So whether it's a CHDO, whether it's a for-
profit or non-profit developer, we're really banking on them having the capacity, both skills and
financial to be able to complete that project.

So as part of your upfront evaluations, as part of your underwriting, you need to collect
information, make an analysis to determine is this the appropriate partner, essentially to complete
that project? So the questions you're asking are going to differ, depending on the specific project,
have they done a project of this size, complexity before, what other projects should they
currently have as part of their workload? Are they new, are they established? And essentially, the
same questions that we are asking a CHDO – I mean, a CHDO essentially is falling under these
requirements that if the CHDO is acting as a developer, then we are evaluating them as a
developer as part of our underwriting process to determine whether they actually have the capacity and the financial wherewithal to be able to complete that project.

So we're gathering information, we're looking at their business history, looking at their staff and experience, thinking about what their current workload is, because that certainly can have an impact on their ability to be able to do that, your specific project. And then you need to look at their financials, which we're going to talk about separately here. So as part of that, because we are counting on this developer to have the financial wherewithal to complete the project, we need to know essentially what their current financial status would be. If there is some kind of a shortfall or cost overrun, we need to make sure that they have the ability to complete this project. So some of the things we might ask for would be essentially a list of what their – we want financial statements about their current financial status, we want to look at what their current calls on capital would be.

So if we get into a cost overrun issue in this project, making sure that all of their available resources are actually called upon for something else. Example we might give, we might have a developer that has a portfolio of 10 properties, but if 8 of those properties are currently struggling, it may be that much of the cash flow that they would be receiving from those other properties was actually either nonexistent or the cash flow from your property is going to be called upon. Things that we might put in place as part of that, A, you might say, I will not fund this project, because I don't believe we have the right developer as part of that project, but you might also put in place things, like a payment of performance bond so that if your contractor goes bankrupt, that you've got insurance in place that's going to provide the dollars to be able to complete that job.

You might also have a completion guarantee in place where the developer is going to be liable for funding the development cost overruns on these projects, but we're trying to make sure that we have not only the right skills, but also a developer who is stable enough to be able to sustain this level of project and see it through to completion. As I mentioned, CHDOs essentially, when they're operating as a developer, we're asking these same levels of questions. And keep in mind that the new HOME rule requires now that you recertify a CHDO for each project as you're funding them. The reason for that is that we're looking at what is their role in this project?

So if they're functioning as the developer in this project, we are going to assess them at a higher level as far as their capacity, their financial standing versus if they are functioning as let's say the owner on this project, but they actually are not going to serve as the developer on this project. So keep in mind not only do we have our standard developer, for-profit, non-profit, but our CHDOs, because of the role, that level of assessment is going to vary based on what their requirement would be. So let's talk a little bit about the project review itself. So as part of your application process, as part of your guidelines, you're going to set in place what your standards are for the information that you're going to need to assemble to be able to complete that review and then you will have protocols and procedures in place on what all of your steps will be before you are willing to sign off, commit funding to that project.

So of course, we're going to need the sources and use the statement, we're going to need a development budget and then because we have an affordability period, we want an operating pro
forma, which is going to project – for a rental property, it's going to project, for the entire affordability period, what their revenue generation is going to be, what their expenses are going to be and then look to see that they have net cash flow that is going to sustain that property and that includes being able to, over time, make payments into operating maintenance reserves, those sorts of things. And again, as I mentioned before, it's sort of an art here rather than science on trying to make sure we don't want to over subsidize, but we also want these projects to be able to —

If we're a little wrong on how we think that local market is going to perform, we want to make sure that these projects, if they hit a couple bumps in the road through that affordability period, will be sustainable. With homebuyers, again, we want a sales plan on the resources that will be available to looking to make sure that we have a development budget that will sustain this project until these units are sold and of course, also, that we have adequate funding in place so that our targeted homebuyers – that there's adequate money to make sure these units will be affordable to them so we'll be able to sell them. So we talked about marketing as being part of our guideline, targeting, geography, project type.

As I mentioned, that might be something that you as the PJ overall have – conduct some market studies and make some decisions even at the point you're designing your program on where you're going to target your funding. Also with income levels, so mixed income projects making some definition of where you want to see your projects go, where you think the need is and where the sustainable projects are. In some cases, you may need to put more money in and do fewer units. We want to make sure that we have real projects that meet need and are going to be sustainable. And really, part of this is looking at how do I protect myself as the PJ on potential risk? If I fail to be conservative enough on my underwriting, I could be at risk of having to have projects that failed, having to convert homebuyer units for rental, whatever that would be.

So it's trying to be a little risk averse on part of this. You're trying to build sustainability in essentially the front end by setting some standards on when you're willing to fund projects and when you're not. So some of the steps you're going to complete as part of that process, you're going to go through your sources and use of statement making sure that all of the costs have been captured in this, that all of the sources are actually in place have been committed. You also will have to look at timing. So it may be that you have sources, for example, your tax credit equity pay-ins, they may be available for this project, but they might not be available at the time that you have a call for some of those funds.

So in some cases, you'll have to look at perhaps you need some bridge financing to essentially cover those gaps in funding until the specific funds become available. As part of this, we want to make sure that the overall development is successful and all the costs have been covered, not just the HOME units, because clearly if the overall project fails, it puts our HOME units at risk. So make sure our sources are committed, that they have – all the uses have been verified. We, of course, have to make sure that they are eligible HOME expenses as part of that, looking at the timing issue that I mentioned about, also looking at making sure that all of our operating costs have been included, including we talked – one of the things that we probably should talk about is there's an eligibility to do in our initial operating reserve, which can be capitalized as part of HOME project costs.
So during that time period from the point that the project is completed through the point that it has been rented up to become stable financially, you could have a shortfall during that rent-up period and this initial operating reserve can be sized and funded with your HOME funds as part of your project commitment to make sure that your project will be sustainable until the point that you're able to get units rented and have a stable project. One of the things that I'll point out on the next to the last bullet here is about maximizing available resources. So there has, in some cases, been a tendency for when folks apply to HOME funds to essentially look at what's the maximum that you as the HOME PJ are offering?

So let's say your maximum award was $600,000. It's essentially plopping into their budget and then backing into the gap with the private lender. We want to make sure that the project itself is accessing all resources and we're only filling that minimum gap. So if the project can afford debt service on a larger private financing, we want that to be maximized and we may need to go back and forth as part of our underwriting on this to determine why is it that if this project could support a $1.5 million loan that they only have $800,000 in it? And perhaps our HOME funds that are needed are actually smaller, because this project could sustain more debt as part of that. That also may be looking at is the owner actually investing a reasonable amount of equity in this individual project?

Trying to determine what is that real gap that HOME funds need to meet and then size our HOME assistance accordingly. So as part of reviewing those development budgets, we really need to have a detailed line item budget that carefully details all of the costs that are associated with this project. We're making sure that A, the costs that are projected for HOME to pay for are eligible costs, we're also making sure that they're customary and reasonable and as we mentioned, reasonable is going to be determined either by procurement or by some process that you have in place for evaluating those costs.

We're going to be looking as part of our cost allocation process, looking at the costs per unit, making and insuring that it is in keeping with those requirements, looking at eligibility for each of the costs that are projected and then making sure that essentially under a cost allocation, we're trying to make sure that if we are saying that we are putting in let's say $79,000 in HOME subsidy per HOME unit, we need to also make sure that we have $79,000 of eligible HOME costs for those specific units to be able to support that particular investment. So we really need a good detailed development budget and in some cases, we may want to or need to break out some of those costs. We have some things that are ineligible for HOME to pay for.

For instance, we know that we can pay for onsite infrastructure, but we can't pay for offsite. So if we have a development budget with a single line item for infrastructure, it may be that that needs to be broken out into two separate line items. If we have, let's say, a community building that's a standalone not part of the affordable housing, it's not going to be an eligible HOME cost. And so that needs to be broken out from our construction costs for the overall project. So really reviewing that development budget, asking questions, making sure that we have the level of detail so that we're able to work our way through these costs and know that we can support our decision that we have eligible, reasonable, appropriate costs for our HOME investment.
As part of that, we mentioned that we need to see our pro forma not only for the development period, but also an operating pro forma that's going to cover the affordability period for that process – for that period. We're going to look at their operating income assumptions about rents, about vacancies, all of the expenses that they're showing, the contributions to reserve. So we've talked about the ability to have an initial operating reserve. A project would normally also have an operating and a maintenance reserve, but those cannot be capitalized with HOME dollars as part of your project funding. So generally, those reserves are going to be built up over time with contributions that are going to come out of your cash flow.

So those things need to be included in that operating pro forma to make sure that there actually will be adequate cash flow to be able to capitalize over time those reserves. The debt service that has to be covered by this, any kind of payment, if you have a balloon payment, you need to make sure all of that has been handled and that you have good documentation on that. So most PJs are going to have a standard review format that is going to essentially trigger them to analyze each one of these required elements and capture the kind of documentation that you need to have in place. So it's going to call out what's my standard for escalation rates for rent?

You're going to compare what this pro forma has projected versus your standard and say, yes, this is in compliance, I can move forward or no, this is going to have to be changed that would kind of work your way through a document that you had completed your due diligence as part of this review process. Also looking over that life of the project, making sure that you've got adequate cash flow throughout the life of the project. If you've got a 20-year affordability period and things look pretty good for the first 15 or 16 years and then began a downward cycle, if you have not been conservative enough on your numbers, it could be that you've got a project that's going to run into trouble during that affordability period.

If you have a rental project funded with HOME that has not completed the affordability period, you will be repaying the entire investment. It's not that you, if you have 18 successful years on a 20-year affordability period, there's no proration to say, we'll give you credit for those 18 years and you only pay back a smaller amount, it's the entire HOME investment you would have an ineligible use of funding. So we really need to make sure that these – our projections are appropriate and that we have been very careful about the assumptions that were used in making this. So we're trying to make sure that these projects have some reserves in place, have some contingencies so that they can make it through any of these difficulties they might experience.

So things like debt coverage ratio and the net operating income, looking at those as metrics going to attract the projected health of those projects. So we mentioned earlier things like looking at those assumptions, about rents, expenses, vacancies, all of that would be a part of that. Part of your process, obviously, you're also needing to make sure am I going to be in compliance with the HOME rent limit? So we have maximum HOME rents that are going to be not only in place when we're funding that project, but over the life of the project, but that's also going to be tempered by what happens in that local market? It might be that the HOME rent allows you to charge, I don't know, $800 a month for your 2-bedroom unit, but it might be that for this to be a viable HOME project, that what's needed for your target population in that market maybe is something lower than that, maybe it's $700 a month.
And so your underwriting ought to be based on what's a realistic rent as part of that and then making sure that we've got reserves that are going to be capitalized, that are going to be adequate over the affordability period. We want to make sure that when we have surprises along the way that we are well prepared for those. Let's talk a little bit about our homebuyer project. We mentioned before that the new HOME rule has a nine-month time period for that project for those units to be sold, to be under a binding agreement or they have to be converted to rental. So if I'm funding a homebuyer project, I really haven't vetted out the project based on would this developer be a good property manager if I had to convert these to rental, do I have the adequate budget in place to be able to do that?

So if we're funding something as a homebuyer project, we really need to be confident that we can actually sell these units. So as part of that, we want to know from the developer what's your plan, when will you start your marketing efforts, who do you see as your buyer on this, all of the details on that to make sure that they have a logical plan in place and that you agree with the assumptions that are being made. Part of that is looking at who's the target buyer, is there a demand, can they afford these particular units, do we have enough not only development funding in this project, but maybe we need some affordability subsidy as part of that also. Depending on how sales are going to occur, it may be that we're going to have additional cash flow that's going to be coming back into that project based on when these units are sold.

So looking at is cash flow going to be adequate to be able to support this project and complete it, if we have a project that takes a long time to be able to sell these units, will they have, from the point that they've completed, adequate funds to be able to cover their expenses in maintaining these units in the sales effort as part of that? And then of course, do we really think that the timelines are going to be achievable for the number of units, the type of units in the particular market? So all of that needs to be carefully part of that plan and the developer has something that looks logical based on what you know about the market. Let's talk a little bit about return to the developer and the owner.

So we talked earlier that we have an obligation to make sure that we are not essentially over subsidizing these projects resulting in that developer or the owner essentially receiving either too high of a profit or too much of a cash flow over the life of that project. Also, things like sales proceeds. If I have a homebuyer development project, we also have to look at what are the proceeds that are going to be received back by that developer when they sell the unit and will those funds be left with that developer or will they be repaid back to the PJ? So as part of this, we're looking at what the returns will be for that project, doing some comparisons of what we have deemed to be reasonable, particularly in that market and for that type of project.

And then it may be that we structure our project in a way so that these are set up as loans. We could even do what we call a cash flow loan where we would evaluate cash flow on an annual basis and some percentage of that is repaid based on the funds available. So first, you need to establish a reasonable rate of return and then have some method of tracking that and making a determination of how you're going to structure that particular project. That would be part of your evaluation and also your guidelines and procedures. Let's talk a little bit about our project selection and then particularly on the subsidy layering.
So I mentioned as we started early on this that the underwriting is looking at the overall project and its viability, but particularly, the subsidy layering is then really thinking about what's the gap in this project and how much of the HOME money actually needs to be put into this project versus could be funded either through private lending or other resources on this project? So we're really looking at this project based on our standards that have been put in place and doing an analysis to determine what's the actual financing gap? As I mentioned earlier, we want to see that the project is maximizing its ability to be self-supporting. So if there is adequate cash flow to support more debt, we might be asking why is it that they're projecting a financing gap that is larger than what we think this project actually should be showing.

As part of that, then we're looking, again, at the return to the owner, looking at your risk on this project and as part of this, we're thinking about all of our compliance risk. So our timelines on this, what we think over the long run for this project. We haven't talked about specifically under the new HOME rules for rehab projects with 26 or more units, we have a requirement for capital needs assessment that is part of the delayed rule, but will be put in place. So with a rehab project, specifically, but really we have the same concern for all of our projects, looking through – looking at our project over the life of that project and thinking about what are the calls on capital going to be on that project? So when will the roof need to be replaced?

When do we project that we will have to – you know, basic surfaces, carpeting, flooring, appliances, those sorts of things that have to be reinvested as systems essentially reach the end of their useful life and thinking about what's our cash flow in this project, what are our capitalized reserves going to be at any particular point in the life of that affordability period and determining will we actually have adequate funds for this project to be sustainable? I mean, frankly we have those same concerns, whether it's rehab, whether it's new construction, whether it's a large scale project or a small scale project, it's thinking about is this project going to be sustainable since we know that we cannot put additional HOME dollars into that project during the affordability period?

Part of this we have to think about, when we talked about sizing of our assistance, we don't want to put a project so tightly on our underwriting that we leave them vulnerable if there is something within a projection that is – that we're wrong on. So we're trying to really balance that between over subsidizing and under subsidizing if under subsidizing is just as great of a risk as putting more money into a project than we need. Also, thinking about not only during the operating period, but we also have to think about during the construction period are there appropriate contingencies built into this project budget, particularly depending on the type of project, type of construction, location?

And then we mentioned during the lease-up period this risk of not being able to meet all of our financial obligations. So let me give you an example, let's say I have built a 60-unit complex, I have completed that construction and I close on my permanent financing on this project, I'm going to rent up the 60 units. In some markets, that – you know, you'll have a waiting list, maybe you're doing a lottery, because there's such a high demand, your rent-up period is going to be incredibly short. And so getting to a stabilized level of revenue may be very fast for you. In other markets and in specific types of population, that rent-up period may take longer. And so in that
case, it may be that the first three, four months I only have a small percentage of my units actually have been rented.

So because I have so many vacant units, I don't have nearly the income coming in from rent that's being paid, but I already have my fixed payments, my offering expenses, my debt service on that project. And so I could have a project that was at risk of financial meltdown essentially during that rent-up period, because they just didn't have enough of those units rented and have adequate cash flow coming in. So this initial operating reserve is one of our ways to mitigate that risk on making sure that that's in place. Now, one thing I will mention as part of your underwriting on the initial operating reserve, that reserve is to be based upon this specific project.

So if I am projecting that my rent-up period in this particular market for this project is only three months, then I would expect that my lease-up, my initial operating reserve is going to be very minimal if needed on this project. If my projections on the market are that my rent-up period is going to be 8, 10 months, then I would expect – then it would be reasonable for you to approve an initial operating reserve that was larger based on this projected need. So the size of that initial operating reserve is not just sort of a magic number, but should be based on what your projections are for the performance of that specific project within that specific market.

In the cases that the HOME assistance is not necessary or reasonable, then you're going to go back to that developer and you might say, we're not going to fund this project, but you might say, based on our underwriting, we can only offer you this amount of money. You might be saying in exchange – the only way I can support giving you the amount of money that you're asking for is I need more HOME units.

So I need more units that I can justify on my investment. That's also going to change that rent structure. And so we're going to target some lower incomes. We might also change our targets on our rent to have some units that are targeted lower than what we standardly see for the HOME program, but you're not able to approve your – and make a commitment of funds until you are able to support that level of investment based on meeting your standards in place.

Now, as we mentioned, things like when there's too high of a rate of return, we can change the loan terms or impose some loan terms that will decrease what that cash flow or rate of return would be for that developer to bring that project back into compliance with our standards. So our key goal really in all of this is to make sure that when we fund the project, not only we know that it's eligible, but we also need to make sure that we are confident that this project will be sustainable for the long term. So at least our affordability period, which under HOME, 5, 10, 15, 20 years as part of that. That's our minimum. We might have a higher standard as part of our underwriting on that. As part of that, we mentioned the capital needs assessment, making sure that this project is going to have adequate reserves.

So as these cash needs are experienced by the project over that affordability period, that we can see that there are going to be adequate reserves in place, adequate cash flow to be able to cover those costs. And as I've said multiple times as we've kind of gone through this, thinking a little bit conservatively and really, what you're having to do is question the projections that you are
being given by the applicant and thinking what do I know about that particular market, what do I know from my own portfolio and make some decisions on whether you think this is appropriate or not. Bottom line on this is that you, as the PJ, are responsible and will have to accept the loss or cover to keep projects viable if you get it wrong on your underwriting.

So really important to have standards in place and having a process to be able to safeguard, that each project has had a thorough examination that you've made an informed decision as how you're going to invest in that particular project. So the tail end of this process is making sure you've documented compliance. As I mentioned, the notice now lays out what your minimum requirements are, including having policies and procedures in place and standards and you're saying as part of that, this is what I'm going to do on each and every project, these – this is the process I'm going to follow, these are the standards that I'm going to use to judge when I make decisions on these projects.

So to be able to show compliance with the regulations and with this notice, you have to be able to demonstrate that you followed those standards and completed that process. So as I mentioned before, I think a lot of you probably have standard tools, standard review documents that you're using. If you haven't already done that, I think you need to look at the notice very carefully and then review what your existing standards, policies and procedures are that are in place to make sure that they fully describe and outline the process that you're following and then think about how will I actually capture that and be able to show that those steps were completed? And oftentimes, it's really taking that process and those standards and incorporating that into some kind of review document that is being completed as you complete your underwriting and subsidy layering.

So calling out, gathering the information that you said you're going to use to review and making some comparison of what that is versus what your standard was and then designating I've reviewed this on the basis of this, here's my process. All of this has to be somehow captured so that when you are being monitored, that there's a way to show that yes, these were completed, here are the steps that I did, here's the basis for my approving this, here's my basis for determining what the gap on this project was and why I was going to fund that. So not only is it captured in a written agreement, but really, your paper trail has to be part of this compliance process. I would presume that the HUD monitoring tool that is used by HUD representatives when they're looking at your program will be updated to ask some additional specific questions that were not included in the past and that in future monitorings that you will have.

Your HUD representative will be looking first at your policies and procedures and using that as part of their evaluation tool when they look at your compliance to make sure that that's in place. So I think for a lot of folks, it's going to be important to review through those things, capture some additional information, think about what you're actually asking for as part of your application process, what you actually are capturing in your paper trail that you're creating as part of your review, underwriting, subsidy layering process and your approval process so that you can demonstrate that you are following this and that you are making funding decisions based on those standards. So that gets us to the end of our slides.
I think at this point, I'll turn things over and ask Kris – I'm going to assume that we have sort of a healthy list of questions that have come in. If you have had a question and have not yet put it into the system, I would encourage you also to go ahead and do that. Kris, do we have questions that we should work through?

Kris: Yeah. We have quite a few questions left. So I've been trying to put them in different topic areas so we could cover them together. So the first one that came up is when you were talking about homebuyer – I think at the very beginning, someone had made a comment that we also want to make sure that we're committing in writing, such as the mortgage prequalification letter or similar document to make sure that there's a firm commitment of sources as well for homebuyers.

Les Warner: Yes. Because much like when we're doing a development deal, we're trying to figure out what's the financial gap? So we can't really do – complete our final underwriting and be able to determine how much that household will need based on our affordability standards until we really know what the actual amount will be. So we may have a buyer that has a prequalified letter from a bank, but that is probably not going to be specifically what the bank will lend on that particular project. So we're going to have to collect, as we do on any other project, all of our sources on that, all of our expenses on that project to be able to complete. And we might, again, be doing something where we have some kind of an interim we believe that we can fund a particular amount, but we can't finalize that until the bank has issued its final –

You know, it may be that they're waiting for the appraisal to come through to be able to make their final call on what their loan amount will be. So it can be a little bit of a moving target.

Kris: Great. The next question is for homeowner rehab. And the question is they wanted to know if underwriting and subsidy layering requirement review is required if they are doing a deferred loan. So 1 percent interest total due at maturity and there's no monthly payments collected.

Les Warner: Yeah. So that's a loan that's not amortized. So it's not requiring regular payments to be made. And so that does not trigger the underwriting requirements on that. It's only when you actually have an amortized loan and you're collecting payments.

Kris: Great. The next one is under rental. Somebody was asking – I think you used the word secured and they weren't sure what that meant. What does secured mean for multifamily rental? I'm not sure, maybe you were talking about commitment, maybe securing the funds.

Les Warner: I probably was talking about making – so as I mentioned, for instance, on tax credits, our standard would be, as a minimum, that the tax credits have been awarded for that project and then we have an initial letter of interest from an equity provider. So we have a dollar figure to be able to size that. If we want to make sure that their private loan has been secured, then we make sure that we have a commitment letter that is specific for that project based on the funding.
So a lot of times, we'll get some kind of initial letter of interest where we don't have a final number and it is a little bit of chicken-and-egg that all the other investors in these projects are going to want to say, I want to see how much the other folks are putting in before I finalize this, but you are held to that until you have been able to document that all those other sources are in place and have a final number, that you can't complete your final underwriting and issue that commitment. You can make a tentative, but not your final. I think that's the context that was used.

Kris: Okay. And then that leads into the next question about rental and low-income housing tax credit. They say, this requirement for all funds to be committed in a tax credit deal is problematic, tax credit awarding agencies require that all soft funds are committed in order to compete to receive a tax credit allocation. Do you anticipate the HOME requirement to be amended?

Les Warner: I don't see the HOME requirement being amended, but what I see – that's why I was mentioning that I think that people will use sort of a two-stage sort of notification system. So when we're talking about being able to finalize your underwriting and count a project as a commitment, that's for the HOME program and for its system. You could certainly put some kind of a prequalified, some kind of carefully worded notification that says that you've reviewed this project and you believe that tentatively you're going to fund it for a particular amount. So essentially, you've found that it's eligible, that the market risks – all these other things that we've talked about you've determined that it's appropriate, but that absolute final number can't be exactly put in place until you've been able to verify these other resources.

So I think for many folks, if you're applying for tax credits, you want a letter from the PJ saying that they're expecting to get HOME funds from the PJ. You can certainly do that, but that does not count as a commitment until you've been able to complete all of these steps and certify it in IDIS and have an executed written agreement.

Kris: Great. Thank you. That leads us into a couple more commitment questions that we have. Somebody wanted you to repeat again if the grantee creates a conditional commitment, that does not mean the conditional commitment can be placed in IDIS. They just want to confirm that.

Les Warner: If you look at the commitment notice, and I believe it's on Page 14, there's a specific clause that explains about a contingency for environmental review and that is the one exception that it allows you to be able to execute a written agreement, be able to set the project up and certify it as a commitment and it does count as a commitment. That's the only condition essentially that could be outstanding and have it still counted as a HOME commitment of funds. But look specifically to the notice and I think it is Page 14. I looked it up earlier today just to review the language.

Kris: Great. Thank you. So the next couple questions follow under the topic areas of policies and procedures. So the first one that came up, they're a small PJ and they sub-allocate funding to housing agencies that run different types of programs and they've reviewed the agencies' programs, policies and procedures as part of their application process and funding process that
historically let the program providers have their own underwriting and subsidy policies. With the new rule, do they now have to have PJ-wide policies that these recipients fall underneath?

Les Warner: Well, if I understand what you've described, it sounds like these – you essentially have subrecipients that are operating programs on behalf of the PJ. And so the HOME regs require that there be policies and procedures in place, but you certainly can have separate policies and procedures for separate programs much like if you, as a PJ, had a multifamily rental program and you had a homebuyer program, you may well have very different policies and procedures in place. The PJ has to make sure that they're approving those policies and procedures and that those are being implemented by the subrecipient.

So I would think that the PJ needs to be able to document that those have been reviewed and approved in advance of the other organization or subrecipient implementing those and also that you would have appropriate oversight to make sure that they actually were following those, whether that's monitoring on the end or you're doing some sampling along the way, but I still think it's acceptable to have a subrecipient operating a program with specific policies and procedures, but you have the requirement to have made sure those are in place and reviewed them and making sure they're being followed.

Kris: Great. So the next falls under, again, policies and procedures, but they're probably the subtopic of reserves and probably fees. They're underwriting two special needs multifamily rental projects and the costs appear reasonable, but they are allowing higher reserves and developer fees up to 18 percent for the developer fee because of the special needs housing stock. What type of documentation would be acceptable for compliance for this since they're allowing higher fees?

Les Warner: Well, to me, you could do it a couple of ways. You might have policies and procedures that went into a lot of detail and already laid out different parameters for different types of projects. And so you would simply, as part of your review, be identifying this isn't my sort of general group, this is special needs and we have a different standard we apply. I think the other alternative would be to have – I think in any of these standards you have in place, the standard is saying, this is what we think escalation rates should be or developer fees or whatever that would be and you are reviewing that particular project against those standards. I think you also could have a narrative or an explanation in there that said, this particular project is outside of these parameters, here is why it is outside of those and this is the basis for making that decision.

So I really think you have a couple of ways to being able to handle that, but I think the key here is something in that paper trail shows how you evaluated it and why you approved this particular project the way it was projected.

Kris: Great. So I'm going to move on to cost allocation. Someone asked a question about a project has 100 units and it's mixed within a certain number of SROs, a certain number of one-bedrooms, certain number of two-bedrooms, certain number of three-bedrooms and they want to know if all the units within that category – within the bedroom size category or practically the same, can they consider those to be comparable?
Les Warner: Well, if – and I want to make sure I'm understanding the question, if you're saying, can I consider all SROs that – and our basis for considering something comparable is generally going to be based on bedroom size and similar amenities. It's not necessarily it goes down to the square feet, but generally, if I have a one-bedroom, I'm going to consider it – as long as it has those comparable amenities, I'm going to consider it to be comparable to another one-bedroom even though there might be some slight difference in square footage for that particular unit. So if that's their question, then yeah, they should be fine. And we particularly see where we have rehab on existing buildings, but you may have many of your units are – they're each a little bit individual and they'll be slightly different in the square footage and some other things.

But if they generally buy a number of bedroom size and amenities, then they generally would be able to be considered comparable. And so your written agreement would – if we're talking about designated HOME-assisted units and having them float amongst comparable units, depending on how that broke down on that particular project, we might be, within our written agreements, specifying we've got efficiency units and we've got one-bedroom and we have two-bedroom flat and two-bedroom townhouse, because maybe there's a significant difference between those particular two-bedroom types within that project.

Kris: Great. So the other question about cost allocation is if their calculation shows they need to have 35 HOME units, do those units need to be fairly distributed among different bedroom sizes?

Les Warner: Yeah. It should be proportional essentially. So you can't be doing your – justifying your investment to HOME funds across a project that includes larger, more expensive units essentially and then designate your affordable units as the smaller. So it would be kind of proportional across bedroom sizes within the property. I think there's some language in the cost allocation notice that gives a little more detail on that.

Kris: Great. So we're going to move into cost reasonableness. Someone was asking if you could just give a general definition again of cost reasonableness and which costs are being assessed for reasonableness, how do they determine that? If you could just give a quick couple points on that one.

Les Warner: Well, it's sort of at a couple of different levels. So if I – let's say I have a – I don't know, I have a $2 million project, on a larger scale, I'm trying to figure out is this really a $2 million project? So it's trying to figure out – and that might be – I might be looking at, I don't know, square footage on the building and kind of looking at my portfolio and say, does this kind of appear to be normal compared to the rest of my portfolio? I mean, that's pretty round on that sort of analysis, but you'd have some justification and those outliers then might be because this sits on a hill and we've got a lot of work to do because of the site or whatever that might be or this is brick construction versus [inaudible] or – we might make some of evaluation of why we think that this number appears to be reasonable compared to the rest of the project.

There are folks that will use someone to do a cost certification. We might look at specific costs within a project that are called out and look at those specific line items also, but you always are being held to this test of A, are the funds that you're – the costs that you're paying for with
HOME reasonable, but also, if they are over projecting the overall cost for the project, they could also be then projecting the gap as being larger. So you kind of need both levels on this.

Kris: Great. Thank you. So the next question about cost reasonableness is if the HFA says the low-income housing tax credit costs are reasonable, can they use that for their own cost reasonableness analysis?

Les Warner: Well, no. So you, as the PJ, on all of what we talked about have a responsibility that you have to sign off based on your own standards. Now, you could adopt a protocol that is based on what the housing finance agency is using if that makes sense for your role in this project, but you will have to have made the call yourself and have had some basis on that. And that's – it's kind of standard theme here where on any of these categories, you're going to have other players involved in these projects and they will have done their due diligence and that's helpful to you, it gives you a little more security on this, but you, as the responsible entity for the HOME funds, have your due diligence that you have to do.

Kris: Great. Thank you. A couple questions about procurement. When you had mentioned that if you're working with a developer and you're not going through procurement, somebody wanted to know is that only for CHDOs or is it for any developer that you're working with where you don't have to go directly through procurement?

Les Warner: So the federal procurement requirements are going to apply to a unit of government and a subrecipient, but a developer, a CHDO are normally not triggering federal procurement. You may be running a program where you have requirements about procurement steps that need to be taken that might not be the federal procurement requirements, but you as a program have said, I expect you, as the developer, to bid this out and be able to present that this is the lowest best cost for this project. Pretty typically in particularly multifamily projects, they are not triggering procurement.

And so in the absence of that, then we have to be able to prove cost reasonableness by having something else to essentially do that function, which is when we begin to having some kind of protocol on comparing costs within our portfolio or trying to do some kind of cost analysis projection for that particular project to try to decide what do we think this project should cost versus what they are presenting.

Kris: And then there was a follow up question, which I think maybe leads to this where if you were saying that you are requiring your developer to do procurement, because that's your own local rule, do they need to have those files in place or is it enough for the PJ just to monitor to make sure it was performed?

Les Warner: Well, you have a requirement on cost reasonableness. So I think you have to have some kind of evidence that that process was completed to be able to say, yes, the amount of funding that we're going to provide here is needed by this project, because we think the costs are real. So I think you have to have some evidence of that and that might be that they provide you – you know, you have some standard documentation that you ask for that maybe isn't all of the paperwork, but provides a summary of that and then you would, as part of monitoring, review
the balance of it to make sure it existed and lined up with that. I think that's a policy decision that you would have to make on what you consider appropriate documentation to have in hand.

Kris: Great. Thank you. There's another one about – this is more about applicability probably for underwriting, subsidy layering you have looking at large scale projects versus small scale projects. Are you able to talk a little bit about the differences? I know the market study might be a little different, but [inaudible].

Les Warner: Sure. So a smaller scale project might not actually be triggering cost allocation if we were doing 100 percent of HOME funds. So that kind of changes that part of the process, but market developer capacity, needing to know that costs are eligible, needing to know that costs are reasonable and figuring out what the real gap is really affects the whole range of scale for projects. It may be easier on a smaller project, because there may be fewer sources of funding, you may have fewer issues about timing on availability and some of that, but generally, I think this is going to apply. I think where we probably have the biggest difference is when we think about the marketing and what we consider to be adequate documentation to be able to determine where the market – is there really a market for this particular proposed project?

And the smaller the project is, the lower the risk there is for that project to be successful and absorbed by the market. And so that sort of reasonable threshold of information I need to collect would also go down.

Kris: Great. So we only have a couple more minutes. Do you want to answer one or two more questions or did you want to wrap up?

Les Warner: Sure. Let's answer and then let's note that if we have questions that we are not able to get to today, we will look at them and work with HUD and it may be that they would add a frequently asked questions that would be posted along with this information. I think that would only be in the case where we felt there was a question that hadn't been sort of answered in the context of this and that they felt needed to be added that wasn't addressed in some way or another.

Kris: Yes. And there – just so you're aware, there are many, many questions we have not gotten to. But I have heard everybody's plea that they want to know about where tools are, are there samples here, where can we find things? So we should at least push everybody to look at the HUD Exchange. There is a lot of good resources listed there under the HOME program page. There are some new – there's going to be another notice coming out on – let's see, what did they say it was on? I'm sorry, [inaudible] here, cost allocation that's going to talk about comparability and give us a little more detail. So there is more guidance coming out from HUD [inaudible].

Les Warner: And I think there may be a homebuyer notice at some point also. I believe I heard that at one point.

Kris: So many, many people have written in, please tell me where I can find something to use, what kind of template can I use? So we'll work with HUD to make sure that that information is listed and where you can find that, but always go to look on the HUD Exchange. I think the last
question – I mean, there was a little bit of confusion and it might be for some new people about the deadlines and they wanted to know how can there be a five-year expenditure deadline when projects are required to be completed in four years? There were quite a few questions coming up on the confusion about the five or the four-year.

Les Warner: Okay. So that's a good question. If we were in a room together and I had a flip chart, I'd be drawing a diagram for you. So when you receive your grant award, the clock starts for that two years to be able to commit your funds. The clock also starts at that point for the five years for the expenditure. So if I were to wait until the second year, almost to the deadline, to make a commitment for – to a particular project, I actually wouldn't have four years to be able to complete that project, because I'm already two years into my five-year expenditure deadline. So I would lose access to my HOME funds the third year of that project. So the two-year commitment deadline and the five-year expenditure deadline, that time period starts with your receiving your award of funding.

The project completion deadline is specific from the point that you actually commit funds to that individual project. Now, I will also say is that most folks, when you – you may have four years to complete the project, I would think most PJs are not going to fund a project that they project will take anywhere close to that time period. I think more typically you will see people probably providing maybe a two-year work period within their grant and you have the ability to then extend that, but most folks are going to steer well clear of being anywhere near what these end timelines are. And obviously, the goal with the two-year commitment is to try to be well ahead of that, if possible. Hopefully that helps without a visual.

I think based on the time, we probably need to wrap this up. I appreciate the numbers of people that have attended. Hopefully this has been helpful for you. Let folks know that there will be a second offering of this on July 28th and the announcements will be coming out on the listserv on the Exchange, I think, rather soon.

And again, the slides and the transcripts will be posted on the HUD Exchange for your access. Thanks, everybody. Have a good day.

(END)