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Prince George's County Department of Housing and Community Development

HOME Investment Partnerships Program Underwriting and Subsidy Layering Guidelines

Policy and Procedures Manual

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HOME Investment Partnerships Program (HOME) Underwriting and Subsidy Layering Guidelines

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I. PURPOSE

The purpose of this document is to articulate the Prince George's County's Department of Housing and Community Development (DHCD) underwriting and subsidy layering underwriting criteria for HOME Investment Partnerships Program (HOME) program established for the purpose of providing gap financing for affordable housing.

DHCD is required to develop and use guidelines to evaluate and ensure that the level of HOME investment does not exceed the amount necessary to provide quality affordable housing. DHCD's underwriting and subsidy layering analysis is predicated upon the U. S. Department of Housing and Urban Development's (HUD) guidance to HOME participating jurisdictions (PJs) in the development and implementation of written subsidy layering and underwriting guidelines in accordance with the HOME regulations at 24 CFR Part 92.

Further, the guidelines in this document align with the prevailing State of Maryland Department of Housing and Community Development, Community Development Administration's (CDA) Maryland Qualified Allocation Plan (QAP) and the Multifamily Rental Financing Program Guide.

The Prince George's County Department of Housing and Community Development has established the following set of Priorities to guide the award of competitive HOME Program funding:

- Located within one mile of the Blue Line transit Corridor
- Located within one mile of the Purple Line transit Corridor
- New construction and/or preservation of affordable housing within one mile of existing and planned Maryland Department of Transportation (MDOT) Metro Stations throughout the County.
- Conformance with housing priorities and guidance in the Prince George's County's 2035: Adopted General Plan; https://pgccouncil.us/DocumentCenter/View/3162/Plan-2035-Approved-General-Plan-Book?bidId=
- Mixed-use, mixed-income affordable housing; and
- Affordable housing that includes sustainable design, energy efficiency and green design standards.

II. APPLICABILITY

The Department shall adhere to HUD's underwriting and subsidy layering requirements at 24 CFR § 92.250, which is applicable to projects for which HOME funds are committed.

This underwriting and subsidy layering guide shall apply to all rental projects developed in whole or in part with HOME assistance. This guide is not applicable to HOME-assisted projects which seek to develop and sell units to homebuyers, whether scattered site or within a designated subdivision or target area. For projects which are only partially funded by HOME funds, DHCD shall assess the financial viability of the entire project, not just the HOME-assisted units.

III. BACKGROUND

For purposes of the HOME Program, underwriting involves the analysis of project assumptions and risks to determine if the public investment is reasonable and the project can be expected to meet all applicable program requirements during the period of affordability. Subsidy layering is a component of project underwriting, which involves assessing whether the proposed level of HOME assistance is appropriate given the level of project investment by other financing sources. This underwriting policy covers the HOME underwriting requirements and the subsidy layering analysis, which forms the basis for the detailed evaluation of the prudent investment of HOME funds by the County.

A. STATUTORY, REGULATORY AND PROGRAM REQUIREMENTS

In accordance with Section 212(f) of the Cranston-Gonzalez National Affordable Housing Act of 1990 (NAHA), as amended, DHCD is required to certify that it will not invest any more HOME funds in combination with other governmental assistance than is necessary to provide quality affordable housing that is financially viable for the period of affordability required in §92.252 or §92.254.

The 2013 HOME Final Rule ("HOME Rule") establishes the requirements for underwriting guidelines to govern DHCD's policies regarding investment of HOME funds in all projects.

§92.250(b) requires DHCD to adopt and evaluate projects according to written underwriting and subsidy layering guidelines for all HOME activities to determine the appropriate HOME investment. These guidelines shall require the examination of project sources and uses, cost and profit reasonableness, market demand, Developer experience and capacity, and financial commitments.

- **Affirmative Furthering Fair Housing**: Prince George's County has a compelling interest in creating fair and open access to affordable housing and promoting compliance with state and federal civil rights obligations. Fair Housing requirements apply to the full spectrum of housing activities, including but not limited to, outreach and marketing, the qualification and selection of residents, and occupancy. As such, this Policy document confirms the County and DHCD's long-standing commitment to affirmatively furthering fair housing. The Developer must complete HUD Form 935: Affirmative Fair Housing Marketing Plan (Multifamily Housing) certifying how it intends to affirmatively further fair housing.

- **Compliance with Other Laws**

  - The Developer and all contractors or subcontractors shall comply with all State and local laws and all applicable Federal laws and regulations, including 24 CFR Part 92, which implements the HOME Program. This shall be a written condition of all contracts and subcontracts and in all solicitations and bid announcements.

  - Developer must carry out each activity in 24 CFR § 92.350 to 92.358, except that Developer does not assume the County's responsibility for environmental review under section 92.352, and the intergovernmental review process in section 92.357 does not apply.

  - Developer agrees to comply with the requirements of the Fair Housing Act (42U.S.C. 3601-20) and implementing regulations at 24 CFR Part 100; Executive Order 11063 (Equal Opportunity in Housing) and implementing regulations at 24 CFR Part 107; and the National Affordable Housing Act of 1990, as amended, 40 CFR 15.

  - Developer agrees that every contract for construction (rehabilitation or new construction) of housing that includes 12 or more units assisted with HOME funds shall be in compliance with the Davis Bacon Fair Labor Standards and Related Acts (40 USC 276(A)-7 and 24 CFR Part 70); the Contract Work Hours and Safety Standards Act, as amended (40 USC 3701 to 3708); the Copeland Anti- Kickback Act, 40 USC 276(c); and the Fair Labor Standards Act of 1938, as amended (29 USC 201, et seq.)

  - Developer agrees to comply with the requirements of Title VI of the Civil Rights Act of 1964 (42 U.S.C. 2000d) (Nondiscrimination in Federally Assisted Programs) and implementing regulations issued at 24 CFR Part 1.

  - Developer agrees to apply the prohibitions against discrimination on the basis of age under the Age Discrimination Act of 1975 (42 U.S.C. 6101-07) and implementing regulations at 24 CFR Part 146, and the prohibitions against discrimination against handicapped individuals under section 504 of the Rehabilitation Act of 1973 (29 U.S.C. 794) and implementing regulations at 24 CFR Part 8; and to comply with the Americans with Disabilities Act (42 USC 12131; 47 USC 155, 201, 218, and 225).

  - Developer agrees to comply with the requirements of 24 CFR 5.105(a) regarding equal opportunity as well as the requirements of Executive Order 11246 (Equal Employment Opportunity) and the implementing regulations issued at 41 CFR Chapter 60.

- Developer agrees that for funding covered by 24 CFR 75, the requirements of Section 3 of the Housing and Urban Development Act of 1968, (12 U.S.C. 1701u) which requires that economic opportunities generated by certain HUD financial assistance shall, to the greatest extent feasible, be given to low and very-low income persons and to businesses that provide economic opportunities for these persons. Developer agrees to comply with applicable County requirements, as established in the County's Section 3 Action Plan, including but not limited to evidence of participation of MBE/WBE business partners and submission of Section 3 Business Plans.

1. Requirements include:

   a. Prioritizing efforts to engage Section 3 workers by:
      - Offering employment and training opportunities to Section 3 workers; and
      - Making contract awards to contractors and subcontractors that provide economic opportunities for Section 3 workers.

   b. Meeting or exceeding the applicable Section 3 Benchmarks established by HUD and Prince George's County. Minimum performance requirements for all projects include:
      - Thirty-five percent (35%) of the total number of labor hours worked by all workers on a Section 3 project are Section 3 workers; and
      - Five percent (5%) of the total number of labor hours worked by all workers on a Section 3 project are Targeted Section 3 workers. This means that the five percent (5%) is included as part of the thirty-five percent (35%) threshold.

2. Prince George's County's Diversity and Equity Policy for Publicly Subsidized Development Projects Requirements include:

   The Developer must comply with the requirements and participation goals of the County's Diversity and Equity Policy for Publicly Subsidized Development Projects (the "Policy"). The Policy and associated requirements and goals are detailed in Section 10-335 of the Prince George's County Code (the "Code") and are as follows:

   a. At least thirty percent (30%) of the Development Costs for Construction (including the design, demolition/site work, and building stages) of the County-Subsidized Project shall be paid to County-Based Small Businesses (CBSB) and/or Locally-Owned and Operated Businesses (LOB), including at least twenty percent (20%) of design costs if applicable. In this Section, "design" includes architectural, engineering, and design work, excluding in-house design costs.
   b. Use Best Efforts to achieve at least twenty-five percent (25%) of the Development Costs for Construction (including the design, demolition/site work and building stages) of the County-Subsidized Project shall be paid to

County-Based Minority Business Enterprises. As a minimum, the Developer shall demonstrate its Best Efforts, as defined above, to meet this Goal.

c. The General Contractor Team for the Project shall include one or more businesses that are County-Based Minority Business Enterprises (CMBE) and/or Locally-Owned and Operated Businesses (LOB).
d. As applicable, the Construction services (including the design, demolition/site work, and building stages) for at least twenty-five percent (25%) of the total work hours on the Project shall be worked by County Residents, including at least twenty percent (20%) of the total work hours of workers in the specialty trades (defined as "specialty trade contractors" in the North American Industry Classification System (NAICS) being worked by County Residents.
e. The Code requires the approval of a Supplier Diversity and Equity Plan by the County.

▪ Developer agrees to comply with the requirements of Executive Order 11625 and 12432 (concerning Minority Business Enterprise), and 12138 (concerning Women's Business Enterprise). Consistent with HUD's responsibilities under these Orders, the Developer must make efforts to encourage the use of minority and women's business enterprises in connection with grant fund activities. See 24 CFR Part 85.36(e), which describes actions to be taken by the Developer to assure minority business enterprises and women's business enterprises are used when possible, in the procurement of property and services.

▪ Developer acknowledges and agrees that its project activities will be subject to the environmental review requirements as specified and required in the regulations issued by the Secretary of HUD pursuant to the multifamily Housing Property Disposition Reform Act of 1994 and published in 24 CFR Part 58.

▪ Developer agrees to insure that any person, business or non-profit organization displaced as a result of the acquisition of any property receives assistance in accordance with the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 at 49 CFR Part 24 (the "Uniform Relocation Act"). Developer agrees to indemnify the County, its agencies, and instrumentalities for any claims arising from or under the Uniform Relocation Act in connection with Developer's acquisition of property and development activities.

▪ Developer acknowledges and agrees that any project assisted with HOME funds shall be subject to the accessibility requirements under 504 of the Rehabilitation Act of 1973 (29 U.S.C. 794) and implementing regulations at 24 CFR Part 8, where applicable.

▪ Developer acknowledges and agrees that the Community Housing Development Organizations (CHDO) shall be subject to the restrictions on participation by ineligible, debarred or suspended persons or entities as described in Executive Order 12549 and at CFR 24 Part 5.105(c).

- Developer agrees to comply with the National Environmental Policy Act of 1969 Environmental (24 CFR Part 58); Section 202 of the Flood Disaster Protection Act of 1973 (42 USC 4106); and the Lead Based Paint Poisoning Act of 1971 (42 USC 4821 et seq.), (24 CFR Part 35).

B. RELATED DHCD HOME PROGRAM REQUIREMENTS

Additionally, DHCD shall evaluate other types of requirements which affect the underwriting of HOME-assisted projects, including, but not limited to:

- **Maximum and minimum per unit subsidy limits (§92.250)**: The amount of HOME funds that DHCD invests on a per-unit basis shall not exceed the per unit dollar limits for elevator-type projects that apply to the area in which the housing is located, as prescribed in CPD Notice 15-003 or successor notices, as periodically updated by HUD. These limits will vary by the number of bedrooms in a unit as published by HUD. The maximum subsidy limits apply to all HOME-assisted units. Under no circumstances may the level of per unit HOME investment exceed the maximum subsidy limits. As required under §92.205(c), DHCD shall impose a minimum subsidy of $1,000 per unit for the HOME Program.

- **Cost allocation (§92.205(d)):** The HOME Program permits the funding of one or more units in a project, including mixed-income and mixed-use properties, as prescribed in CPD Notice 16-15. However, HOME funds may only be used to pay eligible costs for HOME-assisted units. When DHCD designates fewer than 100% of a project's units as HOME-assisted, the County will calculate the eligible costs that are allocable to the assisted units and may only pay the actual costs related to those HOME-assisted units, capped by the maximum subsidy limits. Thus, cost allocation requirements affect project underwriting by dictating either the maximum amount of HOME investment or the minimum required number of units that must be designated as HOME-assisted.

- **Commitment (§92.2)**: DHCD shall not commit HOME funds to an identifiable project until all financial stakeholders in the development project execute a legally binding written agreement. DHCD will not commit funds to a project until all necessary financing is secured and evidenced in writing, the underwriting and subsidy layering has been completed, and construction can be expected to begin within 12 months. It is DHCD's policy to commit all HOME funds within 24 months of the grant award, as required (§92. 92.500(d)(1)(B)). At the Director's discretion, DHCD shall accept program applications on a rolling basis or issue a Notice of Funding Availability (NOFA).

- **Written agreements (§92.504)**: The County is required to execute a written agreement before disbursing HOME funds to any entity, including Developers and owners of rental new construction or rehabilitated housing. The written agreement must capture the project and financing terms that result from the underwriting process, including but not limited to the:

- Commitment and Program Agreement,
- Regulatory Agreement,
- Declaration of Covenants or Restrictive Covenants,
- Deed of Trust, Deed of Trust Note,
- Building Loan Agreement, and
- Payment in Lieu of Taxes Agreement (PILOT), as applicable per funding source.

- **HOME deadlines**: the following program deadlines may affect the underwriting process:

    - Acquisition/demolition (§92.2): DHCD will review the development and marketing plan submitted by the applicant to ensure that any acquisition of standard housing will occur within six months of the contract or purchase agreement date, and construction, or demolition of the property is scheduled or reasonably can be expected to start within 12 months of the agreement date.

    - Project completion (§92.205(e)(2), §92.2): All HOME funded projects must be completed within four years of the date funds are committed to the project.

    - Lease-up (§92.252): If a HOME-assisted rental unit is not occupied by an eligible tenant within six months following project completion, DHCD shall report status and marketing efforts to HUD. If the unit remains unoccupied at 18 months after the project completion date, DHCD, as required by HUD shall repay the HOME funds. Thus, DHCD shall carefully assess the market study and the project plan to ensure that there is documentation of sufficient demand for the proposed units.

- **Property standards (§92.251):** all properties assisted with HOME funds are subject to minimum property standards at project completion, as required by federal, state, and local building regulations and codes. In addition, rental projects are subject to property standards throughout the affordability period. When reviewing a budget as part of the project underwriting, DHCD will ensure that all costs are eligible and the resulting housing units will meet the established property standards. A capital needs assessment is required for rehabilitation projects that consist of 26 or more total units, as applicable in §92.251(b)(1)(ix)). The capital needs assessment shall be compiled by a qualified third-party.

- **Rents/utility allowance (§92.252(a))**: All projects shall comply with HUD published maximum rents that may be charged in HOME-assisted units, depending on the number of bedrooms and project location which may include either actual utilities or a utility allowance. The underwriting process shall cap HOME-assisted units at these rent limits and demonstrate that the project will be financially viable on this basis. DHCD requires the Developer of all HOME-assisted units to submit justification for utility allowances in accordance with HUD's Notice H 2015-04 (June 22, 2015) which establishes a required methodology for calculating utility allowances.

- **Affordability period (§92.252(e)):** All HOME-assisted rental projects are subject to an affordability period, depending on the type and amount of investment. DHCD requires the minimum affordability period to be fifteen (15) years for rehabilitation and twenty (20) years for new construction. As a part of the underwriting process for rental projects, DHCD shall ensure that projects remain financially viable and the assisted units will meet the property standards and affordability requirements for not less than the applicable affordability period, beginning at project completion. The affordability period may vary based on the program of the senior lender, for example: a Tax Credit program.

- **Interest Rate Limits**: At the discretion of the Director, financial assistance in the form of HOME funds provided for eligible projects may be in the form of an amortized loan bearing an interest rate of the lesser of two percent (2%) or the published Applicable Federal Rate (AFR) during the permanent loan period. The interest rate during the construction loan period may be zero percent (0%).

- **Lien Position**: Loans provided with HOME funds will assume a lien position below the primary lender.

IV. OVERVIEW: UNDERWRITING POLICIES AND PROCEDURES

As stated above, under the provisions of §92.250(b) of the HOME Rule and applicable Prince George's County DHCD procedures, DHCD shall not invest any more HOME funds than is necessary to provide quality affordable multifamily rental housing. Additionally, DHCD seeks to ensure that the return to the owner or Developer is reasonable and does not exceed the Department's established standards based on the size, type, and complexity of the project. DHCD will follow CDA's calculation of the Developer's Fee as found in CDA's Multifamily Rental Financing Program Guide.

DHCD's underwriting and subsidy layering policies and procedures shall, at a minimum, include:

- A Market Assessment of the current market demand in the area where the project will be located (see Section V: Market Assessment).

- An assessment of the experience and the financial capacity of the Developer or rental project owner (see Section VI: Developer's Assessment Capacity and Section VI: Financial Capacity).

- An examination of the sources and uses of funds for the proposed project and a determination that all project costs are reasonable (see Section VII: Project Review).

- An assessment of the firm written financial commitments for the project (see Section VIII: Project Review); and

- An assessment of the Developer's Section 3 Plan, as appropriate.

DHCD shall evaluate a project using its underwriting and subsidy layering guidelines before committing HOME funds and shall ensure that its underwriting is revised in response to any changes that may occur in the project budget. DHCD shall conduct a preliminary underwriting analysis by independently evaluating the project budget, financing and development schedule. To confirm that this has occurred, DHCD shall certify in HUD's Integrated Disbursement and Information System (IDIS) that it has followed its underwriting and subsidy layering standards before making a commitment of HOME funds. DHCD shall update the project underwriting at:

- Initial Closing or construction start (since construction costs at the time of project application typically are estimates instead of firm bids and contracts); and

- Before HOME funds, in addition to the original commitment, are awarded to the project during development (e.g., in response to a change order or other changes in project costs).

At the discretion of the Director, the County may permit a third-part contractor or consultant working for the Department to perform underwriting functions or services. However, DHCD retains full authority and will certify in IDIS to the use of its underwriting standards as it pertains to HOME funds.

Although a project that combines HOME and Low-Income Housing Tax Credit (LIHTC) funding may have been underwritten by the state credit allocating agency, (Maryland CDA) DHCD shall review and document compliance with its own underwriting and subsidy layering guidelines. DHCD may choose to review CDA's evaluation (of whether there are excess tax credits) to help ensure that HUD and/or County subsidies are not greater than necessary to provide affordable housing when combining HOME assistance with Tax Credits.

V. MARKET ASSESSMENT

Developers shall provide an assessment of the current market demand in the neighborhood in which the project will be located in compliance with the HOME Rule at §92.250(b)(2) and other applicable County/DHCD requirements.

The market analysis shall provide an assessment of the demand for the type and number of <u>all</u> housing units being developed, including those designated as HOME-assisted and non-HOME–assisted units. DHCD shall determine whether the project can be expected to be rented within the regulatory time frames and at the cost or price estimated by the Developer. DHCD acknowledges the timely occupancy of HOME units by eligible tenants is critical to comply with statutory and regulatory requirements, and rental occupancy deadlines.

The cost of a market assessment shall be borne by the Developer and may be charged as an administrative or project delivery cost and listed under the project's "Sources and Uses." As applicable, the market assessment can take different forms, including independent market studies, waiting lists and other market information assembled by the applicant (Developer) and submitted to DHCD. **DHCD is not required to pay for an external, independent market study or to perform a full, formal market study**.

DHCD's underwriting guidelines has established standards for demonstrating the evidence of *current* market demand that applicants must provide and the required documentation. The Market Study must be no more than six (6) months old as dated from application submission. At the discretion of the Director, DHCD may request an update to the market assessment at any time prior to the project completion. In all cases, however, DHCD shall require the market assessment to be consistent with CDA's guidelines as found in CDA's Multifamily Rental Financing Program Guide.

In some cases, other funders may require independent market studies. At the discretion of the Director, DHCD may accept the independent market study prepared for another funder if the study meets the requirements outlined in this Section. DHCD shall review any market studies or assessments and make its own conclusions about the likelihood of project success.

VI. DEVELOPER CAPACITY ASSESSMENT

Consistent with the HOME Rule and applicable County regulations, DHCD shall adhere to two specific elements of underwriting analysis related to the Developer's application for HOME funds: (1) the experience and the capacity of the Developer (including the entity staff and project team) to implement the project and (2) the fiscal soundness of the Developer to meet its financial obligations and risks of the project. These capacity requirements apply to all Developers of rental housing seeking HOME assistance.

Developer Team Requirements: As further explained below, Developer Team Requirements, include, but not limited to:

- Experience
- Financial Capacity

The term Developer refers inclusively to the project sponsor, project owner, guarantor, and general partner/managing member with an ownership interest in the project's ownership entity whether such roles are held by individuals, corporate entities, partnerships, or limited liability companies. The term Developer specifically excludes the investor/syndicator partner(s) or member(s) of the ownership entity.

The Development Team refers inclusively to the Developer and the team of professionals under contract to the Developer to assist with the overall development of a project. The " Primary

Development Team" consists of the Developer and the project's general contractor, architect, and property manager. The "Secondary Development Team" includes the project's civil engineer, attorney, accountant, and/or other specialized professional service providers.

At the discretion of the Director, all corporations, limited liability companies, or partnerships that make up the Development Team or that will provide guarantees to the transaction shall submit audited, reviewed, or compiled financial statements, as well as interim statements acceptable to DHCD. If possible, financial statements must be prepared according to Generally Accepted Accounting Principles (GAAP). Any individuals providing guarantees or who will be a managing member or general partner within the Development team must submit personal financial statements, including certifications acceptable to DHCD. The required financial statements must include calculations of total assets, total liabilities, current assets, and current liabilities.

A. EXPERIENCE

DHCD shall assess the experience of the Developer by determining whether the Developer has the technical and managerial experience, knowledge, and skills to successfully complete the development. When assessing the Developer's experience, DHCD shall consider both prior experience and the current capacity of the organization, including:

- The corporate or organizational experience of the development entity.
- The experience of the staff assigned to the project and overall quality of the development team.
- DHCD shall evaluate the Primary Development Team based on their record of accomplishment during the past five (5) years with projects that are similar in size, scope, and complexity to the proposed project.
- The prior experience of the individuals compared to their roles in the proposed project.
- Board capacity evaluating whether the board (if a nonprofit) is stable and has the skills and experience to oversee development.
- Developer's project backlog or current workload's effect on its ability to complete the proposed HOME project in a timely manner; and
- Applicant (or its identified management agent) has the capacity to manage the ongoing real estate, and to provide services as proposed.
- **Within the five years prior to the application date, "Primary Development Team members" may not have**:
    - Participated as an owner or manager in the development or operation of a project that has defaulted on a DHCD or other government or private sector loan.

- Consistently failed to provide documentation required by DHCD in connection with other loan applications or the management and operation of other existing projects.

- Been involuntarily removed as a general partner or managing member from any affordable housing project whether or not financed or subsidized by the programs of DHCD.

- Received a limited denial of participation from the U. S. Department of Housing and Urban Development (HUD).

- Been debarred, suspended, or voluntarily excluded from participation in any federal or state program.

- Been directly involved with any project placed on DHCD's defaulted loans watch list due to actions which, in the opinion of the County, are attributable to the sponsor or the Development Team member.

- Unpaid fees, loan arrearages, or other obligations due to DHCD on other projects; or

- Been found by any state or federal agency or court of competent jurisdiction to have acted in violation of the Fair Housing Act, the Civil Rights Act, or any other state or federal law prohibiting discrimination, or failed to comply with the terms of any agreement or court order related to any settlement, conciliation, or legal action related to such a violation.

A Developer/owner needs specific skills and capacity including property management, asset management, service provision (as applicable), and special financing skills.

B. FINANCIAL CAPACITY

DHCD shall examine whether the Developer has the financial capacity necessary to complete the proposed project and determine whether the Developer has:

- Adequate financial management systems and practices.

- Sufficient financial resources to carry the project to completion or through initial lease-up, as the case may be.

- Sufficient liquid assets to meet the short-term emergency needs of the project.

- The cash needed for its equity contributions, pre-development costs, and organizational overhead to support the project during planning & implementation.

- Sufficient financial strength to absorb reasonable project delays and cost overruns; and

- No contingent, portfolio liabilities or financial obligations with respect to its portfolio or other programs that present any significant risks to the proposed HOME project.

When determining whether the Developer has the financial capacity to undertake the project, DHCD may examine financial statements and audits to determine the Developer's net worth, portfolio risk, pre-development funding, and liquidity. It is DHCD's policy that Developers with limited financial resources shall only be considered for projects where cash needs will not exceed the Developer's net or liquid assets. DHCD shall follow CDA's threshold requirements as found in CDA's Multifamily Rental Financing Program Guide.

DHCD shall enforce compliance with specific financial requirements, as applicable to CHDOs and nonprofit sub-recipients, which must have financial accountability standards consistent with 2 CFR 200.302 ("Financial Management") and 2 CFR 200.303 ("Internal Controls"). Other public entities seeking HOME funds as owners or Developers of affordable housing may also be subject to the provisions of 2 CFR part 200 ("Uniform Administrative Requirement, Cost Principles, and Audit Requirements for Federal Awards") or other state and local requirements.

VII. PROJECT REVIEW

Before committing HOME funds, DHCD shall evaluate a proposed project to ensure that funds are invested such that the project is likely to succeed over time. DHCD will assess all of the assistance that has been, or is expected to be, committed to the project. DHCD shall analyze all the factors relevant to project feasibility, which may include, but are not limited to total development costs and available funds; impact of HOME restrictions such as eligible costs, maximum subsidy limits, cost allocation, and rent/utility allowance limitations; rates of return to owners, Developers, sponsors, or investors; and the long-term needs of rental projects and tenants. DHCD shall review primarily, two types of documents in order to assess and underwrite a project for HOME-assisted funds:

- Sources and Uses Statement
- Operating Pro-forma

A. SOURCES AND USES STATEMENT

Developer shall submit a Sources and Uses statement, also known as the development budget as part of its application for HOME program funds. DHCD shall examine the Sources and Uses statement in accordance with its underwriting guidelines. The Sources and Uses of Funds statement must list:

- All Sources (both private and public) of funds with dollar amount(s) and timing of availability for each source, and
- All Uses of funds (for example acquisition costs, site preparation and infrastructure costs, rehabilitation/or construction costs, financing costs, professional fees, Developer fees and other soft costs) associated with the project.

1. **Sources**. Both the definition of commitment in §92.2 and the project evaluation requirements in §92.250 require DHCD to determine that all financing sources are in place before it commits HOME funds to a project. Therefore, DHCD shall request and review the following for all project sources:

a. Letter of Intent and/or firm commitment letters with all terms and conditions for all mortgages, grants, bridge (interim) loans and investment tax credits (historic or low-income, if applicable). At a minimum, letters of intent must state that the project appears feasible and must show the amount of anticipated funding, general repayment terms, and any financial terms and conditions.

b. All firm commitment letters shall be submitted to DHCD prior to closing.

c. If the applicant is a partnership or limited liability corporation, a copy of the partnership agreement or operating agreement, which must indicate the cash contributions by the partner(s) or member(s); and

d. Evidence of available equity funds, as appropriate; and

e. All projects must be financially feasible in accordance with DHCD underwriting standards and generally accepted industry practices.

DHCD shall prepare a subsidy layering analysis as part of the project sources review, to determine that the total amount of HOME assistance is reasonable and necessary. As part of its review, DHCD will assess "funding source points," including:

f. Total funding sources adequate and timely in their availability to cover development costs at all phases of the development – acquisition, construction/rehabilitation, and permanent loan. Before committing HOME funds, DHCD shall determine that all necessary financing is available to cover reasonable costs of development. DHCD shall review any conditions the Developer must meet in order to draw funds and the schedule upon which funds will be available. The availability of sources must match the project's timeline and allow DHCD to anticipate when and for which items it will disburse HOME funds. DHCD shall also review the commitment and availability of permanent funding sources, the repayment terms of which need to be incorporated in the long term operating projections.

g. The other funding sources are compatible with HOME, or they contain different requirements that affect the structure of the project, including unit mix, and these differences are accommodated in the project plan. In its review of written commitments for other funding sources, DHCD will determine whether there are provisions that: (1) conflict with HOME requirements; or (2) are not reflected in the project plan. The availability of sources should match the project's timeline and allow DHCD to anticipate when and for which items it will disburse HOME funds.

h. The funding sources are firmly committed. DHCD will assess all firm written financial commitments to ensure that they are consistent with the underwriting of the project. Firm commitments must be non-speculative sources identified and secured in the amount necessary to complete the project. It is not necessary that financing sources have "closed" or been disbursed. At the discretion of the Director, documentation can include award letters, offer letters, final term sheets, or other commitments which are conditioned upon the receipt of HOME funds. While the document may not include automatic self-expiring clauses or highly conditioned language, it must have all substantial terms tied to a specific project.

2. Uses. The determination of the amount of HOME assistance needed is based on the gap between uses and other sources. All costs not being paid with HOME funds must be necessary and reasonable, as the inclusion of excessive costs inflates the apparent need for public subsidy in a project. In its review of the Sources and Uses statement, DHCD shall assess the detailed breakdown of costs, including all hard and soft costs of the project. DHCD requires Developers to provide project budgets in sufficient itemized detail to evaluate not only the sufficiency of the budget but also to evaluate whether project costs are reasonable both on a line item basis and in the aggregate. If the documentation is not adequate and does not support the costs as stated, DHCD reserves the right to request additional documentation. Note that for projects with tax credits to be sold, the proceeds from the sale of these credits must be identified as a source of funding. For projects with LIHTC, the project must have received a reservation from the State of Maryland CDA and be able to provide a good faith offer of equity investment from an investor prior to the issuance of a HOME commitment.

<u>DHCD shall request and review documentation for all line item costs in the budget, including:</u>

a. Documentation of acquisition costs, such as purchase agreement, option or closing statement and appraisal or other documentation of value that is reasonable given site remediation and prep costs.

b. Construction cost estimate, construction contract or preliminary bid(s), including evidence that:

- The design incorporates "green principles" for energy-efficiency.
- The scope will ensure property standards compliance and economic useful life for at least the compliance period.
- Costs are reasonably related to scope.
- Costs are final or based on detailed specifications to be considered reliable.
- There is a reasonable contingency provision for construction or rehabilitation costs.

c. All soft costs, such as non-construction line items are reasonable and supported, and reflect all expected project-related costs, including contracts, quotes or other agreements substantiating key professional costs, as well as the basis for estimating other soft costs and working capital items, including capitalized reserves.

d. Total fees (including other fees collected by the Developer and consultants) are reasonable compared to market and costs of doing this project and Developer's fee is inclusive of all fees paid to the Developer, processing agents, as well as development consultants, and includes deferred fees.

e. Agreements governing the various reserves which are capitalized at closing (to verify that the reserves cannot be withdrawn later as fees or distributions).

f. Reserve contributions – Reasonable contributions to operating and replacement reserves (taking into account capitalized contributions to reserves).

g. A third-party appraisal (to substantiate the value of the land and the value of the property after rehabilitation or the structure being built).

h. If LIHTC are utilized, documentation on the syndication costs (legal, accounting, tax opinion, etc.) from the organization that will syndicate and sell the offering to ensure that the project can support the fees necessary to syndicate/fund the project.

i. All of the proposed costs of development are "necessary and reasonable" in compliance with Office of Management and Budget (OMB) cost principles contained in 2 CFR part 200. Costs are considered "necessary" if they are required to implement the project in full compliance with all program standards. According to 2 CFR part 200, a cost is reasonable if it "does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost." The determination of reasonable cost will include the following factors:

- Costs of comparable projects in the same geographical area.
- The qualifications of the costs estimators for the various budget line items; and
- Comparable costs published by recognized industry cost index services for construction are reasonable.

j. The proposed costs are sufficient to achieve all program requirements, including property standards, to provide quality housing for at least the affordability period. DHCD shall ensure that the project budget is adequate to meet and maintain the property standards of §92.251 and all other HOME as well as other cross-cutting federal requirements that apply to its development. The completion of a capital needs assessment or estimate of the property's useful life is essential to this analysis in rehabilitation projects.

k. The costs proposed to be paid with HOME funds are eligible under the HOME rule. Refer to the HOME rule at §92.206 for additional guidance on eligible costs.

l. Costs are correctly allocated to the HOME-assisted assisted units.

m. Total development cost per unit does not exceed the HOME Maximum Per-Unit Subsidy limits as noted in Section III.B.

n. All costs are necessary to the project's long-term viability.

B. OPERATING PRO FORMA

Developers are required to provide an operating pro forma for all rental projects. The pro forma must be for a minimum of 20 years of project income, expenses and cash flow. Additionally, DHCD's underwriting and subsidy layering pro forma guidelines will follow the State of Maryland CDA Form 202.

DHCD shall evaluate the reasonableness of the financial assumptions of the project to establish minimum total per unit operating costs. DHCD shall evaluate the sufficiency of both specific line item(s) and total operating costs. In addition, long-term operating projections over the period of affordability must be based on reasonable assumptions and must demonstrate that the project can cover expenses and debt service throughout the affordability period.

DHCD shall scrutinize the pro forma consistent with its written guidelines and ensure the cash flow projections are realistic in light of economic conditions. DHCD shall balance the need for public subsidy to make the project viable while safeguarding the investment of HOME funds in the project by ensuring that projected income and expenses are reasonable, and provide resources that are sufficient for the property's upkeep and planned capital repairs during the affordability period.

Long-term operating projections shall be based on reasonable assumptions about how revenues and operating costs are expected to change over time, and demonstrate the project is expected to operate within normal operating parameters throughout the affordability period. Consistent with the CDA guidelines, DHCD shall assume the same trending factors for project revenues and operating costs as pertaining to annual increases.

1. Projected Income. Operating revenues must be based on achievable rent levels, reasonable vacancy and collection loss, and conservative estimates of non-residential sources of incomes.

   a. In most projects, non-residential revenue from fees/late charges, commercial income, interest, laundry/vending, or other similar sources likely will be modest, therefore, DHCD recommends that these fees should be projected conservatively.

   b. Utility allowances must be justified and calculated in accordance with HUD's Notice H 2015-04 (June 22, 2015), as noted in Section III B.7.

c. DHCD shall ensure initial rents for the HOME-assisted units do not exceed the prevailing levels, as established by HUD annually.

d. Vacancy projections shall reflect local market conditions and account for both physical vacancy and collections loss. DHCD shall use CDA's prevailing vacancy loss percentage for all multi-family and senior housing rental projects.

e. The rate of projected growth for rental income and other revenues shall be appropriate to the local market and regulatory limits. DHCD shall use CDA's prevailing projected growth for rental income and other revenues for all multi-family and senior rental projects.

f. In projects with deeply targeted rents, lower than average rates of revenue increase should be used, as utility allowances will surpass rent increases. Net Operating Income (gross revenue minus operating expenses) must be sufficient to cover debt service obligations and mandatory replacement reserve funding and generate reasonable but not excessive Cash Flow throughout the period of affordability.

g. Cash flow projections are reasonable and not excessive for equity invested (if any).

h. Reasonable contributions to operating and replacement reserves (taking into account capitalized contributions to reserves) are required for all multi-family or senior housing rental projects. DHCD shall use CDA's prevailing capital and operating reserve requirements.

i. Net Operating Income and net available for debt service shall be reasonable to maximize borrowing potential and debt service coverage factor is reasonable or reflects lender requirements. DHCD shall use CDA's prevailing debt service coverage factor when underwriting multi-family and senior housing rental projects.

2. Projected Expenses**.** DHCD requires all operating costs to be presented in sufficient detail to compare line items against properties that are similar in physical type and size, in order to make a determination whether the planned expenditures are sufficient and reasonable. The operating budget should, at minimum, include general management expenses, maintenance and operating costs, any project paid utilities, taxes, insurance premiums, and adequate deposits to replacement reserves. DHCD requires the submission and evaluation of total operating costs to be summarized in "per unit per year" amounts. The Operating Pro forma Projected Expenses should include the following:

a. All operating costs (e.g. water/sewer rates or lawn mowing);

b. Management and other fees to the owner based on the local market.

c. The identity of interest (also referred to as related party) relationships with contracted property management, repair/rehabilitation contractors, or other project vendors must be disclosed.

d. DHCD reserves the right to change the Reserve for Replacement (RFR) based on the type of physical product, the target population, and whether the building is newly constructed or rehabilitated.

e. Each project must establish an initial operating reserve equal to between three (3) and six (6) months of underwritten operating expenses, debt service payments, and required deposits to other reserves;

f. Minimum replacement reserve deposits should be specified based on the characteristics of each project. Reserve needs may vary based on the type of physical product, the target population, and whether the building is newly constructed or rehabilitated.

g. Any debt service or other funding/reserve requirements related to 'secondary' financing in mixed financed deals, if applicable.

h. Cash flow evaluated from a "debt coverage ratio" perspective.

i. Adequate provision for services and justification to reflect the target population's needs; service revenue sources identified sufficient to cover service expenses (separate from real estate operations); and

j. Marketing costs are reasonable and sufficient.

C. PROFIT AND RETURNS TO DEVELOPER

DHCD's underwriting guidelines requires any profit or return on the owner's or Developer's investment will not exceed prevailing established standards, based on the State of Maryland CDA guidelines. This analysis includes projected profit flow to the Developer as operating cash flow from rental projects and any other professional fees being paid to the Developer or related entities.

DHCD may provide HOME Program funds to support new construction, substantial rehabilitation of multi-family housing, therefore Developers and owners may financially benefit from HOME-assisted projects in several ways:

- **Developer Fees**: These are fees charged by the Developer as a part of the project cost to compensate for the risk, time and effort to build, and sell or lease the property. Developer fees are allowed under the HOME program. DHCD shall follow CDA's fee schedules while considering the following:

  - The scope and complexity of the project being developed.
  - The size of the project.
  - The relative risk the Developer is taking.
  - The costs a Developer will incur from the fee as compared to those being charged

as project costs.

- Total fees (including other fees collected by the Developer and/or consultant) are reasonable compared to market and costs of the project.

- The fees that are regularly and customarily allowed in similar programs and projects; and

- Other fees the project is generating for the Developer and its related entities.

- **Cash-Flow**: Assuming that the rental property is properly structured and financed, successfully attracts residents, and is effectively managed; the project likely will have net cash-flow after the payment of debt service. Cash-flow is distributed to the owner and/or investors as a return on their original investment.

- **Tax Benefits**: Rental owners and/or investors can also benefit from tax savings (from depreciation or cost amortization) —a reduction in the income taxes they owe due to tax losses or tax credits.

- **Equity Appreciation**: Over time, the value of the rental project sponsor/owner's ownership share in the project will increase as debt financing is paid down (due to the portion of debt service that is applied to the loan principal), and depending on market conditions, the property may appreciate in value.

- **Identity of Interest (IOI) Roles:** Some Developers may also own construction companies and if this company is used for the HOME project, the construction firm may earn reasonable profit and overhead as a component of the development budget. If the rental property owner also operates a property management company contracted to service the property, the Developer may earn fees from those activities. These and other IOI contracts require additional scrutiny by DHCD to make sure that they are clearly disclosed, priced at arms-length rates, and subject to cancellation if the IOI contractor does not provide acceptable service. For additional information on Identity of Interest (IOI), see The Management Agent Handbook (4381.5) | HUD.gov / U.S. Department of Housing and Urban Development (HUD)

D. OTHER DEVELOPMENT FACTORS

In addition to the underwriting criteria referenced above in this document, DHCD shall also examine whether the Developer has the capacity necessary to complete the proposed project and thereby determine the following:

- Readiness to proceed – Project plans are sufficiently advanced to ensure timely expenditure of HOME funds upon award:

- Site control – Developer owns or controls the site. Any evidence demonstrating the Developer has and will maintain site control for at least 180 days after the DHCD or State application deadline date, whichever occurs later.

- Status of approvals – Community approvals are in place or strong support is in evidence.

- Written evidence of Commitment of funds from all financial sources and stakeholders.

- Project designs are complete.

- Leveraged Funds – Every dollar amount of County funds shall be significantly leveraged with funding from other private, state, and federal sources. DHCD seeks to obtain, at minimum, a 10:1 leverage ratio per each affordable housing project.

Matching of HOME Funds – The County must contribute or match no less than 25 cents for each dollar of HOME funds spent on affordable housing. The matching contribution adds to the resources available for HOME-assisted or HOME-eligible projects and must come in the form of a permanent contribution to affordable housing. Generally, investments from State or local governments or the private sector qualify as matching contributions, whereas Federal funds (such as CDBG) do not qualify. Eligible sources of a match for HOME funds include Cash; donated construction materials or volunteer labor; value of donated land or real property; value of foregone interest, taxes, fees, or charges levied by public or private entities; Investments in on-or offsite improvements; proceeds from bond financing; and the cost of supportive services provided to families living in HOME units.

VIII. ESTABLISHING THE LEVEL OF HOME SUBSIDY (SUBSIDY LAYERING)

DHCD uses the aforementioned underwriting criteria to determine the amount of investment needed to make a project feasible, referred to as "gap analysis." Gap Analysis is used to determine the gap between approved costs (Uses) and available financing and other subsidies (Sources). DHCD analyses the gap based on selected factors, some of which can be modified prior to commitment, including:

- Level of physical improvements.
- Rent levels and affordability.
- Income levels being served (e.g., a target population of 60 percent of median income could require less assistance than if the target population is below 30 percent of area median income).

- Payment terms of all funding, including HOME, and other public funding; and

- "Standard" per Unit Costs based on Construction Type and Unit Size.

In addition to conducting the subsidy layering review described above, before committing HOME funds to a project, DHCD shall:

- **Evaluate Debt Capacity**. Ensure that the lender's financing terms are reasonable and comparable to those available from other lenders. The following factors will be considered:

  - Willingness of other lenders to finance at a higher loan to value ratio (LTV).

  - Willingness of other lenders to finance at a lower debt coverage ratio (DCR), and

  - The interest rate is competitive with what other lenders are willing to offer, or when applicable, the interest rate used in modeling aligns with the State DHCD funding programs.

- **Evaluate Equity Contributions**. Evaluate the full spectrum of returns that are accruing to owners and investors. If it appears that the project is returning a higher level of return than is warranted given project risk and market conditions, DHCD may require additional equity investment (or reduce the level of HOME assistance). Also, evaluate the calculations of tax credit basis and market price to determine if the projected amount of tax credit equity is reasonable based on the tax credit investor's term sheet.

If the total amount of HOME assistance and other sources exceeds the amount that DHCD determines is necessary to make the project feasible and viable for at least the affordability period, DHCD may consider:

- Reducing the amount of HOME assistance.

- Increasing the number of HOME assisted units in the project or lowering the target income levels and rents to be charged, and

- Imposing loan terms that bring the rate of return into line with standards.

DHCD may deny HOME assistance if the applicant refuses to make reasonable adjustments or to limit its return/costs in compliance with underwriting guidelines or if it appears that HOME funds are not needed to close a financing gap. At the discretion of the Director, DHCD shall identify the amount of subsidy needed through gap and other project analysis, and determine that all HOME assistance must be used on program-eligible costs or activities. HOME funds are capped by the following important measures:

- Total HOME-eligible costs allocable to assisted units; and

- The maximum subsidy as permitted by regulation for the assisted units (based on unit size).

- Local Contributions. A local contribution shall be a contribution which is not contingent upon completion of tasks or improvements that are not related to the project and which:

  - Reduces development costs, such as:

    - The donation or long-term leasing of land or improvements.

    - Capital funds for acquisition, construction, rehabilitation, or development costs.

    - Locally installed infrastructure or site improvements which reduce off-site costs attributable to the project; or

    - Waiver of local fees for permits, tap fees, impact fees, and other fees and charges.

  - Reduces operating expenses, such as:

    - Operating or rent subsidies for the project; or

    - Real estate tax abatement or a payment in lieu of taxes (PILOT). PILOTs frequently serve as operating subsidies by reducing annual County property tax obligations in the post-construction period. In return for the County accepting a reduced property tax payment, the Developer agrees to restrict the levels of rents further ensuring the continued long-term affordability of the project. The ultimate ability of a project to successfully secure all sources of financing is also dependent upon the Prince George's County Council's (the "County Council") authorization of a PILOT agreement. Consideration of a PILOT is an important component of County HOME underwriting since the underwriting of both may have to be performed in unison. To account for legislative timelines and procedures, Developers shall submit PILOT requests no later than four (4) months in advance of the anticipated close of construction financing.

As part of the underwriting process, DHCD shall allow adequate time for the process of drafting of a memo to the County Executive and legislation through the County Council. All allocations of HOME funds must be approved by resolution of the Prince George's County Council, and the underwriting process must incorporate this necessary step into its scrutiny of Developers' projected timelines.

IX. UNDERWRITING TO PROMOTE SELF-SUSTAINING PROJECTS

DHCD, through the issuance of HOME funds and its guiding procedures and underwriting principles, focuses on promoting long-term financial viability and self-sustaining operations for assisted and/or non-assisted projects during their affordability periods, subject to various factors which contribute to new construction and the preservation of affordable housing. To ensure the availability, sustainability, and preservation of affordable housing with HOME Program funds, DHCD seeks to ensure the availability of both operating and capital reserve funds in the projects pro forma. Whether a project can remain viable and self-sustaining over time partly will depend on whether the project:

- Can accommodate moderate "income shocks" such as an increase in vacancy.
- Can accommodate moderate "expense shocks" such as an increase in utility rates; and
- Can self-fund its major repairs and replacements ("capital needs") from a combination of its Reserve funds, its cash flow, and future refinancing.

To do so, DHCD seeks to approach the underwriting process in a way that helps to assure:

- Gross potential rents that are actually achievable, taking into account location, design, and intended resident population.
- An allowance for rent loss (vacancy, bad debt, and concessions) that reflects the likely long-term average the property can be expected to achieve.
- Underwritten operating expenses that are likely to be adequate to allow a competent management agent to operate the property successfully, in a typical year.
- Trending factors for income and expenses that are reasonable and prudent.
- Sufficient debt service coverage to allow the property to survive income and expense shocks.

Reserve funding that will be adequate to meet the property's capital needs over the HOME affordability period.

X. DOCUMENTING COMPLIANCE

Consistent with this document, DHCD shall follow policies and procedures for documenting all elements of the required underwriting and subsidy layering analysis. Each project file shall contain the required project evaluation, demonstrating that DHCD's guidelines have been applied to the project. Additionally, DHCD shall document compliance with this requirement as evidenced by an affirmative review and approved underwriting and subsidy layering analysis with dated signatures. The written agreement must reflect project underwriting. If changes are made to underwriting or subsidy layering during the development period, DHCD shall update its written agreement and project file documentation.