CHAPTER 3: CHDO REQUIREMENTS AND ACTIVITIES

At least 15 percent of HOME funds must be set aside for specific activities to be undertaken by a special type of nonprofit called a Community Housing Development Organization (CHDO). This chapter details the set-aside requirement, the qualifications of a CHDO and the types of assistance PJs may provide CHDOs. This chapter also covers how to identify and select CHDOs, as well as ways to build long-term relationships with CHDOs.

NOTES

PART I: HOME PROGRAM REQUIREMENTS

CHDO SET-ASIDE REQUIREMENT

♦ A Community Housing Development Organization (CHDO) is a private nonprofit, community-based service organization that has obtained or intends to obtain staff with the capacity to develop affordable housing for the community it serves.

♦ PJs must set aside a minimum of 15 percent of their HOME allocations for housing development activities in which qualified CHDOs are the owners, developers and/or sponsors of the housing. PJs must have a reasonable expectation of specific projects going forward.

Reservation of Set-Aside of Funds for CHDOs

♦ PJs have up to 24 months from after the last day of the month in which HUD signs the HOME Investment Partnership Agreement transmittal letter to identify and designate the CHDOs they plan to work with, and to reserve monies for the CHDOs’ use.

➢ PJs may set aside more than 15 percent of their funds for housing owned, developed or sponsored by CHDOs.

➢ CHDOs may engage in other HOME-eligible activities in which they are not the owners, developers or sponsors of the housing. However, the HOME funds committed to those activities will not count toward the set-aside.
The CHDO reservation of funds can be made by the PJ before specific projects are identified.

Recapture of CHDO Set-Aside Funds

♦ All CHDO set-aside funds that are not reserved for designated CHDOs by participating jurisdictions within 24 months will be recaptured by HUD.

♦ HUD will reallocate all recaptured CHDO funds by making them available to PJs.

    ➢ Reallocation will be made through periodic competitions, each announced in a Notice of Funding Availability (NOFA).

    ➢ Reallocated CHDO set-aside funds made available to a PJ through the NOFA process must be used for projects sponsored, developed or owned by CHDOs.

CHDO QUALIFYING CRITERIA

♦ A CHDO is a specific type of private nonprofit entity. CHDOs must meet certain requirements pertaining to their:

    ➢ Legal status;

    ➢ Organizational structure; and

    ➢ Capacity and experience.

♦ HUD Notice CPD 97-11 (included in the Appendix) details these requirements.

Legal Status

♦ Organized under state/local law: CHDOs must be organized under state and local law.

♦ Purpose of organization: Provision of decent housing that is affordable to low- and moderate-income persons must be among the purposes of the organization. This commitment must be evidenced in the CHDO’s:

    ➢ Charter;

    ➢ Articles of incorporation;

    ➢ By-laws; or

    ➢ A resolution of the CHDO's board of directors.
♦ **No individual benefit:** No part of the CHDO’s earnings (profits) may benefit any members, founders, contributors or individuals.

♦ **Clearly defined service area:** A CHDO should have a clearly defined *geographic* service area.
  - CHDOs do not need to represent a single neighborhood.
  - For urban areas, a CHDO may include in its service area a neighborhood or neighborhoods, city, county, or metropolitan area.
  - For rural areas, a CHDO may include in its service area a neighborhood or neighborhoods, town, village, county or multi-county area (but not the entire State).
  - Nonprofits serving special populations *must also* define the geographic boundaries of their service areas in order to qualify as CHDOs.

♦ **Nonprofit status:** A CHDO must have received a tax-exempt ruling from the IRS under Section 501(c) of the Internal Revenue Code of 1986 in order to be designated by the PJ as a CHDO. (See Attachment 3-1 “IRS Nonprofit Status.”)
  - There are many incorporation options under Section 501(c), depending on the type and purpose of the organization seeking the designation for tax-exemption.
  - The 501(c) designations permissible under HOME are:
    - 501(c)(3) status -- a charitable, nonprofit corporation;
    - 501(c)(4) status -- a community or civic organization;
    - Section 905 status -- a subordinate organization of a 501(c) organization.
  - IRS standards for granting a 501(c)(3) designation for housing development organizations are narrowly applied, lengthening the time it can take to receive a 501(c)(3) designation.
    - Designation can take nine to 24 months.
    - The timeframe varies by IRS region.
CHAPTER 3: CHDO REQUIREMENTS AND ACTIVITIES

Conditional designation: The IRS will usually grant new applicants a **conditional** designation of 501(c) status, valid for a specified period of time (usually three years).

- During that period of time, the organizations may operate legally as 501(c) organizations, with all benefits pursuant to that designation, while the IRS monitors their operations.

Final designation: Assuming they operate in compliance with applicable regulations during this period, the IRS will grant them **final** 501(c) designation.

The HOME requirement for a 501(c) designation can be fulfilled by having either a **conditional** or a **final** designation from the IRS.

Organizational Structure

- The CHDO is intended to respond to a particular community's needs. Therefore, the structure of the board of directors of a CHDO is viewed as the main indicator of community control over the CHDO.

- The CHDO board must be composed as follows:
  - At least one-third must be representatives of the low-income community.
  - No more than one-third may be public officials or employees of the PJ or State Recipient.
  - The balance is unrestricted, and may include people such as human and social service providers, lenders, individuals with access to philanthropic resources, or others willing to contribute their professional expertise.

- There are also maximum limits on representation and control by a for-profit entity when the CHDO is sponsored by a for-profit entity.

- Low-income community representation: As noted above, a **minimum** of one-third of the board must consist of representatives of the low-income community.
There are three ways to meet this requirement:

1. **Residents of low-income neighborhoods in the community.**
   - Low-income neighborhoods are defined as neighborhoods where 51 percent or more of the residents are low-income.
   - Residents of low-income neighborhoods on CHDO boards do **not** have to be low-income themselves.

   **and/or**

2. **Low-income residents of the community.**
   - In urban areas, "community" is not necessarily limited to a single neighborhood, but may include several neighborhoods, the city, county or metropolitan area.
   - In rural areas, "community" may also cover a multi-county area (but not the whole state). The board need **not** include low-income residents from each county in the multi-county area.
   - Low-income residents of low-income neighborhoods in the community **do not** need to submit proof of their income.
   - If low-income residents of the community who do not live in low-income neighborhoods are necessary to meet this threshold, the CHDO must obtain a certification from the resident that the resident does qualify as low-income. No PJ verification of the CHDO certification of income is required.

   **and/or**

3. **Elected representatives of low-income neighborhood organizations.**
   - A **low-income neighborhood organization** is an organization composed primarily of residents of a low-income neighborhood.
   - The primary purpose of the organization must be to serve the interests of the neighborhood residents.
   - Block groups, town watch organizations, civic associations, neighborhood church groups and NeighborWorks® organizations can be examples of low-income neighborhood organizations.
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✔ The governing body of the low-income neighborhood organization may elect the representative(s) to serve on the CHDO board.

♦ Low-income input: Input from the low-income community is not met solely by having low-income representation on the board.

➢ The CHDO must also provide a formal process for low-income program beneficiaries to advise the CHDO on design, location of sites, development and management of affordable housing. The process must be described in writing, and must be included in the organization’s by-laws or a board resolution.

➢ This requirement is especially important for CHDOs serving a large geographic area, where it may not be possible for a CHDO to have low-income board representation from every neighborhood in which the CHDO will develop, own or sponsor housing.

➢ CHDOs should establish systems for community involvement in parts of their service areas where housing will be developed, but which are not represented on their boards. Such systems might include special committees of neighbors of a proposed development site, neighborhood advisory councils or open town meetings.

♦ Public-sector limits: A maximum of one-third of the governing board may consist of representatives of the public sector.

➢ This limitation is intended to ensure that separation exists between PJs and CHDOs, and that CHDOs are indeed community-based and community-controlled organizations.

➢ A member of the governing board of a CHDO would be considered a representative of the public sector if he or she is a public official, including:

  • Elected officials of the PJ/State recipient - council members, aldermen, commissioners, state legislators, members of a school board, etc.

  • Appointed public officials of the PJ/State recipient - members of a planning or zoning commission, or of any other regulatory and/or advisory boards or commissions that are appointed by a PJ official.
• Public employees of the PJ/State recipient - all employees of public agencies (including the schools) or departments of the PJ's government (e.g., a clerk in the water and sewer department, a public facility janitor or a secretary in the tax assessment office); or

• Appointed by a public official - any individual who is not necessarily a public official, but who has been appointed by a public official (as described above) to serve on the CHDO board

➤ Members of the board appointed by public officials cannot select other members of the board.

➤ What if the public official is low-income? Public officials and/or appointees who themselves are either low-income community residents or residents of a low-income neighborhood count against the one-third maximum limit of public sector representatives. However, they do not count toward the one-third minimum requirement of community representatives.

   Example: Alderman Robert "Big Bob" Jones creates a nonprofit with a nine-member board to be a CHDO for his ward. The alderman appoints himself and two good friends to the board. At that point, three members of the board are considered to be representatives of the public sector. This means that the nonprofit has reached the one-third maximum limit for public officials and appointees. "Big Bob" realizes that he cannot appoint any other members to the board, but he still wants to have control over a majority of the board members. "Big Bob" designates his two good friends to select at least two other board members. A public official has directly or indirectly appointed five out of the nine members of the board, so Big Bob's nonprofit would not qualify to be a CHDO.

   Example: Truetown Neighbors Together (TNT), Inc., wants to qualify as a CHDO. The group fulfills every other requirement and is now at the point of reviewing its board composition for compliance with CHDO requirements. TNT has long been proud of its measure of neighborhood control, because six of the 12 members of its board reside in Truetown, a low-income neighborhood. However, included in the six are: the neighborhood's alderwoman, a member of the school board and a neighborhood resident appointed by the mayor to serve on the city's planning and zoning commission. The other six members are neither low-
income nor public officials/appointees. The current TNT board does not exceed the one-third maximum limit on public-sector representatives, since only three out of 12 members are public officials/appointees. However, the three public officials/appointees, even though they live in the low-income neighborhood, cannot count toward the minimum one-third community representative requirement. Therefore, TNT’s board does not currently meet that threshold requirement.

♦ PJs, public bodies or instrumentalities: PJs, public bodies or instrumentalities of public bodies cannot be considered CHDOs. Examples of instrumentalities of public bodies include public housing authorities (PHAs), urban renewal agencies, redevelopment authorities and downtown development authorities.

♦ These limits on public-sector representation on CHDO boards only serve to define CHDOs. There are other (not specific to HOME) restrictions on the participation of public officials on the boards of nonprofit organizations seeking public funds. PJs should observe their conflict-of-interest guidelines in this regard as well.

♦ Sponsored CHDOs: Nonprofits that have been sponsored by other nonprofits, charities, religious organizations, local or state government, public agencies or for-profit corporations may qualify as CHDOs, but certain additional requirements and board limitations can apply.

➢ Nonprofit and charity sponsors:

  ✓ There are no limits on the proportion of the board that may be appointed by nonprofit or charity sponsors, as long as the minimum one-third community representation is met and the maximum one-third public representation is not exceeded.

  ✓ A one-year minimum history of service to the community by the sponsoring nonprofit or charity may help a new nonprofit to qualify as a CHDO.

➢ Religious organization sponsors:

  ✓ Organizations that are religious or faith-based are eligible, on the same basis as any other organization, to participate in the HOME Program. Government entities are not to discriminate against an organization on the basis of the organization’s religious character or affiliation.
CHAPTER 3: CHDO REQUIREMENTS AND ACTIVITIES

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✓ However, organizations directly funded under HOME may not engage in inherently religious activities. If the organization conducts such activities, they must be offered separately and participation must be voluntary for the beneficiaries of the assistance provided.

Additional guidance regarding religious or faith-based organizations is provided in 92.2.57 of the HOME final rule.

➢ Local/state government and public agency sponsors:
  ✓ A local or state government and/or a public agency cannot qualify as a CHDO, but may sponsor the creation of CHDOs.
  ✓ Government officials and appointees of the government cannot exceed one-third of the members of the board.
  ✓ All other CHDO rules and requirements also apply.

➢ For-profit corporate sponsors:
  ✓ A CHDO cannot be controlled by, nor be under the direction of, for-profit entities or individuals seeking profit from the organization.
  ✓ CHDOs may be sponsored or organized by a for-profit if:
    • The primary purpose of the for-profit sponsor is not the development or management of housing (that is, a builder, developer or real estate management firm may not spin off a CHDO);
    • The for-profit appoints no more than one-third of the CHDO’s governing board and the board members appointed by the for-profit do not appoint the remaining members of the board; and
    • The CHDO is free to contract for goods and services from any vendors it selects.

Capacity and Experience

♦ CHDO experience: A CHDO must also demonstrate that it has at least one year of experience serving the community where it intends to develop the HOME-assisted housing.
CHAPTER 3: CHDO REQUIREMENTS AND ACTIVITIES

- Newly created organizations wishing to become CHDOs can meet this requirement if the parent (or sponsoring) organization is a nonprofit and has provided services to the community for at least one year.

- The year of service does not have to be directly related to housing.

  Example: The United Way of Hometown creates a new nonprofit corporation to develop single-family homes for homebuyers. Although the nonprofit is new, the United Way of Hometown was chartered 50 years ago and has considerable low-income community experience. By sponsoring the creation of the new nonprofit, the United Way has fulfilled this requirement.

- Prior service to the community cannot consist of a for-profit organization’s work in that community.

♦ CHDO capacity: CHDOs must demonstrate the capacity of their key staff to carry out the HOME-assisted activities they are planning. This means that CHDOs must have:

  - Experienced key staff who have successfully completed projects similar to those proposed by the CHDO;

  or

  - Key staff with limited or no experience, and who will use experienced consultants for the planning and development activities, as long as there is a plan in place for the consultant to train the key staff.

♦ Differences in required experience and capacity: There are significant differences in the type of experience and capacity that is required to carry out the variety of housing development activities eligible under the HOME program. Therefore, "experience in having completed similar projects" is different for development/management of rental housing and development/sale of housing for homebuyers.

  Example: The Cranberry Orchard Neighborhood Development Organization (CONDO) has successfully developed more than 100 units of housing for homebuyers by acquiring, rehabbing and re-selling existing single-family homes. CONDO plans to use a similar stock of single-family homes for a scattered-site, 30-unit rental housing development, which it will own and manage. This is CONDO's first experience in rental housing development. To demonstrate key staff capacity to carry out the
HOME-assisted activity they are proposing, CONDO will retain a consultant, who will develop a training plan. During development of CONDO’s first rental housing project, the consultant will also assist CONDO’s key staff on development issues specifically related to rental housing.

♦ Because the purpose of the CHDO capacity requirement is to build staff expertise, CHDOs must have their own professional staffs. This means that the key staff required to demonstrate CHDO capacity cannot be:

- Municipal, county or state employees; or
- Consultants (paid or volunteer) not planning to train for the CHDO’s key staff.

♦ Financial standards: CHDOs must have financial accountability standards that conform to 24 CFR 84.21, "Standards for Financial Management Systems."

ELIGIBLE USES OF HOME FUNDS BY CHDOs

♦ With PJ approval, CHDOs may use HOME funds for all eligible HOME activities. However, only certain types of activities count toward the minimum 15 percent set-aside.

- Eligible: Eligible set-aside activities include the following when carried out by a CHDO acting as an owner, sponsor or developer:
  - Acquisition and/or rehabilitation of rental housing;
  - New construction of rental housing;
  - Acquisition and/or rehabilitation of homebuyer properties;
  - New construction of homebuyer properties; and
  - Direct financial assistance to purchasers of HOME-assisted housing sponsored or developed by a CHDO with HOME funds.
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- **Ineligible**: The following activities are ineligible set-aside activities, but may be carried out by the CHDO as a subrecipient:
  - Tenant-based rental assistance (TBRA);
  - Homeowner rehabilitation; and
  - Brokering or other real estate transaction.

**CHDO SET-ASIDE ROLES: OWNER, DEVELOPER AND SPONSOR**

- CHDO set-aside funds may be used by CHDOs for those HOME activities where the CHDO acts as the developer, sponsor and/or owner of the housing.

- **Owner**: The CHDO is an “owner” when it holds valid legal title to or has a long-term (99-year minimum) leasehold interest in a rental property. The CHDO may be an owner with one or more individuals, corporations, partnerships or other legal entities.

  *Example*: A CHDO owns a property and contracts with another entity (for-profit or nonprofit) to act as a developer, and to construct new/ rehabilitate existing building(s). After completion of the development, the CHDO will maintain ownership of the property.

  - While the CHDO may be solely the owner, with another entity acting as a developer, it may also be the **owner and developer** of its own project.

  - The CHDO may own a property in partnership with either a majority or minority interest. However, the CHDO -- in partnership with a wholly owned for-profit or nonprofit subsidiary -- must be the managing general partner with effective control (in decision-making authority) of the project.

- **Developer**: A CHDO is a “developer” when it either owns a property and develops a project, or has a contractual obligation to a property owner to develop a project.

  - If the CHDO owns the property, it must obtain financing and rehabilitate or construct the project.

    - *For HOME-assisted rental housing*: At project completion, the CHDO may maintain ownership and manage the project over the long-term, or it may
transfer the project to another entity for long-term ownership and management.

- For HOME-assisted homebuyer project: The CHDO transfers title of the property and the HOME obligations to an eligible homebuyer within a specified timeframe of project completion.

- If the CHDO does not own the property, it must be under a contractual obligation with the owner to obtain financing and rehabilitate or construct the project. Under this scenario, the CHDO assumes all of the risks and rewards associated with being the project developer. A written agreement between the CHDO and the property owner must detail the CHDO’s specific obligations.

- For HOME-assisted rental housing: The CHDO may, at project completion, manage the project for the owner.

- For homebuyer housing: The owner must transfer title of the property and the HOME obligations to eligible homebuyers within a specified timeframe of project completion.

- If the CHDO develops the property for an owner pursuant to a written or other agreement with the PJ, the CHDO is acting in the capacity of a subrecipient.

♦ Sponsor: A CHDO is a “sponsor” for HOME-assisted rental or homebuyer housing according to the circumstances outlined below.

- For HOME-assisted rental housing: The CHDO develops a project that it solely or partially owns and agrees to convey ownership to a second nonprofit organization at a predetermined time. The conveyance may take place prior to, during or upon completion of the development phase.

  - The HOME funds are invested in the project owned by the CHDO sponsor.
  
  - The CHDO sponsor identifies the particular nonprofit organization that will obtain ownership of the property prior to commitment of HOME funds.

  - The other nonprofit will assume from the CHDO at a specified time all HOME obligations (including repayment of loans and tenant and rent requirements) for the project. If the property is not transferred to the nonprofit organization, the CHDO sponsor will remain liable for the HOME obligations.
The other nonprofit organization must be **financially and legally separate** from the CHDO sponsor. (The second nonprofit may have been created by the CHDO; nevertheless, it is a separate entity from the CHDO.)

The CHDO sponsor must provide sufficient resources to the nonprofit organization to ensure the completion of development and long-term operation of the project.

**Example:** A CHDO enters into a legally binding agreement with ElderCare, an existing nonprofit organization experienced in providing enhanced housing services for the elderly. The CHDO agrees to purchase and rehabilitate a vacant 50-unit property and convey the property to ElderCare upon completion of the construction phase. ElderCare will assume responsibility for the long-term management of the project, and for the fulfillment of all obligations and requirements associated with the use of the HOME funds.

For a HOME-assisted homebuyer’s program: The CHDO owns a property, then shifts responsibility for the project to another nonprofit at some specified time in the development process. The second nonprofit in turn transfers title, along with the HOME loan/grant obligations and resale requirements, to a HOME-qualified homebuyer within a specified timeframe.

- The HOME funds are invested in the property owned by the CHDO.

- The other nonprofit being sponsored by the CHDO acquires the completed units, or brings to completion the rehabilitation or construction of the property.

- At completion of the rehabilitation or construction, the sponsored nonprofit is required to sell (transfer) to a homebuyer the property, along with the HOME loan/grant obligations.

- This sponsorship role could include a lease-purchase approach (for a period not to exceed three years) whereby the sponsored nonprofit would lease the property to a homebuyer for a period not to exceed two years. At the expiration of the lease, the sponsored nonprofits must sell or transfer the property, along with the HOME loan/grant obligations, to the homebuyer. If the property is not
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transferred, the sponsored nonprofit retains ownership, and all HOME rental requirements will apply.

- The CHDO must always own the property prior to the development phase of the project.
- The Final Rule makes direct homeownership assistance to a homebuyer eligible for the set-aside, provided the assistance is used toward the purchase of a residence owned, developed or sponsored by a CHDO using HOME assistance.

♦ Similar roles: The developer and sponsor roles are similar in many ways.

- In both the developer and sponsor roles, the CHDO carries out some or all of the principal project development activities -- such as acquisition, financing, construction management and putting together a capable development team -- to bring a project from conception to completion.
- However, as developer, the CHDO need not own the property.
- As sponsor, the CHDO must own the property and shift the responsibility from the CHDO to another specific nonprofit at some specified time in the development process. Transfer could occur, for example, at:
  - Initiation of the construction,
  - Completion of the construction, or
  - Issuance of the certificate of occupancy.
- The HOME long-term affordability requirements for the project are the responsibility of the owner or subsequent owners of the property.

CHDOs vs. Subrecipients

♦ A community-based nonprofit organization may meet all of the regulatory requirements to be designated as a CHDO. However, in order for CHDO activities to count toward the CHDO set-aside, the CHDO must be the developer, sponsor and/or owner of the HOME-assisted housing.

Homeowners Cannot “Hire” a CHDO
An existing homeowner cannot "hire" a CHDO developer or sponsor to complete the rehabilitation (for example, select the contractor, construction management, etc.) of his/her residence.
CHDO as subrecipient: CHDOs may play the role of a "subrecipient" undertaking all other HOME-eligible activities, even if these activities do not count toward the CHDO set-aside.

Example: A CDBG-funded youth job corps managed by a CHDO provides construction assistance work on HOME-assisted projects in a single-family rehabilitation program. This is not a set-aside activity.

- Being a HOME "subrecipient" is not the same as being a CDBG subrecipient.
  - A HOME subrecipient is an entity selected by the PJ to administer aspects of a HOME program (that is, screen projects, market activities, review and certify tenant income, counsel potential homebuyers) or an entire HOME activity (that is, manage a TBRA program or review requests for HOME funds for the rental housing production set-aside).
  - Unlike CDBG, an entity that receives an investment of HOME funds for an eligible HOME project only is not considered a HOME subrecipient.

- Restrictions: When a CHDO is acting in the capacity of a HOME subrecipient, it may not also receive HOME funds to develop, sponsor or own housing funded through the subrecipient activity the CHDO administers. Doing so would constitute a conflict-of-interest for the CHDO.

Example: Homeville has selected a qualified CHDO, Housing Now, to administer its $570,000 rental production set-aside program. As per the terms of their HOME subrecipient agreement, Housing Now will have responsibility for reviewing proposals submitted for rental production set-aside loans and grants, and making funding recommendations to Homeville. Housing Now may not serve as developer, sponsor or owner for any of the rental production set-aside monies it is involved in administering.

Example: The Tri-County Consortium has selected a qualified CHDO, Adams County Housing Endeavors (ACHE), to administer its HOME program in areas of the Consortium outside of Adams County. Under the terms of their HOME subrecipient agreement, ACHE will solicit and review all proposals for HOME grants and loans for the consortium’s homeownership and rental housing development activities. If adequate systems are in place to ensure that ACHE will not have influence over HOME
funding decisions by the Consortium for projects in Adams County, ACHE may develop, sponsor or own HOME-assisted affordable housing within Adams County.

SPECIAL ASSISTANCE TO CHDOs

♦ The PJ may use HOME funds to provide special assistance to CHDOs. This assistance includes:
  ➢ Project pre-development loans;
  ➢ Operating assistance;
  ➢ Use of HOME project proceeds; and
  ➢ Capacity-building assistance.

♦ In contrast to the 15 percent set-aside, which is mandated, a PJ has total discretion over whether to provide these special forms of assistance.

♦ CHDOs in dual roles: A CHDO that is also functioning as a subrecipient or contractor is eligible to receive funding for administrative expenses (subject to the 10 percent cap) for project delivery costs related to non-set-aside activities.

Project Pre-development Loans

♦ A portion of CHDO set-aside funds may be provided to CHDOs for project-specific pre-development assistance.
  ➢ The project specific pre-development assistance is intended to assure that CHDOs have access to funds for up-front, eligible project expenditures. This assistance provides a form of project feasibility "line of credit" that many nonprofit developers need, but often have difficulty obtaining from private sources.
  ➢ All costs must be related to a specific project which, if deemed feasible, would receive HOME funds for development.
  ➢ Project pre-development costs may not exceed customary and reasonable project preparation costs.

♦ Types of pre-development assistance: The two primary types of project pre-development assistance include:
  ➢ Technical assistance and site control loans, and
  ➢ Seed money loans.

Exhibit 3-1 compares the two types of loans.
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EXHIBIT 3-1
PRE-DEVELOPMENT LOANS

<table>
<thead>
<tr>
<th>TA and Site Control Loans</th>
<th>Seed Money Loans</th>
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<tbody>
<tr>
<td><strong>Purpose</strong></td>
<td>Establish preliminary feasibility of a specific project.</td>
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<tr>
<td><strong>Timing</strong></td>
<td>Used prior to gaining site control.</td>
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</table>
| **Uses**                 | Limited to:  
  • Initial feasibility study  
  • Consulting fees  
  • Cost of preliminary financial application  
  • Fees: architects, legal, engineers, development team  
  • Site control expenses  
  • Title clearance costs | Preconstruction costs, including but not limited to:  
  • Cost of construction loan commitments  
  • Architectural plans and specifications  
  • Costs of zoning approvals  
  • Costs of engineering studies  
  • Legal fees |
| **Loan Terms**           | None specified by HOME. | None specified by HOME. |
| **Repayment**            | Repaid from construction loan or other project income. May be waived if there are impediments to project development or if it is deemed infeasible. | Repaid from construction loan or other project income. May be waived if there are impediments to project development or if it is deemed infeasible. |
| **Environmental Clearance** | Do not require environmental clearance prior to expenditure of funds. | Requires environmental clearance prior to commitment of funds. |

NOTES

♦ Allowable percentage: The total of HOME funds used for CHDO project pre-development assistance may not exceed 10 percent of the total amount of HOME funds reserved for CHDOs by the PJ in any given grant year for CHDO set-aside eligible activities.

➢ There is no requirement that project pre-development assistance be limited to 10 percent of the HOME funds reserved for a particular project. The total of funds available to a PJ for project-specific loans may be distributed at the PJ's discretion among eligible CHDO projects.

Example: New Home City has designated 40 percent of its $1 million HOME allocation to five CHDOs for set-aside eligible projects. The PJ can determine if and how it will make its project-specific pre-development loans to the five CHDOs it has designated, provided that the total amount of the loans does not exceed 10 percent of its CHDO designation of $400,000, or $40,000. The PJ may make a single project-specific loan to one CHDO for any amount up to $40,000. Or, it may choose to divide the total amount available among all of the CHDOs it has designated.
♦ The loan: Project pre-development assistance may only be provided to CHDOs in the form of a loan. A loan may be structured as an amortizing or non-amortizing loan. CHDOs must repay pre-development loans to the PJ from construction loan proceeds or other project income or the loan may be incorporated into additional project financing.

- The PJ may waive repayment of the loan, in whole or in part, if there are impediments to project development that the PJ believes are reasonably beyond the control of the CHDO, or if the project is deemed to be infeasible.

- The CHDO should request and the PJ should approve project pre-development assistance only where there is a reasonable expectation that the project will prove feasible.

♦ Triggering the match: HOME funds used for project pre-development loans, like any other use of HOME funds, trigger the match requirements of the HOME program. However, match liability incurred for funds expended for pre-development loans is forgiven if the project does not proceed. (See Chapter 8: Match.)

Operating Expenses

♦ Up to five percent of a PJ's HOME allocation may be used to provide general operating assistance to CHDOs that are receiving set-aside funds for an activity (or activities) or are under a written agreement to receive set-aside funds within 24 months of the date of the agreement. Operating expenses are not an eligible cost for CHDO set-aside funds.

♦ Limitations: Assistance for operating expenses in each fiscal year may not exceed $50,000, or 50 percent of the CHDO's total annual operating expenses for that year, whichever is greater.
Funds awarded to the CHDO by the PJ for operating expenses (under 24 CFR Part 92.208), funds provided to the CHDO by HUD through intermediaries for organizational support and housing education (under 24 CFR Part 92.302), and capacity-building funds committed to the CHDO in first 24 months of PJ participation in the program count toward the $50,000/50 percent cap (under 24 CFR 92.300(b)).

The Final Rule provides that administrative funds awarded to a CHDO as a subrecipient do not count toward the $50,000/50 percent cap.

Eligible uses: Operating expenses are reasonable and necessary costs for the operation of the CHDO, including:

- Salaries, wages, benefits and other employee compensation;
- Employee education, training and travel;
- Rent and utilities;
- Communication costs;
- Taxes and insurance; and
- Equipment, materials and supplies.

Project Proceeds

At the discretion of the PJ, a CHDO may be authorized to retain some or all of the proceeds generated from a CHDO development activity.

Proceeds would include interest on HOME loans or proceeds from permanent financing.

Such proceeds are not considered program income and are not subject to HOME Program requirements.

Example: Uptown, Inc., a qualified CHDO, develops a small subdivision of 35 single family homes for sale to low-income homebuyers. The PJ has provided the CHDO with HOME assistance totaling $350,000 for the construction of the units. The purchasers of the units obtain first mortgage financing from private lenders, which will repay the CHDO’s construction loans.
and other development debt. The PJ has determined, through an assessment of Uptown, Inc.'s track record and capacity, that Uptown, Inc. may retain any project proceeds for future low-income housing activities, which include a homebuyer counseling program and additional development of affordable homeownership housing. These specific activities are detailed in the written agreement between the PJ and Uptown, Inc.

♦ **Eligible uses:** The PJ determines how project proceeds may be used. Eligible uses include:

  - HOME-eligible activities, or
  - Other low-income housing activities, which may include operational support of the CHDO (assuming the CHDO continues to meet its mission of providing affordable housing).

♦ The PJ must stipulate in its written agreement with the CHDO whether the CHDO may retain project proceeds or whether proceeds must be returned to the PJ.

  - Where the PJ has permitted the CHDO to retain project proceeds, the written agreement must specify how the proceeds will be used.
  - PJs may want to include a reversion of assets clause in the written agreement; however, this is not required.

♦ **Flexible policy:** The PJ may have a flexible policy on the use of proceeds that differs from CHDO to CHDO, or even from project to project.

*Example:* The Smith County PJ works with six CHDOs. Four of them are small developers who have difficulty covering pre-development costs. Smith County decides to permit each of these CHDOs to retain project proceeds. The People for Progress CHDO is a multi-county developer with a substantial portfolio and a multi-million dollar operating budget. Smith County decides to require People for Progress to return project proceeds to the County, where the proceeds will be treated as program income.

The Elm Street CHDO has developed two projects for which Smith County has permitted it to retain project proceeds. Elm Street explains to Smith County that Elm Street's third project will complete its development agenda for its service area. Smith County decides to require the return of proceeds from Project Three.
Further guidance on CHDO project proceeds is provided in HUD Notice CPD 97-11 and 97-09 (both in the Appendix).

**Capacity-Building Assistance**

♦ PJs are required to make reasonable efforts to identify CHDOs that are capable, or can reasonably be expected to become capable, of carrying out CHDO set-aside activities.

♦ New PJs (that is, PJs still within the first 24 months of participation in the HOME Program) that cannot identify a sufficient number of capable CHDOs may commit a limited amount of HOME funds for capacity-building assistance.

➢ The maximum that can be used for capacity-building assistance is 20 percent of the minimum 15 percent set-aside, but no more than $150,000 during the 24-month period.

➢ Capacity-building funds can be used in various ways:

  - The PJ may contract with an intermediary organization or other entity to provide technical assistance to the CHDO;
  - The PJ may provide funds directly to the CHDO to obtain training and/or technical assistance; or
  - The PJ may pay the costs of CHDO operating expenses, including staffing.

♦ PJs must commit capacity-building funds within 24 months from the date of HUD execution of the HOME Investment Partnership Agreement. If set-aside funds are not committed to capacity-building assistance within the 24-month period, they must be committed to CHDO projects to avoid being recaptured.
SELECTING CHDOs

♦ Three steps: There are three steps to finding and qualifying the right organizations to become CHDOs.

➢ Step 1: **Identify** the existing nonprofits in the community.

➢ Step 2: Determine whether the nonprofits are **eligible** based on HUD criteria.

➢ Step 3: Assess whether the nonprofits are **capable** of performing desired CHDO activities.

♦ The steps are discussed below.

**Step 1: Identify Potential CHDOs**

♦ To start the process of identifying and qualifying CHDOs, the PJ may want to do a number of things.

➢ Invite community development corporations (CDCs) and other nonprofits to an information session about the HOME program and CHDO provisions.

➢ Promote the benefits of CHDO designation, including:
  ✓ Availability of a specific HOME set-aside for affordable housing activities, and
  ✓ Use of HOME funds for operating expenses and pre-development costs.

➢ Meet individually with groups likely to be designated as CHDOs, or that the PJ will work with to obtain CHDO designation.

♦ A list of the different types of organizations to contact regarding potential CHDOs is provided as Exhibit 3-2.
EXHIBIT 3-2
POTENTIAL CHDO CONTACTS

- Existing CDBG subrecipients
- Lending institution referrals
- State housing finance agency referrals
- State community development agencies
- Community foundations/philanthropies
- United Way and other community fund drives
- Corporate foundations
- National housing intermediary organizations, such as:
  - Neighborhood Reinvestment Corporation
  - Local Initiatives Support Corporation
  - Enterprise Foundation
- National nonprofit associations, such as:
  - National Congress for Community Economic Development
  - National Association of Community Action Agencies
  - Housing Assistance Council
- State-wide and local nonprofit agencies and service providers
- National and local nonprofit advocacy organizations
- Community land trusts

Step 2: Determine Eligibility

- Once the CHDO candidates are identified, the PJ must determine whether organizations meet the CHDO qualifications outlined in the HOME regulations. (The eligibility criteria were discussed in Part 1 of this chapter.)

- The CHDO checklist from HUD Notice CPD 97-11 is a useful aid in determining eligibility. This notice is included in the Appendix.

Step 3: Assess CHDO Capability

- Once an organization has been determined eligible as a CHDO, the PJ must ascertain whether the CHDO is actually capable of carrying out the responsibilities of a CHDO.

- Assessing capacity: There are a number of questions to ask when assessing an organization’s capacity. Asking these questions will help PJs determine which organizations are qualified and capable of carrying out CHDO-eligible activities, and which ones need to make changes or build capacity to quality.
CHAPTER 3: CHDO REQUIREMENTS AND ACTIVITIES

NOTES

- **Organizational issues:**
  - What is the primary business of the organization?
  - Does the firm have a mission statement?
  - What is the composition of the board?
  - What is relationship of the board to the staff?
  - How long has the organization been in operation?
  - How have the services or programs changed since the organization began?
  - Is there a current business plan?

- **Experience and capacity:**
  - Has the nonprofit produced successful affordable housing projects?
  - What is the current status of projects funded in previous years?
  - Are affordable past rental projects still occupied by lower-income tenants? If not, why?
  - Are the past projects well-maintained?
  - Are tenants pleased with the project development and management?

- **Finance and accounting standards and procedures:**
  - What is the current annual operating budget? How about the last three years?
  - Operating funds come from what sources?
  - Are these funding sources likely to continue?
  - Is the CHDO audited by a certified public accountant as evidenced by audit reports?
  - Is the organization financially solvent?
  - Who maintains the organization's accounting records?
  - Are financial records maintained manually or is computer software used?
  - Does the organization have insurance?
CHAPTER 3: CHDO REQUIREMENTS AND ACTIVITIES

- Staffing issues:
  - Who is the director? What are his/her experience and capabilities?
  - How many staff are there?
  - Who are the staff members? What experience and capabilities do they have?
  - What is the organizational structure?
  - Is there much staff turnover?
  - Does the organization have staff training and evaluation procedures in place?

BUILDING CHDO ELIGIBILITY AND CAPACITY

♦ Based on the results of a PJ’s search for qualified organizations and assessment of capacity and experience, the PJ may need to help particular nonprofits become eligible as CHDOs or develop greater capacity to carry out CHDO-eligible activities.

♦ Why PJs should invest in capacity-building: There are many good reasons for PJs to invest in building CHDO eligibility and capacity. For example:
  - CHDOs can help PJs spend HOME funds. PJs are required to set-aside 15 percent of each annual HOME allocation for affordable housing development by CHDOs.
  - CHDOs can bring to a PJ’s HOME program an understanding of and commitment to low-income communities.
  - As community-based nonprofit developers, CHDOs can draw on a wide array of resources from the community -- private, philanthropic, volunteer and public sector sources for affordable housing development.
  - CHDOs are accountable to the communities they serve and to the residents of the housing they develop.
  - Because they are community-based, CHDO are accessible property owners who can be reached when problems arise.
  - Community needs change over time, and community-based organizations are better able to adapt their programs to those changing needs.
CHDO REQUIREMENTS AND ACTIVITIES

CHDOs can and do engage in a wide range of community-building, support services and economic development activities to rebuild their communities.

Building Eligibility

The following table specifies critical eligibility issues that may have to be addressed in order to qualify a nonprofit organization as a CHDO:

<table>
<thead>
<tr>
<th>CHDO ELIGIBILITY CONSIDERATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Does the organization have:</strong></td>
</tr>
<tr>
<td>♦ 501 (c)(3) or (4) status?</td>
</tr>
<tr>
<td>♦ at least 1/3 low-income board representation; no more than 1/3 public officials?</td>
</tr>
<tr>
<td>♦ if a spin-off of a for-profit, no more than 1/3 from the sponsoring business?</td>
</tr>
<tr>
<td>♦ at least one year's experience serving the community?</td>
</tr>
<tr>
<td>♦ Commitment to housing?</td>
</tr>
</tbody>
</table>
CHAPTER 3: CHDO REQUIREMENTS AND ACTIVITIES

Building Capacity

♦ Eligibility is only part of the story. CHDOs must also have capacity to undertake and complete projects within 12 months of the HOME project commitment.

♦ Existing CHDOs: Building improved capacity within existing CHDOs requires a variety of approaches. Examples may include:
  - **Good business planning**: Just like emerging for-profit enterprises, nonprofits must develop and follow a sound business plan.
  - **Sufficient capital**: Adequate capital to sustain the nonprofit’s housing efforts and operating needs is essential.
  - **Keen marketing/customer knowledge**: Nonprofit organizations, just like their for-profit counterparts, must know their markets and their customers.
  - **Technical expertise**: Good business planning, customer knowledge and sufficient operating capital allow the nonprofit to get to the development stage. But the nonprofit must still “deliver the goods.” This requires the appropriate skills and expertise.
  - **Strong leadership and staffing**: Ultimately, it is the people -- especially the leadership -- within the organization that make the difference.

♦ New CHDOs: There may also be a need to create new CHDOs to make use of the set-aside in future years. Creating new organizations to qualify as CHDOs makes sense where:
  - No CHDOs exist;
  - Potential groups don't want to get into bricks-and-mortar projects, which are the only types of projects eligible as CHDO activities; or
  - Qualified groups do not have sufficient capacity to make prudent use of the set-aside funds.

♦ **Starting a nonprofit**: PJs may want to start a nonprofit that will qualify as a CHDO.
  - This is an opportunity to create an organization structured especially to carry out HOME projects. However, as previously discussed, organizing a nonprofit is neither simple nor quick.
CHAPTER 3: CHDO REQUIREMENTS AND ACTIVITIES

NOTES

Coming up with the requisite one-year experience can be problematic. However, during the time it takes to process the nonprofit’s articles of incorporation and obtain an IRS ruling, the organization can begin to function in ways that count toward its service record.

BUILDING LONG-TERM RELATIONSHIPS WITH CHDOs

♦ **Multi-year approach:** There are several factors in the HOME program that make it necessary for PJs to take a multi-year approach to the design and development of their HOME programs, and particularly toward their relationships with CHDOs.

♦ These factors include:
  - The scale of funding involved;
  - The need to commit funds to projects within 24 months of a single-year’s allocation; and
  - The need to commit program income to HOME-eligible projects before new HOME funds can be committed.

♦ Given these factors, the PJ needs enough CHDO capacity to keep the production pipeline flowing. Since even the most experienced CHDOs may see all of their capacity consumed by their first HOME-funded project, additional CHDOs will have to be prepared for the years to come.

♦ **Building successful partnerships:** Building successful long-term partnerships between and among PJs and CHDOs requires:
  - Planning for anticipated future-year set-aside allocations;
  - Building the capacity of the system already in place;
  - Establishing a shared vision;

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**Notes of Caution**

PJs must carefully avoid controlling organizations they charter.

- Remember that PJs may not assign staff to a CHDO on either a full or part-time basis in order to fulfill the CHDO’s capacity requirements.
- CHDOs may not pay the PJ for any technical assistance and/or training the PJ provides.
CHAPTER 3: CHDO REQUIREMENTS AND ACTIVITIES

- Monitoring the performance of the partnership on an ongoing basis; and
- Creating a CHDO network within the community, and connecting it to a broader CHDO network operating nationwide.

Planning for future set-aside allocations: The appropriation of HOME funds and the establishment of the minimum CHDO set-aside are functions of Congress, and they cannot be programmed over a multi-year period. However, many communities develop general plans based on "best case/worst-case" assumptions.

- By combining a review of its Consolidated Plan with the anticipated levels of new HOME funding and program income, PJs can begin to develop a plan for future HOME and CHDO set-aside allocations.
- PJs will need to develop their own assumptions for best-case and worst-case HOME funding scenarios, to anticipate their levels of programmatic activities.
- More accurate forecasting can be made for program income derived from the repayment of HOME funds invested in HOME projects.

Building the capacity of the system: As stated above, PJs can do a great deal to help CHDOs build their capacity. However, PJs will often find that the need to build capacity exceeds their resources. For this reason, HUD provides technical assistance and training through consultants and national intermediaries.

- Training: HUD provides training on the provisions of the HOME program through a three-year contract with training consultants. This training will include topics of interest to CHDOs.
- Technical assistance: HUD also administers a technical assistance program geared toward CHDO capacity-building. Through contracts with national, regional, state and local nonprofit housing intermediary organizations, HUD provides assistance on:
  - Organizational support: to cover operational expenses, and expenses for training and legal, engineering and other forms of technical assistance that the CHDO staff, board or members may require;
NOTES

✓ **Housing education**: for CHDOs to provide or administer programs to educate, counsel, and/or organize tenants and homeowners eligible for HOME assistance;

✓ **Program-wide support**: technical assistance, training and continuing support for CHDOs to manage and conserve property developed with HOME assistance;

✓ **Benevolent loan funds**: technical assistance to increase local ability to attract private investment in benevolent (below-market) loan funds for affordable housing development;

✓ **Facilitating women in home-building profession**: technical assistance to businesses, unions and organizations involved in rehabilitation and construction of housing in low/moderate income areas to help women residing in these areas obtain jobs involving such activities;

✓ **Community development banks and credit unions**: technical assistance to help establish privately owned community financial institutions that can finance the development of affordable housing; and

✓ **Developing community land trusts**: funds to community land trusts for organizational support, technical assistance, education, training and continuing support, or to community organizations to establish a community land trust.

♦ **Establishing a shared vision**: To sustain a long-term, successful partnership, the PJ must have an understanding with each CHDO of their common goals and expectations. Some good steps to take:

- Identify areas of common interest.
- Establish shared goals.
- Define roles.
- Clarify expectations -- both short-term and long-term.

♦ **Monitoring partnership performance**: The process of reviewing and evaluating the performance of the partnership should be an ongoing one, particularly in the early years of the program. This process will help to identify strengths and weaknesses in CHDO operations, the design and implementation of the local HOME program, and the support
systems necessary for CHDOs to operate and for the HOME program to succeed.

- This information should be reviewed on an ongoing basis for the purposes of identifying what needs to be changed, and for securing the appropriate technical assistance and training needed to do so.

- The level, type and areas of need will vary from CHDO to CHDO, and, within CHDOs, from year to year. By evaluating the performance of CHDOs over time, technical assistance and capacity-building will be fluid processes that remain relevant to the needs of the HOME program.

- **Evaluation**: An evaluation of CHDO performance may include a review of the following factors:
  - Completion of funded projects,
  - Timeliness and ability to complete projects within established budget parameters,
  - Human resources,
  - Adequate financial resources,
  - Ability to leverage other resources,
  - Adequate financial systems,
  - Board operations,
  - Strategic plans,
  - Organizational work plans,
  - Record-keeping,
  - Compliance with HOME targeting requirements, and
  - Board composition and operations.

- **Creating a CHDO network**: Creating CHDO networks at the national, state and local levels can be a very effective vehicle for increasing the capacity of the CHDO housing production system.

- Establishing peer mentor relationships can be one of the most effective means for developing capacity.
In many cases, local experience proves to be the most valuable and least expensive to share. Creating a network or forum for CHDOs to interact on a regular basis may be the best way to facilitate this.

In the past, building such networks among nonprofits at local, state and national levels has helped assure that:

- Political support is maintained,
- More private resources are leveraged,
- Greater learning is shared, and
- The impact of individual activities is felt nationally.

**National level:** At the national level, many intermediaries and industry groups have developed their membership bases, and offer training opportunities and access to technical assistance for their member organizations. Typically, the information is shared through newsletters and publications, as well as through annual national and regional conferences that heavily emphasize information-sharing, networking and training.

**State level:** At the state level, similar associations and networks have been established to advocate state government support for affordable housing development. Often, these associations have been important allies of local governments seeking state support for their efforts.

**Local level:** At the local level, roundtables and brown-bag lunches are frequently held among housing advocates and providers, to keep one another informed of what they are doing and to identify areas of common concern for coordinated action.
ATTACHMENT 3-1

IRS NONPROFIT STATUS

♦ Section 501(c)(3) Status:

- This is the nonprofit status most sought by nonprofit housing development organizations, because contributions to an organization with 501(c)(3) status are an eligible tax deduction for the donor.

- 501(c)(3) organizations operate under the following restrictions:
  - Group must be organized for religious, charitable, scientific, literary, educational, testing for public safety, or prevention of cruelty to animals purposes.
  - None of the net earnings may benefit private individuals.
  - No substantial part of the activities may be devoted to lobbying (influencing legislation), and the organization may not participate in or intervene in political campaigns on behalf of candidates.
  - Group must be organized in its article of incorporation for charitable and/or educational purposes.

♦ 501(c)(4) Status:

- This tax exemption is for organizations operated exclusively for the promotion of social welfare.

- Like 501(c)(3) organizations, these organizations pay no tax on income, except for certain unrelated business activities.

- Unlike 501(c)(3) organizations, 501(c)(4) organizations:
  - May engage in substantial lobbying activities;
  - Have greater latitude to serve individuals who are not low-income or minority, as long as the activity serves the common good and general welfare; and
  - May not offer donors tax deductions for their contributions.

♦ Section 905 -- Subordinate Organization of a 501(c):

- This refers to the local member organizations (that are not separately incorporated) of an existing national organization with a 501(c) designation.

- If the local organization is a subordinate organization (for example, a chapter, local, post, or unit of a central organization), the central organization would need to receive a group 501(c) tax exemption designation.
• The local subordinate organization could be included under the central organization’s 501(c) designation if it is defined by the IRS as a public charity.

• The local subordinate would not be included under the central organization's 501(c) designation if it is defined by the IRS as a private foundation.

• The IRS would determine if the local subordinate is a public charity on the basis of the sources and uses of its funds and of other factors defined in Section 905 of the Code.

• In terms of the HOME program, a subordinate organization that is determined by the IRS to be a public charity is considered to have the required 501(c) status.

• The subordinate organization would still need to meet all of the other requirements for CHDOs. However, qualifying as a subordinate organization may be a way to shorten the time necessary to receive a CHDO designation. This is due to the fact that the subordinate organization may be able to receive the required tax-exempt status based upon the credentials of an existing group.