Creating an NSP-Eligible Rental Project

About this Tool

Description:

This resource is intended for grantees and their partners developing multifamily rental projects. It contains a general discussion of rental basics, relevant rules and regulations, definitions, and more. Topic areas covered include property size, the 25 percent set-aside requirement, the tradeoff between affordability and long-term viability, the minimum affordability period, eligible uses under NSP, mixed-income projects, and funding types.

Source of Document:

This document was adapted from various NSP guidance documents and technical assistance tools used in the field.

Disclaimer:

This document is not an official HUD document and has not been reviewed by HUD counsel. It is provided for informational purposes only. Any binding agreement should be reviewed by attorneys for the parties to the agreement and must conform to state and local laws.

This resource is part of the NSP Toolkits. Additional toolkit resources may be found at www.hud.gov/nspta

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In General

NSP permits a wide variety of eligible activities, but there are a series of NSP requirements that grantees must keep in mind when designing NSP rental programs, and that potential developers of rental projects need to keep in mind when designing a proposed rental project.

Who may develop Rental Properties with NSP Funds?

Rental properties may be developed by the NSP Grantee directly, or through individuals, non-profit organizations, or for-profit organizations.

Property Size

Rental strategies may be targeted for small rental properties (1-4 units) or for large rental properties (5 or more units).

In the Toolkit section of the NSP web site, the 1-4 unit properties are called “1-4 Unit Scattered Site Rental” and the larger properties are called “Multifamily Rental”. Notwithstanding this terminology in the Toolkits, grantees and potential sponsors should note that scattered site projects of more than 4 units can be funded under NSP.

The NSP 25% Set-aside Requirement for 50% AMI and Below

Grantees are required to expend 25% of their NSP funds for beneficiaries with household income at or below 50% of Area Median Income (“AMI”)[1]. In this document, we will refer to this requirement as the “LH25 Set-Aside” requirement (LH25 is the funding code for this set-aside in HUD’s grant management software). In many areas, it is difficult to provide homeownership solutions for households in this income range. Accordingly, many grantees decide to pursue rental strategies to help achieve compliance with this set-aside requirement.

Only those units that are restricted for occupancy by households with incomes at or below 50% AMI, and that have rents affordable at 50% AMI[2], will count toward the LH25 Set-Aside requirement.

[1] In this document, we will not use the terms “very low-income” or “low-income” because these terms are potentially confusing. HUD has generally directed that CDBG terminology be used for NSP. Under CDBG terminology, beneficiaries with incomes at 50% AMI or below are termed “low income” beneficiaries, whereas in many other programs, these same beneficiaries are termed “very low-income”. Accordingly, grantees and developers are advised to request clarification when the terms “very low-income” and “low-income” are used in NSP.

[2] That is, with rent and utilities not more than 30% of 50% AMI (adjusted for household size).

Grantees and potential developers should keep in mind that activity must take place on “foreclosed” or “abandoned” property in order to count toward fulfillment of the LH25 Set-Aside requirement.

Grantees and potential developers should keep in mind that only permanent housing units may count toward the LH25 Set-Aside requirement. Homeless shelters, transitional housing, and other projects that are classified as “facilities” under CDBG are not eligible to count toward the LH25 Set-Aside requirement.

The Trade-off Between Affordability and Long-Term Financial Viability

Grantees and potential developers should also keep in mind that the 50% AMI rent may not provide adequate revenue to support the long-term viability of the project. Accordingly, a grantee should not require that 100% of units be affordable at 50% AMI unless the grantee is certain that the 50% AMI rent is sufficient to support viable projects. Similarly, before deciding on the mix of affordability within a proposed project, a developer should first make sure that the proposed project will have sufficient revenue to be viable long-term.

Definitions

(From April 9, 2010 Federal Register[3]): Abandoned. A home or residential property is abandoned if either (a) mortgage, tribal leasehold, or tax payments are at least 90 days delinquent, or (b) a code enforcement inspection has determined that the property is not habitable and the owner has taken no corrective actions within 90 days of notification of the deficiencies, or (c) the property is subject to a court-ordered receivership or nuisance abatement related to abandonment pursuant to state, local or tribal law or otherwise meets a state definition of an abandoned home or residential property..

(From NSP Notice[4]): Blighted structure. A structure is blighted when it exhibits objectively determinable signs of deterioration sufficient to constitute a threat to human health, safety, and public welfare.

“Demolished” is not defined in the NSP Notice.

(From April 9, 2010 Federal Register): Foreclosed. A home or residential property has been foreclosed upon if any of the following conditions apply: (a) The property’s current delinquency status is at least 60 days delinquent under the Mortgage Bankers of America delinquency calculation and the owner has been notified of this delinquency, or (b) the property owner is 90 days or more delinquent on tax payments, or (c) under state, local, or tribal law, foreclosure proceedings have been initiated or completed, or d) foreclosure proceedings have been completed and title has been transferred to an intermediary aggregator or servicer that is not an NSP grantee, contractor, subrecipient, developer, or end user

[3] HUD published revised definitions for “Abandoned” and “Foreclosed” under NSP, in the April 9, 2010 Federal Register.

[4] In this paper, references to the “NSP Notice” refer to the Federal Register notice dated October 6, 2008. Section II.A of the NSP Notice contains definitions.

"Vacant" is not defined in the NSP Notice. However, HUD posted the following FAQ that provides useful guidance. "Q: Is vacant, undeveloped land eligible to be redeveloped under Eligible Use E?
A: In order for a property to be "redeveloped" under Eligible Use E, it must have been previously developed and is now vacant. Raw land would not be eligible for redevelopment. It will be up to the grantee to demonstrate that the property had been previously developed. Previous redevelopment could include vacant buildings or infrastructure improvements such as roads, water, sewer, power lines, etc. However, land that has been farmland, open space, wilderness, etc. would not be eligible for redevelopment. The Department has not imposed any specific standard on how long a property has to be vacant in order to qualify for redevelopment under Eligible Use E; grantees should exercise reasonable judgment in this area. A property that had once been a factory and has been idle for 20 years is not going to raise any issue. However, reasonable minds might question using NSP1 funds to redevelop a site where the previous development was demolished 100 years ago and the property has lain fallow ever since."

NSP Requirements Regarding "Affordable Rents" and Minimum Affordability Period

Grantees have flexibility in defining these provisions of their NSP Action Plans. Accordingly, potential developers of rental properties should become familiar with the Grantee's NSP Action Plan to be in compliance with these requirements. The Grantee's NSP Action Plan will include requirements for Affordable Rents for units targeted at 50%-80% AMI and for units targeted at 80%-120% AMI.

A Note Regarding Eligible Property Types

The discussion immediately below (NSP Eligible Uses) refers to NSP definitions of "foreclosed", "abandoned", "demolished" and "vacant" properties. For an extended discussion of these definitions, see the Definitions section above.

NSP Eligible Uses

There are five Eligible Uses of NSP funds. Eligible Uses can be combined within a single project.

Rental project development can take place under three of these five Eligible Uses (the examples below are for multifamily rental projects, but the same principles are applicable to small rental projects):

- Eligible Use A (financing mechanisms) – for example, the NSP Grantee could make a soft loan to the purchaser of an existing, foreclosed, multifamily rental project, with or without out rehab.
    - NSP funds must be provided as a loan, and may never be provided as a grant.
    - Grantees and potential developers should note that Eligible Use A is restricted to properties that are "foreclosed".
    - The timing of the site acquisition will be important.[5]

[5] The two most important timing considerations are: (a) the property cannot be acquired until the grantee has completed the environmental review process; and (b) the property must be acquired in a manner that satisfies the

- Eligible Use B (purchase and rehabilitation) – for example, The NSP Grantee could make a soft loan to the purchaser of an existing, foreclosed, multifamily rental project, with rehab.
    - Grantees and potential developers should note that Eligible Use B is restricted to properties that are "foreclosed" or "abandoned".
    - Eligible Use B can fund rehab only (without funding the cost to acquire the underlying properties), but the underlying properties still must be "foreclosed" or "abandoned", with the same timing restrictions as those noted above under Eligible Use A.
    - Eligible Use B can fund demolition and reconstruction as well as traditional rehab. Both activities count as "rehab" for NSP purposes.
    - While an abandoned property may hypothetically be purchased directly from the existing owner(s) before foreclosure is completed, it is a difficult, time-consuming, and probably impractical approach to purchasing existing properties.

- Eligible Use E (redevelopment) – for example, an NSP Grantee could make a soft loan to the purchaser of several scattered sites on which residential structures have already been demolished, for the new construction of a 28 unit rental project.
    - Grantees and potential developers should note that Eligible Use E is restricted to properties that are "demolished" or "vacant".
    - Grantees and potential developers should note that never-developed sites on the fringe of development ("Greenfield" sites) are not eligible for NSP funding.
    - HUD's definition of "previously developed" includes properties where infrastructure may exist, even though no physical structure has been on prior to the redevelopment, so infill lots in which infrastructure exists could be eligible for redevelopment under this provision.
    - Demolition funding cannot be provided under Eligible Use E. If a grantee wishes to provide NSP funding for demolition in connection with a multifamily rental project, the grantee would have to provide that funding under Eligible Use B (purchase and rehab) or Eligible Use D (demolition).

NSP and Mixed-Income Projects

Under current guidance (June 2010), NSP funds are restricted for use on projects that consist entirely of NSP-eligible units.[6] NSP-eligible units must be restricted to occupancy by households with incomes no higher than 120% AMI. Under current guidance, a typical mixed income project (with 60% market rate units and 40% affordable units) would not be eligible for NSP funding. However, if the sponsor agreed to a restriction that the higher-rent units are available only to households at or below 120% AMI, and

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requirements of the NSP definition of "foreclosed" (grantees should maintain documentation showing how the acquisition of each foreclosed property satisfied these definitional requirements).

[6] Note: This requirement is expected to change through a technical correction in the NSP3 Notice.

that the rent would be affordable at 120% AMI, the entire project would be eligible for NSP funding. For example:

- In a 40 unit project with 24 market rate units and 16 units restricted at 50% AMI, the project would not be eligible for NSP funding.
- In a 40 unit project with 24 units restricted at 120% AMI and 16 units restricted at 50% AMI, all 40 units would be eligible for NSP funding, but only the NSP funds associated with the 16 50% AMI units could count toward satisfaction of the grantee's LH25 Set-Aside requirement.

Types of Funding to Support Rental Projects

Grantees are reminded that (in the "Bridge Notice" published in the June 19, 2009 Federal Register) HUD provided that "...grantees are strongly encouraged to avoid the undue enrichment of entities that are not subrecipients. For example, grantees are encouraged to structure assistance to developers that undertake acquisition and/or rehabilitation as loans rather than grants".

Most Grantees will likely provide NSP funds to rental project in the form of a soft loan. A recommended practice for issuing soft loans is to require repayment from any sales or refinancing proceeds (at any point during the affordability period) and to structure the loans so as to share in any excess cash flow.

If a particular project appears likely to have significant cash flow, the grantee might choose to provide some funding in the form of a "hard loan" (with fixed monthly payments) and to provide the balance in the form of a soft loan.

NSP does not have any requirements concerning the interest rate for a loan; accordingly, a grantee could choose to make loans at a market rate of interest or at a below-market rate of interest.