State of Indiana
Community Enhancement and Economic Development Loan Program

(Section 108 Guaranteed Loan Program)

Policies & Procedures

Indiana Housing and Community Development Authority

Indiana Office of Community and Rural Affairs

State of Indiana
Community Enhancement and Economic Development Loan Program
Policies & Procedures

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SECTION 1: INTRODUCTION AND APPLICATION POLICY

A: Introduction

The Indiana Office of Community Rural Affairs (OCRA) and the Indiana Housing and Community Development Authority (IHCDA) have established a loan pool with federally guaranteed loan proceeds offered through the U.S. Department of Housing and Urban Development (HUD). Indiana receives an annual federal entitlement under the Community Development Block Grant (CDBG) Program. In accordance with the federal regulations found in 24 CFR 570, Subpart M, a state may develop procedures and requirements to assist local units of government that do not receive CDBG funds directly from the U.S. Department of Housing and Urban Development (a list of who is eligible can be found in Exhibit F) to apply for loans from the HUD Section 108 Loan Guarantee Program. The state proposes to assist units of local government by providing access to a State managed loan pool, which shall be funded with Section 108 loan proceeds in an amount not to exceed $135,000,000.

Utilizing a non-competitive method of distribution, the State will make third party loans to units of local government for three purposes:

1. Economic Development
2. Housing Development
3. Community Development

B: Definitions

1. *Borrower* – a private entity that borrows Section 108 funds from a *Recipient (Local Government Unit)* to finance eligible activities in furtherance of a National Objective as approved by the *CEED Administrator.*

2. *CEED Administrator* – the person responsible for ensuring that the *CEED Loan Program* operates in accordance with the approved plan and applicable State and Federal rules and regulation.

3. *CEED Loan Committee – the committee of State personnel and/or directors who approve loan requests submitted by the CEED Administrator.*

4. *CEED Loan Program* – The State of Indiana Small Cities Section 108 Loan Program.

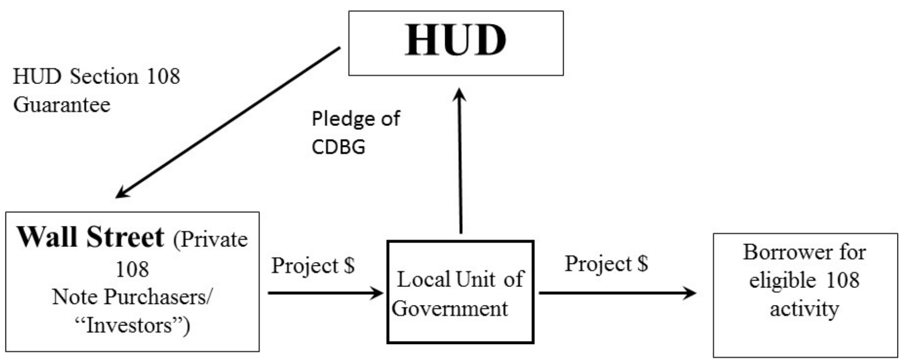
4. *CEED Program User Loan* – loan to a *Borrower* or Sub-recipient *f*or the purpose of financing eligible activities in furtherance of a National Objective as approved by the *CEED Administrator*.

5. *Local Unit of Government – unit of general purpose local government that is eligible to receive loan funding under the CEED Loan Program and is the direct borrower of CEED funding from the State.*

6. *Recipient* – eligible Local Government Unit receiving loan funding under the *CEED Loan Program*.

7. *Sub-recipient* – governmental or not-for-profit entity that undertakes public works and responsibilities that receives a *CEED Loan Program* User Loan from a *Recipient.*

See below for a sample flow of funds for the CEED program.



C: Section 108 Loan Summary

The Community Enhancement and Economic Development Loan Program (CEED) is an economic and community development-financing tool authorized under Section 108 of Title I of the Housing and Community Development Act of 1974, as amended. The CEED program is a method of assisting non-entitlement local governments with certain unique and large-scale economic development projects that cannot proceed without the loan guarantee. In order to be eligible a project must meet all applicable CDBG requirements and result in significant employment and/or benefit for low and moderate income persons, or meet another vital community development need. Projects that are eligible for financing under existing federal, state, regional or local programs (or from private sources?) will generally not be considered for guarantee assistance unless existing programs would fail to fully meet a project's need, as determined by the CEED Administrator in their sole discretion.

Section 108 funds are raised through OCRA's "Pledge of Grants" to the U.S. Department of Housing and Urban Development (HUD) in order to obtain a federal guarantee of notes issued by the local government. The federally guaranteed notes are sold into private markets through public offerings conducted by HUD. By approving the project, a State pledges its future CDBG funds as the ultimate repayment source should a Section 108 loan default. The State's participation in the Section 108 program does not involve a pledge of Indiana's full faith and credit nor does it commit any funding to the local government.

D: Eligible Applicants

Only units of local government that do not receive direct allocations of Community Development Block Grant from the U.S. Department of Housing and Urban Development may apply to the State of Indiana's Community Enhancement and Economic Development Loan Fund, or CEED Fund, and applications for loans from the CEED fund may be only for the project types listed below. The total maximum amount of CEED financing per project that an eligible public entity may receive is limited to $7,000,000. Additionally, an eligible public entity cannot exceed $7,000,000 in total indebtedness of CEED funding. A minimum loan request of $500,000 is required. A list of ineligible Local Government Units can be found in Exhibit B.

Eligible applicants must be in good standing with the State of Indiana and HUD (e.g. not debarred, suspended, or on a watch list and in compliance on other awards) in order to be considered for CEED funding.

E: Eligible Activities & Projects

All activities funded with Section 108 loan funds will be evaluated in accordance with the *Criteria of National Objectives* found in the HUD Guidelines under 25 CFR Sub-Par C, 570.208. These criteria include:

1. Activities benefiting low- and moderate- income persons
2. Activities which aid in the prevention or elimination of slums or blight
3. Urgent need

All proposed Section 108 activities must meet one of these National Objectives. Activities designed to meet community development needs having particular urgency will not be eligible unless one of the other National Objectives listed above is met. Traditionally economic development activities are intended to create or retain jobs for low- and moderate- income persons, but other types of Section 108 loans must also meet an objective such as undertaking an activity that benefits low-and-moderate income persons or is located in a predominantly low-and moderate-income area.

Only those activities authorized by The Housing and Community Development Act of 1974, as amended and listed below, are eligible for CEED financing. For purposes of the CEED Loan Program, eligible activities are listed below. . Proposed activities must be based on firm written commitments from local units of government, sub-recipient or borrower.

Eligible activities under the Section 108 program are those identified in 24 CFR Part 570.703 which include (a) Acquisition of improved or unimproved real property, including acquisition for economic development purposes; (b) Rehabilitation of real property owned or acquired by the public entity or its designated public agency; (c) Payment of interest on obligations guaranteed under the 108 program; (d) Relocation payments and other relocation assistance for individuals, families, businesses, nonprofit organizations, and from operations who must relocate permanently or temporarily as a result of an activity financed with guaranteed loan funds, where assistance is: (1) Required under the provisions of section 570.606(b) or (c); or (2) Determined by the public entity to be appropriate under the provisions of section 570.606(d); (e) Clearance, demolition and removal, including movement of structures to other sites, of buildings and improvements on real property acquired or rehabilitated pursuant to activities a and b of this section; (f) Site preparation, including construction, reconstruction, or installation of public and other site improvements, utilities, or facilities (other than buildings), which is related to the redevelopment or use of the real property acquired or rehabilitated pursuant to activities (a) and (b) of this section, or for an economic development purpose; (g) Payment of issuance, underwriting, servicing, trust administration and other costs associated with private sector financing of debt obligations under the 108 program; (i) The following economic development activities: (1) Activities eligible under section 570.203; and (2) Community economic development projects eligible under section 570.204; (k) A debt service reserve to be used in accordance with requirements specified in the contract entered into pursuant to CFR Part 570.705(b)(1).

Eligible communities may apply for any of the following categories of eligible projects. The following three general categories list examples project types that are eligible for CEED financing.

1. <u>Economic Development Projects</u>

   Examples of economic development projects include but are not limited to loans made by the public entity to a for-profit business, development of a business or industrial park, construction or reconstruction of infrastructure to support a business, or implementation of a redevelopment project.

   a. **Business Loans –** funding provided to a firm for expansion of its operations. Funds may be used for construction, purchase of machinery and equipment, gap financing, or as a credit enhancement. A project of this type would normally include other sources of debt and equity as well as capital invested by the company. The project must create new job opportunities which must be made available to low- and moderate-income persons. The Section 108 loan would be repaid by the company from cash flow.

   b. **Infrastructure Improvements –** for purposes including but not limited to the construction or reconstruction of access roads, the extension of public utilities, or installation of a railroad spur line to serve a private business or industry. The project should create new job opportunities which must be made available to low- and moderate-income persons. The Section 108 loan would be repaid by the LUG from available cash flow, other sources of revenue or other cash flow source acceptable to CEED administrator.

   c. **Redevelopment Project –** funds would be used for the acquisition, relocation, rehabilitation of buildings, and clearance of site(s) for redevelopment purposes. The land would be sold to public or private redevelopers and the funds from the sale of the land would be used to pay off the CEED loan, along with supplemental funding including but not limited to tax incremental financing (T.I.F.), or CDBG annual allocations. The project must benefit low- and moderate-income persons through the creation of new job opportunities.

d. **Bridge/Construction Loans –** funds may be used to provide interim financing for construction of commercial, including but not limited to projects utilizing rehabilitation tax credits or renewable energy tax credits to extend beyond the construction period. The loan would be repaid with permanent financing and/or equity.

2. <u>Housing Development Projects</u>

Examples of housing projects that are eligible for CEED loans include but are not limited to rehabilitation of existing housing or acquisition/construction of sites for new development. All housing activities funded with CEED proceeds must benefit- and moderate-income persons.

a. **Bridge Loans –** funds may be used to provide interim financing for construction of single family or multi-family residential units for homeownership or as rental housing, by an entity undertaking housing development supported by a local unit of government intended to extend beyond the construction period to decrease the amount of permanent subsidy necessary for the project by enhancing investor returns. The loan would be repaid with permanent financing and/or capital contributions from the equity investor. . Sources of permanent financing could be through the Indiana Housing & Community Development Agency, low-income housing tax credits, or private banks. The CEED loan could be used as a “bridge” loan for construction financing. Repayment of the CEED loan would be made when the permanent financing closes.

b. **Construction Loans –** funds may be used to provide interim financing for construction of single family or multi-family residential units for homeownership or as rental housing, by an entity undertaking housing development supported by a local unit of government. Sources of permanent financing could be through the Indiana Housing & Community Development Authority, low-income housing tax credits, or private banks. Repayment of the CEED loan would be made at the time when the permanent financing closes.

c. **Permanent Loans –** funds may be used to provide permanent, term financing for a rehabilitation or new construction rental development. Repayment of the CEED loan would be made through amortized loan payments from project cash flow or from other sources as approved by CEED loan committee.

3. Community Development

Public facilities and infrastructure type projects may be undertaken by local units of government with CEED loan funds. These projects must benefit the low- and moderate-income population of the area they are intended to serve.

a. **Water and Sewer –** funds may be used to construct, reconstruct, or expand water and sewer lines to serve low- and moderate-income areas of the community. Repayment of the Section CEED could be from long term user fees for the lines or from general revenue funds.

b. **Storm Water –** funds may be used to construct, reconstruct, or expand storm sewer lines to the low- and moderate-income areas of a community. These types of projects are often difficult to finance with other sources of funds. Repayment of the CEED loan would most likely be from multiple sources such as sewer fees and general revenue.

c. **Parks and Recreation –** funds may be used for the expansion of an existing park facility or the development of a new facility. The facility must principally benefit low- and moderate-income persons. Repayment of the CEED loan could be from general revenue funds.

d. **Streetscape Improvements –** funds may be used to provide loans for building façade improvements, streetscape work such as tree planting, walks, curbs, street furniture, signage, street reconstruction, etc. The area must serve principally low- and moderate-income persons, or be part of a redevelopment project to prevent or eliminate slums and blight. CEED loan repayment would be from a special tax levy on the property owners through the establishment of a neighborhood improvement district or a business improvement district (B.I.D.), or another cash flow source approved by the CEED administrator

e. **Public Facilities –** funds may be used for purchase, rehabilitation or construction of public facilities which principally benefit low/mod income persons. Repayment of the CEED Loan would be from general revenue funds or another cash flow source approved by the CEED administrator.

f. **Brownfield Remediation –** funds may be used for the remediation of abandoned, idled and underused industrial and commercial facilities where expansion or redevelopment is burdened by real or potential environmental contamination.

SECTION 2: UNDERWRITING STANDARDS AND GUIDELINES

A: General Loan Parameters

All CEED Standards for Financial Underwriting will comply with Federal Regulations for the use of Section 108 loan funds. If the guidelines below differ from Federal Regulations, the Federal Regulations shall prevail.

1. Project Costs Are Reasonable

   a. All project costs will be carefully reviewed for reasonableness. A breakdown of all project costs will be required for the CEED loan application. Fair market price quotations, engineer's estimates, and/or appraisals must be submitted to support all project cost elements. Third party price quotations or a comparison of prices under existing contracts or services from previous projects are required to verify all costs. A "sources and uses of funds" form will be reviewed for each "use of funds" (cost element). A determination will be made by the CEED loan committee in its sole discretion on the reasonableness of the cost for construction, machinery and equipment costs. Costs will be reviewed based on estimates from third-party contracts (architect, engineer, equipment supplier, installer, etc.) for land/building acquisition. A determination will be made by the CEED loan committee in its sole discretion that the price is reasonable based upon fair market value by a certified real estate appraisal. For development costs (such as building fees, architectural/ engineering fees, or financing fees), a determination will be made by the CEED loan committee in its sole discretion if the costs are itemized and supported by contracts or other documentation.

   b. For a working capital loan (if applicable), a comparison will be made on the amount of working capital requested as compared to industry averages, risk, historical needs of the business and the projected need. This will be accomplished by analyzing the financial statements, projections, operating cycle and financial ratios of the borrower.

2. All Sources of Project Financing Are Committed

   A review will be made to determine if sufficient sources of funds have been identified and are committed to the project as determined by the CEED loan committee in its sole discretion. The participating financing parties must have the demonstrated financial capacity to provide the funds in a timely manner. The terms and conditions of all other sources of funding must be disclosed.

   A "sources and uses of funds" form will be reviewed for all sources of funds. A determination will be made if there is evidence verifying the commitment or an intent to commit funds under terms and conditions acceptable to the CEED loan committee.

a. For debt (loan) sources, letters of intent or interest no older than six months must be provided with the specific level of commitment and the terms and conditions of the loan along with copies of the actual loan package that was submitted to the lender with the application for CEED loan funds. If a CEED loan is approved, during the closing process documentation of a firm commitment of other debt sources must be submitted.

b. For grant sources, a letter of commitment for each source must be provided which outlines the level of commitment, the terms of the commitment, any conditions precedent to funding and the timing for receipt of the funds.

c. For equity (cash) sources, a determination will be made by the CEED loan committee in its sole discretion if the equity can be verified by business or personal bank financial statements. If the equity is to be provided by an outside investor, evidence must be obtained on the level of commitment, the terms and conditions if any, and availability of funds (with an accompanying financial statement from the investor verifying the availability of the funds).

3. <u>Section 108 Loans Are Not Substituted for Non-Federal Funds</u>

The amounts and sources of funds will be reviewed by the CEED loan committee to ensure that Section 108 loan funds are not being used to substantially reduce the amount of non-federal funding for the project.

In order to receive a Section 108 loan, a project must have a "financial gap." This gap must be documented. There are three types of financial gaps.

a. **Unavailability of Capital**. The project can afford the cost of financing, but is unable to obtain the funds from private debt and/or equity sources. The gap may be a result of a lender's loan to value requirements or the inherent risk of the project or the industry. For example, a loan may be provided for 70% of the project's costs, which leaves a 30% financing gap. The business may not have the cash to "bridge" the gap, or its cash flow would be seriously restricted by doing so, which would jeopardize the business. The project sponsor must demonstrate that it has applied for funding from other sources and been rejected, or that other financing is not available, in a form acceptable to the CEED administrator.

b. **Cost of Capital**. The project cannot support the interest rate, the loan term, and/or the collateral requirements of other lenders. The lender must demonstrate, in a form acceptable to the CEED administrator, that it is unwilling to change its terms. The gap may only be a problem in the initial years of the project. A pro forma and cash flow statement must be reviewed with a sensitivity analysis to determine whether to defer principal and/or interest, or to allow the loan to be amortized over a longer period.

c. **Return on Equity Investment.** The project's financial returns may be too low to justify the business or a third party investor to proceed with the project. The risks of the project outweigh the returns. The rate of return on investment must be reviewed and adjusted to industry standards, as well as location risks, to determine if the gap exists. The CEED loan rate and term can be designed to provide a return that is in line with similar projects. This may not apply to non-profit organizations.

4. <u>The Project Is Financially Feasible</u>

The project will be examined to determine its viability and assure that the public benefit will be realized. The current and historical financial statements of both the business and principals will be analyzed. Income and expenses shall be evaluated and compared to historical and industry averages. Project costs will also be reviewed to determine their reasonableness, as determined by the CEED administrator in its sole discretion.

As a part of this financial analysis, the past, current, and projected financial data will be analyzed to determine if the job estimates are reasonable and can be supported. Labor costs shall be checked against industry averages.

The terms and conditions of the CEED loan must be appropriate. The interest rate should be set such that available cash flow is sufficient to meet debt obligations with enough remaining cash flow to operate successfully. The terms of the financing will be determined based on the use of funds. Generally speaking, terms will be established based upon the following:

- Working Capital: 3 – 7 years
- Machinery and equipment: 3- 15 years, depending on the useful life
- Non-residential real estate: 10 years, construction/bridge 2 years
- Residential Real Estate: permanent 15 – 20 years, construction/bridge 2-3 years

Loan terms are subject to the initial notes for the loan program once established by HUD, therefore a longer loan amortization schedule may be justified on a case by case basis with a balloon payment due at the end of the term of the loan or economic life of the asset. Each loan review will include a written explanation of the appropriate analysis and the reason for recommending the loan terms and conditions.

5. <u>The Return on Equity Investment is Reasonable</u>

The CEED loan application will be reviewed to determine if the return on investment to the business owner is reasonable. The amount of cash that the investor/owner is projected to receive, in relation to their initial equity, shall not unduly enrich them. However, the analysis will also take into consideration if the return on investment is too low, which could cause the investor/owner to lose motivation and not follow through with the project.

The CEED administrator shall review projected revenues, expenses (including owners' and officer's salaries), owners' draws, debt service and net operating income. A comparison to historical financial information will be made in relation to industry averages to determine reasonableness.

A review of the business' obligations and the personal obligations of the business owner(s) will determine what return on equity investment is necessary to meet personal and business obligations. If the return on investment is above the industry averages, adjusted for risk and local conditions, steps will be taken to adjust CEED 108 loan terms or owners'/officers' salaries and/or draws. If the return on investment is below the industry average, the loan terms may be adjusting to bring it closer to the industry average in the sole discretion of the CEED Loan Committee.

6. <u>The CEED Loan Fund Disbursement Schedule is Feasible.</u>

The disbursement of CEED funds will be negotiated with applicants and other funding sources. CEED loan funds should be disbursed in a manner that does not put the CEED loan at undue risk relative to other sources of funds. The sources and uses of funds will be reviewed to determine if the CEED loan funds will be expended at the same rate as the other funds. A review of the other funding sources' policies on the order of expenditure of funds will be made. If these policies require the public funds to be disbursed first, the CEED Administrator will insure that adequate safeguards are taken to manage risk to the CEED program. Such safeguards may include but not be limited to performance or completion bonds.

7. <u>The Project is Feasible</u>

In addition to analysis of the development pro forma for a project, an analysis will also be made on the operating pro forma of the development and the assumptions behind it. The CEED loan application must thus be supported with additional documentation, including but not limited to:

- Market studies
- Real estate appraisals
- Feasibility studies.

These reports must be no more than 6 months old and prepared by a third party source which has the qualifications to perform the study. In-house or subsidiary vendors will not be considered since this is not an arms-length transaction.

These studies are especially important in evaluating capacity to cover debt service for housing projects, commercial projects and community development activities. For projects that do not generate revenue, engineering and other types of feasibility studies are necessary to properly evaluate a project.

A complete list of the required documentation is listed in the application package.

8. The Site and Location Are Suitable

The project site and its location will also be evaluated for each Section 108 loan application. The following factors will be reviewed to determine the suitability of the project in relation to its environment.

a. The neighborhood where the project is located should show signs of stability with strong and continuous growth patterns. In the case of a redevelopment area, the proposed redevelopment area plan must be sufficiently designed and funded to achieve the anticipated outcomes.

b. The property's condition is important, both structurally and environmentally. Third party studies and reports will be analyzed to determine property condition, such as: a property appraisal, Phase I Environmental Site Assessment, property condition assessment, and, if necessary, an operations and maintenance program for removal of asbestos, lead-based paint, radon, PCB's, other toxic waste, and the removal of underground storage tasks.

c. An evaluation must be made in regard to adequate zoning. A statement from the community zoning officer must affirm that the proposed use of the site is classified as either a legal conforming or a legal non-conforming use under local zoning requirements. If a zoning variance is required, the variance must be approved and in place at the time application is made for CEED funding.

d. Proof of ownership and proper title to the property must be demonstrated to CEED administrator's satisfaction which can include purchase options, a title report or another commitment.

e. A survey of the property from a licensed land surveyor showing metes and bounds, a written legal description, easements, encumbrances, rights-of-ways, physical features, and utility lines must be furnished for review.

9. Public Benefit Shall be Determined (*for Economic Developments Loans)

The project must meet the HUD Public Benefit test as found in the HUD Guidelines in 24 CFR Sub-Part C, 570.209 (b) *Standards for Evaluating Public Benefit*. Economic development loans must meet the following criteria:

a. Create or retain at least one full-time equivalent, permanent job per $35,000 of CEED funds used; or:

b. Provide goods or services to residents of an area, such that the number of low-income/moderate-income persons residing in the areas served by the assisted businesses amounts to at least one low-and moderate-income person per $350 of CEED funds.

10. <u>The Development Team Has the Capacity and Capability to Undertake the Project</u>

A written description of the development team will be evaluated. This description will outline roles and responsibilities and provide previous experience in similar types of developments. This will be supplemented with resumes and historical backgrounds.

11. <u>The Loan Will Be Repaid</u>

All Section 108 loans must be repaid. In all cases, project cash flow and other sources of funds as appropriate will be evaluated to determine capacity to repay the loan. Cash flow from the project must be sufficient to repay debt service. The target range for cash flow coverage are as follows:

- Economic Development Business loans: $1.25 in cash flow for every $1.00 of debt service
- Commercial Real Estate loans: $1.25 in cash flow for every $1.00 of debt service
- Housing Real Estate loans: $1.10 in cash flow for every $1.00 of debt service
- Community Facility loans: $1.10 in cash flow for every $1.00 of debt service
- Bridge Loans: DCR n/a

Additional sources of cash flow will be required for loans that have a cash flow coverage less than the above requirements. This may include but is not limited to a cash reserve account for debt service from the owner or an investor, and a cash equivalent resource, such as a certificate of deposit. The CEED loan committee can waive the minimum debt coverage on a case-by-case basis with the approval of HUD.

For projects that do not generate income from operations, other sources of funds that may be considered for repayment including but not limited to:

a. Increase in property taxes (e.g. tax increment financing (TIF))

b. Revenues derived from a project (e.g. lease payments, rental payments, or parking revenue)

c. User fees (e.g. water or sewer fees)

B: Borrowers, Key Principals, and Required Financials

1. Borrower

The borrower that closes the transaction with HUD must be a Local Unit of Government; however, the end borrower of the Section 108 loan may be a public entity, a designated public agency, a non-profit corporation, or a private single purpose entity or corporation. An evaluation of the borrower's capacity and capability will be made by the CEED loan committee in their sole discretion.

In the case of a private single purpose entity, allowable ownership may be individual(s), general or limited partnerships, corporations, and limited liability companies.

The borrower must be financially sound as demonstrated by accountant-prepared financial statements. This includes both private entities and units of local government. Borrowers will be required to authorize CEED to obtain and review credit reports and any other credit related information.

2. Key Principals

In the event the borrower is not an individual, the key principals of the borrower must be identified. A "key principal" is a person who is critical to the successful operation and management of the business. A review of the company's organizational documents will be made to determine the appropriate person(s) to designate as a key principal. A thorough credit review will be completed for each key principal.

Key principals must have financial capacity and relevant experience, as demonstrated by resumes and financial statements. Credit checks and full background disclosure will be required on all individuals or entities owning or controlling twenty percent (20%) or greater interest in the company.

Key principals will collectively have the obligation to guarantee one hundred percent (100%) of the loan's principal balance.

3. Financials

The borrower's and key principals' overall financial strength, as well as their previous history of ownership and successful operation of a business will be considered. A complete list of financial documentation that will be reviewed is included in the CEED Application Checklist. T

C: Underwriting Guidelines

1. Multi-Family / Rental Housing Underwriting Guidelines

The following are underwriting guidelines for multi-family rental developments. However, all applicants should be aware that these are guidelines only and the numbers submitted should reflect the nature and true cost of the development proposed. CEED loan committee will consider exceptions to these guidelines on a case by case basis if supporting documentation is provided. The operating assumptions outlined below will be analyzed in conjunction with the current market as documented in the submitted market study.

a. Total Operating Expenses – CEED loan committee will consider the reasonableness of operating expenses for each Development based on information submitted by the Applicant. Applicant must provide documentation of estimated property taxes and insurance for the proposed development (i.e. a statement of how the Applicant determined the estimated taxes and insurance for the development). All developments must be underwritten with a minimum operating expense of $2,500 per unit per year.

b. Management Fee– 5 to 7% of "effective gross income" (gross income for all units less vacancy rate).

c. Vacancy Rate – 6% to 8%

d. Expense Growth – 3%, with at least a 1% spread between expense growth and rental income growth

e. Rental Income Growth – 0-2%/year

f. Operating Reserves – four (4) to six (6) months (operating expenses, excluding replacement reserves, plus debt service) or $1,500 per unit (whichever is greater)

g. Replacement Reserve- Required for all developments and must be included in the operating budget. Contributions must be made to the reserve account, starting on or before the conversion date of the construction loan to permanent loan and must be funded for the term of the loan. The following minimum contributions must be used:

1. Multi-family Rehabilitation: $350 per unit per year
2. Multi-family New Construction: $250 per unit per year
3. Single Family Rehabilitation or New Construction Units: $420 per unit per year
4. Historic Rehabilitation: $420 per unit per year

Replacement reserve funds must only be used for capital improvements (substantial improvements to the real estate such as re-roofing, structural repairs, or major projects to replace or upgrade existing furnishings, but not including replacement of individual appliances or minor repairs) and must **not** be used for general maintenance expenses. Less restrictive provisions as required by other lenders must be approved by CEED loan committee.

Stabilized DCR: 1.15 to 1.35. For developments structured with no hard debt, the minimum cash flow before deferred developer fee must be at least $250 per unit annually.

Stabilization usually occurs in Year 2. The debt coverage ratio projection for a development should not go below 1:1 during the complete fifteen (15) year affordability period to be considered financially feasible. If the underwriting is outside these guidelines, then the Applicant must provide a written detailed explanation with third-party documentation supporting the explanation (approval of underwriting from other financing institutions/funding sources will not constitute acceptable supporting documentation). Tax abatement is an example of what may cause the debt coverage ratio to be higher than these guidelines. Evidence of approved tax abatement must be provided in the application.

Developments without hard debt are allowed, but will be subject to additional scrutiny from CEED loan committee. Developments submitted with no debt will not have a debt coverage ratio but will be required to have a cash flow without having an undue profit. This will be determined by a ratio of Effective Gross Income to Total Annual Expenses (including reserve for replacement). A ratio of 1.15 shall be the minimum required to be considered feasible by CEED loan committee in Years 1 through 15.

2. Non-Residential Underwriting Guidelines:

Type:	Construction, rehabilitation, or mini-perm loans.
Term:	Up to ten (10) years.
Amortization:	Up to twenty-five (25) years depending on property type and age, with a twenty (20) year maximum preferred.
Interest Rate:	The Interest rate on interim borrowing is priced at the 3 month London Interbank Offered Rate (LIBOR) plus 250 basis points (2.5%). The interest rate on Permanent financing is priced at Treasury's rate for similar maturity periods e.g. 5, 10, or 20 years, plus 250 basis points (2.5%)

Security: First lien mortgage, collateral assignment of rents and leases, UCC filing on furniture, fixtures, and equipment, and guarantee from the borrower.

Operating Expense: TBD

Operating Reserves: TBD

Loan-to-value: Maximum eighty-percent (80%).

Sources of Financing: The total project costs must equal the project's total sources of financing, inclusive of equity, with all sources identified with the name of the funding source and the dollar amount.

Debt Service Coverage: A <u>minimum</u> of 1.10 - 1.20

Additional Required Documentation (Non-Residential):

1. Site Plan, if applicable;
2. Detailed Sources and Uses of Funds to show that sources equal uses and the identification of each source;
3. Stabilized pro forma showing detailed rental income, expense stops, operating expense reimbursements, operating expenses, and market vacancy.
4. Sensitivity analysis with respect to occupancy of the local tenants, local tenant rental rates, and interest rates.
5. Experience of development team and operations management.
6. Financial statements and/or financial summary of the borrower(s) and, when applicable, guarantor(s).
7. Evidence of lessor/owner financial capacity as well as evidence of leasing commitments for one hundred percent (100%) of the space.

3. <u>Construction and Tax Credit Equity Bridge Loan Underwriting</u>

CEED will provide construction loans and tax credit equity bridge loans to foster the production of affordable multifamily housing. Projects can be acquisition with substantial rehabilitation. Construction loans must have a permanent loan commitment from a lender acceptable to CEED loan committee.

a) <u>Loan Requirements</u>

- The Development must have an award of 9% tax credits from IHCDA and require additional funding to be completed and placed-in-service. For purposes of the CEED criteria, "award" means one of the following:
  - A reservation of credits approved by IHCDA Board of Directors; or
  - A fully executed Carryover Agreement

- The Development must have an equity commitment, including financial projections.
- The Development must demonstrate that it continues to meet the Qualified Allocation Plan's Criteria for Approval including: marketability, overall financial feasibility, viability, experience of the development team, and no outstanding noncompliance issues for existing developments.
- Construction or bridge loan request may not exceed $7,000,000.

b) Eligible Procedures

All sources of funding must agree to a disbursement protocol that identifies the expenses that each source of funds can finance, and the general order that funds will be drawn from sources to meet construction expenses.

Any legitimate construction period development expense is an eligible use of the Section 108 Loan Fund. CEED administrator or its designee will conduct regular monitoring, and must approve all proposed disbursements with funding on a monthly percentage-of-completion basis.

Developer fee pay-outs or some portion of the payout, including any developer related consultant fees, cannot exceed one-third of the funded developer fee amount (net of any planned developer fee loan) until completion of construction. Modifications to this payment schedule may be made on a case-by-case basis to reflect specific requirements of a project's equity investor provided that, at CEED loan committee's 's discretion, sufficient performance based incentives are maintained to achieve timely construction completion, final closing, and rent-up of the project.

c) Underwriting Criteria

The following underwriting criteria are required for use when assessing construction and bridge loan applications. Additional underwriting criteria other than those described below may be considered on a loan-by-loan basis.

i. **Type of Loan:** Construction and/or bridge loans that are scheduled to be repaid in accordance with the capital contributions per the investor note and the permanent loan commitment for projects utilizing Federal Low Income Housing Tax Credits (Housing Credits).

ii. **Eligible Projects:** Projects that have received a reservation or allocation of Housing Credits and have secured a permanent or construction/permanent loan commitment.

iii. **Eligible Borrowers:** Project sponsors must be organized as a partnership or limited liability company with the general partner or managing member having commitments or letters of intent from each investor to contribute equity to the project in exchange for an ownership interest conveying the tax credits, losses, or other tax benefits that the project generates.

iv. **Eligible Investors:** The syndicator/investor must demonstrate the financial and managerial resources to contribute the required equity to the project.

v. **Investor Note:** A promissory note executed by each investor in the project partnership in favor of the borrower partnership.

vi. **Security:** Assignment of the Investor Note provided by the tax credit investor(s); Collateral assignment of the project partnership's security interest in each investor's interest in the project partnership; and assignment of Construction Contract. At its discretion, CEED loan committee may request additional security or guarantees.

vii. **Loan Amounts and Term:** Minimum of $500,000. In general, the maximum loan amount will be limited by the availability of funding sources. However, applicants may request up to $7 million. Loan terms may not exceed 36 months.

viii. **Payment Terms:** Interest only payments will be required on an annual basis from the date of loan closing. Principal repayments shall match the scheduled capital payments by investors.

ix. **Loan to Value:** Loan to appraised value of all collateral for CEED loan and all debt generally shall not exceed 85%.

x. **Initial Investor Payment:** Investors must provide at least 10% of the total scheduled investor contributions to the partnership at close of partnership, 20% of the scheduled investor contributions must be paid in prior to construction completion. CEED loan committee reserves the right to require higher contribution prior to construction completion.

Interest Rates: The Interest rate on interim borrowing is priced at the 3 month London Interbank Offered Rate (LIBOR) plus 250 basis points (2.5%). The interest rate on Permanent financing is priced at Treasury's rate for similar maturity periods e.g. 5, 10, or 20 years, plus 250 basis points (2.5%)

xi. **Guarantees:** Corporate guarantees may be required depending on loan size and risk. Construction completion guarantees are required from the Contractor, Owner and Developer. Operating deficit guarantee from owner.

d) Items Needed for Initial Underwriting
- Updated Letter of Intent or commitment letter from equity provider
- Construction contract
- Architect contract
- Copies of rental subsidy agreements
- Updated commitment from other funding sources if applicable
- Building plans and specs
- Payment and performance bond or Letter of Credit commitment
- Survey
- Management Agreement
- Form of rental agreement
- Tax credit allocation award documentation
- Evidence of utilities availability to site
- Marketing plan
- Phase 1 environmental and any additional studies/mitigation plans arising from the Phase 1.
- Ground leases (if applicable)
- Evidence of proper zoning
- Evidence of site control
- Other items as requested by CEED administrator:
    - Source of reserve funding
    - Cushion between Equity Pay-in and Construction/Bridge financing
    - Equity pay-in schedule
    - Assignment of equity from owner as security for loan
    - Funds backing operating deficit guarantee from owner
    - Owner guarantees on other projects

D: Waivers and Modifications

The CEED Loan Committee, in its sole discretion, may consider a waiver request from any Applicant/Developer in regards to any policy requirement on a case-by-case basis. (Note: the CEED Committee does not have the authority to waive statutory or regulatory requirements).

The Applicant must submit the waiver request along with the original application. The waiver request must include 1) the details of the specific requirement for which the waiver is being requested, 2) a detailed description as to why the development cannot meet the requirement, and 3) any additional information the Applicant would like the CEED Loan Committee to consider with the request. The CEED Loan Committee will provide a written response approving or denying the request.

The CEED Loan Committee, in its sole discretion, may consider a modification request from an Applicant/Developer that has received a CEED award on a case-by-case basis. The CEED Loan Committee must evaluate each request to see how the change would have affected the original funding and underwriting of the development, as well as to ensure that the proposed change will not cause noncompliance.

SECTION 3: COMPLIANCE REQUIREMENTS

A: Grant Administrators

All non-housing CEED awards must use an OCRA approved certified grant administrator. A list of certified Grant Administrators can be found on the OCRA website at: http://www.in.gov/ocra/2617.htm

B: Conflict of Interest

A public servant who knowingly or intentionally has a pecuniary interest in or derives a profit from a contract or purchase connected with an action by the governmental entity served by the public servant commits conflict of interest, a Class D Felony. A public servant has a pecuniary interest in a contract or purchase if the contract or purchase will result or is intended to result in an ascertainable increase in the income or net worth of the public servant or a dependent of the public servant who is under the direct or indirect administrative control of the public servant or receives a contract or purchase order that is reviewed, approved, or directly or indirectly administered by the public servant. "Dependent" means any of the following: the spouse of a public servant; a child, stepchild, or adoptee (as defined in I.C. 31-3-4-1) of a public servant who is unemancipated and less than eighteen (18) years of age; and any individual more than one-half (1/2) of whose support is provided during a year by the public servant.

C: Procurement

Borrowers must follow federal procurement rules when purchasing services, supplies, materials or equipment. The applicable federal regulations are contained in:

1. State and local governments and Indian tribes – 24 CFR Part 85
2. Nonprofits, institutions of higher education and hospitals – OMB Circular A-110, as implemented through 24 CFR Part 84.

In accordance with HUD regulations, projects for private for-profit businesses are exempt from HUD procurement policies.

*For more information on procurement requirements for housing developments, see Chapter 10 of IHCDA's *CDBG & HOME Program Manual.*

*For more information on procurement requirements for non-housing developments, see Chapter 3 of OCRA's *CDBG Handbook*.

D: Contract and Bonding Requirements

1. Construction Contract Requirements

   CEED loan committee must approve the construction contract. The construction contract must contain all of the requirements in the State of Indiana's MultiFamily Finance Guidelines. Contracts must adhere to all Section 3 and Davis Bacon guidelines as outlined in Exhibit G. A review of the historical financial statements will be made in regard to labor costs as a percentage of revenue. A comparison of the percentage of projected labor costs will determine if the projected labor figures are consistent with the project's revenue. The labor costs will also be evaluated against industry averages. The assumptions used to project revenue and labor costs must be supported by market/industry information and historical financial statements

2. Bonding Requirements

   All construction projects will require that the general contractor be backed by a 100 percent Payment and Performance Bond from a qualified bonding company, or a Letter of Credit (LOC) valued at 25 percent of the total construction loan. The CEED Administrator will determine in its sole discretion if a bonding company is qualified or a LOC is satisfactory. The bond must include OCRA, IHCDA and HUD as Joint Obligee. If a LOC is used, it must be kept in place for 90 days after substantial completion or completion of all construction activities, whichever is later.

*For more information on required contract language for housing developments, see Chapter 10 of IHCDA's *CDBG & HOME Program Manual.*

*For more information on required contract language for non-housing developments, see Chapter s 7 and 9 of OCRA's *CDBG Handbook.*

E: Other Federal Regulations

The following regulations must be followed. For additional guidance for housing developments, see IHCDA's *CDBG & HOME Program Manual.* For additional guidance on non-housing developments, see OCRA's *CDBG Handbook*.

Lead Based Paint

- See Chapter 2 of IHCDA's *CDBG & HOME Program Manual*

Fair Housing /Accessibility

- See Chapters 3 & 5 of IHCDA's *CDBG & HOME Program Manual*
- See Chapter 8 of OCRA's *CDBG Handbook*

Uniform Relocation Act

- See Chapter 4 of IHCDA's *CDBG & HOME Program Manual*
- See Chapter 5 of OCRA's *CDBG Handbook*

Section 3

- See Chapter 7 of IHCDA's *CDBG & HOME Program Manual*
- See Chapter 8 of OCRA's *CDBG Handbook*

Davis Bacon / Labor Standards

- See Chapter 9 of IHCDA's *CDBG & HOME Program Manual*
- See Chapter 9 of OCRA's *CDBG Handbook*

Environmental & Historic Review

- See Chapter 11 of IHCDA's *CDBG & HOME Program Manual*
- See Chapter 4 of OCRA's *CDBG Handbook*

Income Qualification & Verification for Housing Developments

- See Chapter 8 of IHCDA's *CDBG & HOME Program Manual*

F: Affordability Periods / Lien and Restrictive Covenants for Residential Developments

Rental developments will be subject to a Lien and Restrictive Covenant Agreement (LRCA) that must be executed against every residential property constructed, rehabilitated, or acquired, in whole or in part, with Development Fund funds. The lien will assign a minimum fifteen (15) year affordability period for all rental housing developments. If the award is made in conjunction with Low-Income Housing Tax Credits, the development will be subject to the applicable tax credit compliance and extended use period. If the award is made in conjunction with HOME or CDBG funding, the development will be subject to the applicable program affordability period.

Upon occurrence of any of the following events during the affordability period, the entire sum secured by the lien, without interest, shall be due and payable by developer and/or owner upon demand. Repayment may be demanded upon: (1) transfer or conveyance of the real estate by deed, land contract, lease, or otherwise, during the affordability period; (2) commencement of foreclosure proceedings by any mortgagee (or deed in lieu of foreclosure), within the affordability period; or (3) determination that units are not being used as a residence by a qualifying tenant or not leased according to the program affordability requirements. The award recipient will be responsible for repaying IHCDA.

EXHIBIT A

CEED'S COLLATERAL POLICIES

Every loan should have two ways out. The first way out is cash flow. The second way out is collateral. Within reason, the stronger the first way out, the less concerned we need to be about the second way out. Collateral should be adequate to secure the obligation. Key person life insurance is also normally required.

Regardless of how strong or weak a company's cash flow appears, the CEED Loan Committee should assess the adequacy of the second way out, that is, of the collateral being offered to secure the loan. Collateral value is not the same as the fair market value of the real or personal property offered as collateral because the time and cost of liquidating the collateral will cause the net proceeds to be less than the hypothetical fair market value of the collateral.

In the case of machinery and equipment (M&E), foreclosure on M&E normally involves an auction or liquidator who sells the collateral for a price substantially below fair market value in order to liquidate the collateral quickly and to allow for the cost of removal from one site and the installation at another site. The value of M&E pledged will be discounted accordingly.

Finally, regarding receivables and inventory, the collateral value of these assets are far less than their cost for face foreclosure on M&E normally involves an auction or liquidator who sells the collateral for a price substantially below fair market value in order to liquidate the collateral quickly and to allow for the cost of removal from one site and the installation at another site assets.

Collateral Value Coverage

Collateral Value ≥ 1:1 Loan Amount

The following are the guidelines the CEED Loan Committee uses in assessing collateral value:

COMMERCIAL OR RESIDENTIAL REAL ESTATE: 80% of Value

If CEED receives a first lien on a piece of commercial property, the collateral value of the property will be 80% of the fair market value of the property as determined by an objective and independent outside appraisal. If CEED takes a mortgage on a piece of property on which there is a preceding lien, the collateral value of the property will be 80% of the fair market value of the property, less the amount of preceding lien. CEED will not accept a lien position lower than second position on real property.

MACHINERY AND EQUIPMENT: 65-80% of Value

CEED will require a lien of no lower than first position on new and used equipment. If CEED receives a first lien on a new piece of machinery and equipment (M&E), the collateral value of that piece of M&E will be 80% of the fair market value of the M&E. Fair market value can be determined either through independent appraisal or through an estimate from a reputable equipment dealer who opines as to the economic life of the asset, the cost new, and the value of the specific piece of equipment being offered as collateral. If existing M&E is used, the collateral value of the used M&E will be 65% of the fair market value of the M&E. In situations where there are preceding liens on a piece of M&E, the collateral value is assumed to be zero.

This discussion relates to “heavy” equipment and production equipment. In certain instances, and at the sole discretion of CEED loan committee, other assets may be valued for collateral analysis purposes.

TAX INCREMENT AND OTHER SOURCES OF PUBLIC REVENUES: 90% of Value

Pledges of increments of local tax receipts or other sources of public revenue such as gaming will only be accepted on revenue streams with three or more years of demonstrated positive cash flow. The collateral value will not exceed 90% of uncommitted value of the revenue stream based on a 7% discount rate.

OTHER NEGOTIATED SECURITY: DETERMINED ON A CASE BY CASE BASIS

The collateral value of other negotiated security will be determined on a case-by-case basis. CEED loan committee may at its discretion require borrowers to provide additional security including but not limited to: (a) personal guarantees, (b) debt service reserves, or (c) other security mechanisms appropriate to the project.

CEED’S PERSONAL GUARANTEE POLICIES

All CEED loans require the personal guarantees of every owner of 20% or more of the company stock. In some instances, the guarantees of non-owner key management are also required. In general, the guarantees are "unlimited" (i.e. guaranteeing full repayment of the loan, irrespective of percentage of ownership or personal net worth).

The third component of the CEED Classification System relates to the net worth of the principals who are pledging their personal guarantee to repay the CEED loan.

Based on the information provided by the guarantors (Personal Financial Statement), CEED discounts the assessment of assets and subtracts all existing personal liabilities in order to reach an "Adjusted Net Worth" figure. Those discounts are as follows:

PERSONAL ASSET	DISCOUNTED %
Cash and Savings Accounts	0%
IRA or other Retirement Accounts (if they can be pledged or borrowed against, otherwise they are discounted 100%)	50%
Unqualified and substantiated A/R and N/R (from other than the SBC)	100%
Life Insurance CSV	0%
Real Estate (less all liens)	20-25%
Automobile and Other Personal Property	80%
Unqualified "Other Assets"	100%

From discounted value of the personal assets, the face amounts of all existing and contingent liabilities is subtracted in order to calculate an Adjusted Net Worth.

Adequate Adjusted Net Worth ("+" Class)

Adjusted Net Worth <CEED Loan Amount

In those instances where the combined Adjusted Net Worth of the guarantors is greater than the CEED loan amount, that loan will be accorded a "+" classification.

Insubstantial Adjusted Net Worth ("-" Class)

CEED Loan Amount < Adjusted Net Worth

In those instances where the combined Adjusted Net Worth of the guarantors is less than the CEED loan amount, that loan will be accorded a "-" classification.

Obviously a strong Class IA+ or Class IB+ deal which is otherwise eligible stands a very good chance of being approved as submitted.

EXHIBIT B

Ineligible Local Units of Government

- Anderson
- Bloomington
- Carmel
- Columbus
- East Chicago
- Elkhart
- Evansville
- Fort Wayne
- Gary
- Goshen
- Hammond
- Indianapolis
- Kokomo
- Lafayette
- La Porte
- Michigan City
- Mishawaka
- Muncie
- New Albany
- South Bend
- Terre Haute
- West Lafayette
- Hamilton County- except those cities that are not eligible under the County CDBG grant
- Lake County