Indiana Housing Conference

Indiana's must-attend conference for affordable housing professionals.

CHDO Track

- CHDO 101
- Single-Family Housing Development
- Packaging HOME Rental Projects
- HOME Rental: CHDO Roles & Capacity
- Business Planning & Financial Management for CHDOs

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Indiana Housing & Community Development Authority

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* Several handouts are "draft" documents produced for HUD by TDA Consulting for publication in a planned *CHDO Toolkit*. While these were approved by HUD for use in various CHDO-related trainings, they have not been finalized for formal publication pending HUD's issuance of a new CPD Notice on CHDO issues. As such, while they represent the current state of HUD training, they are subject to change prior to final approval.

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CHDO 101

August 25, 2016

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Indiana Housing & Community Development Authority

Welcome & Introductions

- Delivered by Steve Lathom, TDA Consulting
  - www.tdainc.org
  - slathom@tdainc.org
  - 517-203-4130
- Session Objectives and Format
  - CHDO Set-Aside
  - CHDO Definition
  - CHDO Benefits

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The CHDO Set-Aside

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Commitment of Set-Aside Funds

- All funds committed w/in 24 months of HUD agreement with PJ
- To commit funds
  - Specifically identifiable project (address or legal)
  - Project must meet requirements for commitment (more in later sessions)
  - CHDO must be owner, developer, or sponsor as defined by §92.300(a) (more in later sessions)
  - PJ must certify CHDO meets definition, including capacity

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CHDO Certification Timing

- CHDO certification — meet the CHDO definition at §92.2
  - Required at the time of set-aside project commitment
- CHDO is expected to remain a CHDO throughout period of affordability
  - PJ determines monitoring procedure

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Meeting the CHDO Definition

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CHDO Legal Status

- To be eligible, organization must:
  - Be organized under state and local law
  - Have among its purposes to provide decent and affordable housing to low income persons
  - Net earnings provide no benefit to members, founders, or other individuals
  - Not be under control of individuals/entities seeking to profit
  - Have IRS tax exempt status, usually 501(c)(3)
  - Not be a governmental entity

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Governmental Entity

Governmental entities:

- Participating jurisdiction
- Other jurisdiction (state or unit of local government)
- Indian tribe
- Public housing authority
- Indian housing authority
- Housing finance agency
- Redevelopment authority

Not “governmental” for CHDO definition:

- Independent school districts (separately elected school board)
- State universities/community colleges with independently elected board
- Non-housing regional authorities (e.g. regional sewer authority, water district, airport authority, etc.)

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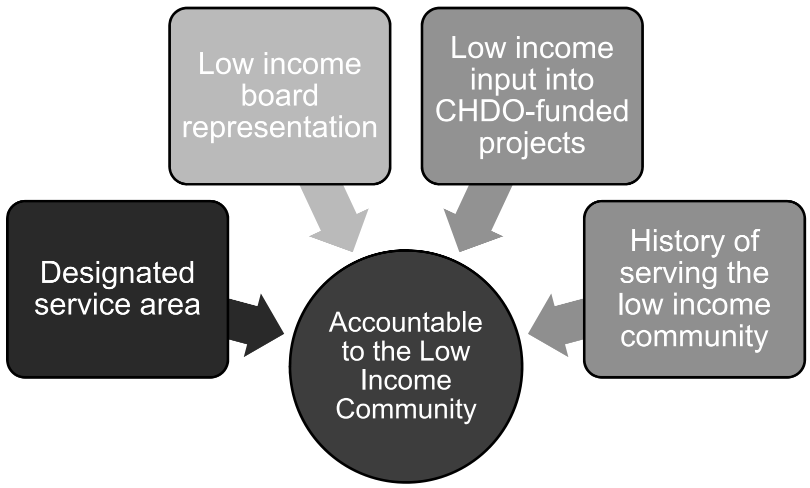
Accountability to the LI Community



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What Is the CHDO's "Community"?

- CHDO must designate its "service area" for its CHDO's activities
- The "community":
  - May be multi-jurisdictional
  - Cannot be entire state
- The service area will be the basis for determining accountability to the low income community

10

Low Income Board Composition

- At least 1/3 low income representation on board
  - Low-income residents of the community
  - Residents of low-income neighborhoods
  - Elected representatives of LI neighborhood org
- Government officials, employees, or appointees may not be counted as low income representatives
- Separate limits on board for independence from government & for-profit entities
  - More in a minute

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Low-Income Input

- Must have formal process for low income beneficiaries to provide input on project design, siting, development, & management
  - Must be described in writing and documented
  - Must be in by-laws or resolution
- Methods may include:
  - Special committees, neighborhood advisory boards
  - Open town meetings
  - Surveys

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History of Service

- Organization must have at least 1 year of history serving the community
  - Not limited to housing, could include services (e.g., head start, job training, tax prep, food bank, etc.)
- If CHDO was formed by local churches, service organizations, neighborhood orgs, the parent organization's history of service may count

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Capacity

- Financial management system
  - Must conform to 2 CFR 200.302 - .303
- CHDO must have paid staff with demonstrated capacity appropriate to CHDO "role" & project
  - Own, Develop, and Sponsor roles discussed later…
  - Two distinct issues:
    1. Does the CHDO have directly paid staff?
    2. Do the staff have capacity to implement project?

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1. Who Count as Staff?

- Paid staff must be directly employed & paid by the CHDO
  - Could be W-2 or contracted; full-time or part-time
- Staff cannot be:
  - Donated by, contracted through, or cost allocated from another entity (including parent nonprofit)
  - Board members or volunteers
  - Consultants—except 1st year of CHDO funding
  - No officials/employees of government entities or for-profit creator

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2. Do Staff Have Capacity?

- Capacity is based on:
  - Staff skills
  - Prior experience
  - Availability to perform project activities (time available & other commitments)
- Project needs vary based on tenure type (for-sale v. rental), size, complexity, etc.
- Discuss expectations with PJ

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Independence

- Applicable to all CHDOs
  - Max. 1/3 of board may be public officials, appointees, or employees of governmental entities
  - Organization's employees cannot also be governmental officials or employed by governmental entities
- If created by a governmental entity
  - Governmental entity cannot appoint more than 1/3 of board, those members may not appoint remaining 2/3

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Independence cont…

- If CHDO was created by a for-profit
  - For-profit cannot have housing development or management as primary purpose
  - For-profit cannot appoint more than 1/3 of board, those members cannot appoint remaining 2/3
  - Officers/employees of for-profit cannot be CHDO employees
  - CHDO must be free to contract for goods/services from vendors of its own choosing

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Optional Assistance to CHDOs

- Rule permits 3 additional ways that PJs can choose to assist CHDOs:
  – Operating assistance
  – Pre-development loans
  – CHDO proceeds
- CHDOs need to discuss with PJs
  – These are not entitlements
  – They reduce funds available for other uses

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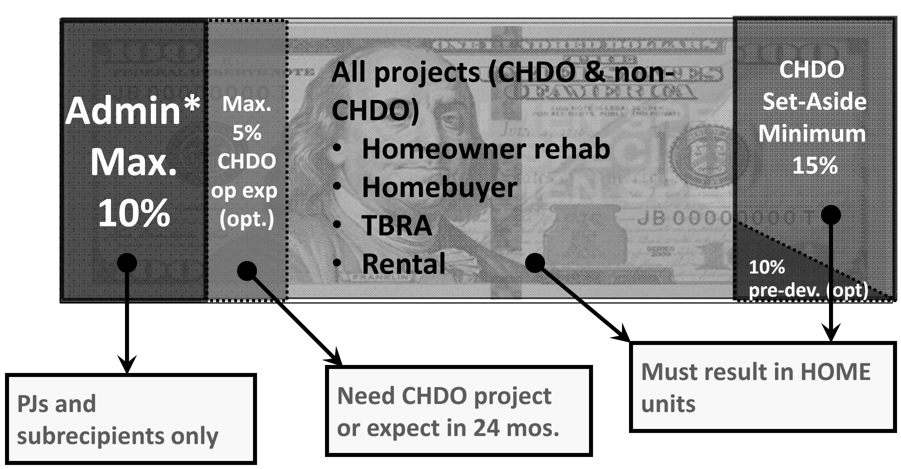
PJ Annual Allocation Breakdown



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Operating Assistance

- From non-set-aside PJ project funds
  - Cumulative maximum of 5% of HOME allocation
- Use for operating costs of PJ (e.g., staff, office)
  - Limit: greater of 50% operating budget or $50K
- CHDO must have set-aside award or PJ expects to fund w/in 24 months
  - Can award funds to develop staff capacity to meet & comply with certification
- Requires separate written agreement

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Predevelopment Loans

- Maximum 10% of CHDO set-aside
- For typical predevelopment costs (e.g., site control, planning costs, etc.) needed prior to readiness for full commitment
  - PJ determine if environmental clearance required
- If project proceeds, repaid or rolled into project award
- If project determined infeasible, PJ may forgive

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CHDO Proceeds

- Net proceeds of HOME investment:
  - PJ option: Returned as Program Income or allow CHDO to retain as CHDO Proceeds
  - Most often, net proceeds of homebuyer sales
- If retained, CHDO may use for
  - Other HOME-eligible activities
  - "Other housing activities to benefit LI families" as defined by the PJ
- Use controlled through written agreement and monitored by PJ

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- Session Objectives and Format
  - Key regulatory drivers
  - Shifting to buyer-driven programs
  - Deployment of HOME funds in CHDO projects
  - Projecting buyer purchasing power

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Eligible CHDO Set-Aside Activities

- Eligible CHDO set-aside homebuyer activities
  - Acquisition-rehab
  - New construction
- May include buyer assistance as integrated part of development project
- Can involve lease-purchase if conveyed within
  - 36 months of LP agreement w/initial buyer OR
  - Limited time to final replacement buyer or rent

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Regulatory Drivers

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CHDO Role: Developer

- CHDO itself owns, rehabs or constructs, then sells property to low income buyer
- May include direct buyer assistance (e.g. DPA)
  - Set-aside funding used exclusively for direct assistance alone cannot be more than 10% of HOME used for development
  - Does not limit pass-through of development funds or PJ non-set-aside HOME assistance

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"New" Rule Provisions

- Only project-specific commitments
  - Identify address or legal description
  - No generic reservations (projects to be named later)
- Prior to committing funds, a PJ must
  - Underwrite financial viability
  - Assess the market for proposed units
- Sale to the buyer
  - Ratified contract in place within 9 months of construction completion
  - Buyer must be underwritten, assistance sized to specific circumstances

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Shifting PJ Perspectives

- Transition to buyer-driven programs
  - Pre-sales prior to commitment
  - Demonstrated pipeline of buyers
- Follow the market, don't try to create it
  - HOME alone is not sufficient for revitalization
- Developing market assessment framework

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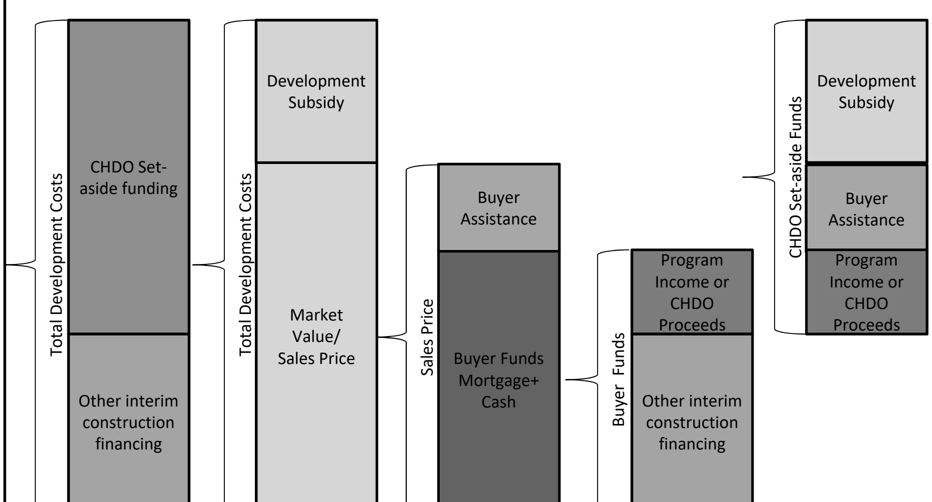
Set-aside Funds in Homebuyer



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Three Steps to Packaging a Homebuyer Project

1. Analyze the market

Sales price	Potential buyers

2. Estimate buyer financing & assistance

1^{st} mortgage	HOME assistance

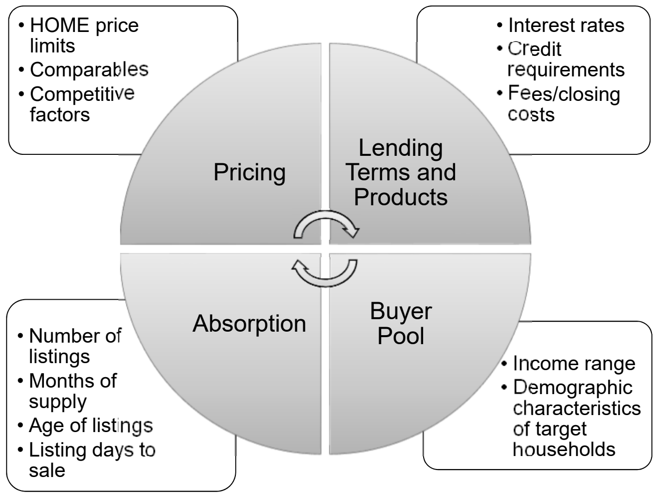
3. Assemble the Development Budget

Uses	Sources

What Type of Market Analysis?

- A PJ is required to do a “market assessment”
  - Some financing sources require independent market studies, but HOME does not per se
  - PJ may require, esp. if building multiple units on spec
- Homebuyer projects are likely to be in-house analysis by a CHDO and a PJ and rely more on sales analysis and primary data on low-income buyers
  - Market listings and comparable sales
  - Waiting lists, counseling, pre-qualification lists, membership lists, and community outreach

What Does a CHDO Want to Learn from a Market?



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What Buyers Bring to the Table

- Homebuyers bring the “permanent financing”
  - Homebuyer funds: downpayment + 1st mortgage
  - HOME fills some/all of gap between price and homebuyer funds, but only what is minimally necessary
- Estimating buyer funds when buyers not known
  - Estimate homebuyer financing needed based on buyers at the low end of the eligible/affordable range

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How To Estimate Buyer Assistance

1. Determine what homebuyers can afford to pay toward sales price of home
   – Mortgage
   – Downpayment
2. Determine the "affordability gap"
3. Estimate need for HOME assistance by project homebuyer(s)
   – Closing cost assistance may be added later

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Sizing the 1st Mortgage

- Lenders use ratios to "size" the mortgage
  – Front end ratio: housing expense to income ratio:
  – Back end ratio: total debt to income ratio
- But general market ratios may not fit LI buyers
  – Ratios that work for middle income may not leave enough income for other costs for LI HH
  – Back ratio more important constraint for LI buyers, but front ratio used for project planning
- PJ must have buyer standards for 1st mortgage
  – Should address ratio standards

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Front End Ratio

- Housing Costs (PITI) ÷ Gross Income
  - Principal + Interest + Taxes + Insurance
  - Also HOA fees + Mortgage Insurance (as applicable)
- Typical ranges of 25% to 33%
  - Higher ratio = larger loan but larger monthly payment
  - Lower ratio = more affordable mortgage payments, but less purchasing power and larger gap
- Ratio impacts sustainability risk

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Front Ratio Example

Gross income	$35,000	
Front end ratio	x 28%	
	= $9,800	per year
	÷ 12	months
	= $817	max per month
	- $150	taxes/insurance
	= $667	max/month for P+I

Max loan at 4% for 30 years = $139,710

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Back End Ratio

- Total debt ÷ gross income
- Total debt includes PITI plus:
  – Installment debt (e.g., car loan) and
  – Revolving debt (e.g. credit cards)
- Typical back end ratios are 36-42%
- Back ratio likely to limit the loan amount, due to high levels of other debt
  – PJs should set minimum front ratios to cap other debt effect on mortgage

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Back Ratio Example

Gross income	$35,000	
Back end ratio	x 38%	
	= $13,300	per year
	÷ 12	months
	= $1,108	max per month
	- $150	tax/insurance
	- $268	car payment
	- $100	credit card payment
	= $590	max for P & I (was $667)

Max loan at 4% for 30 years = $123,582

~$16,127 reduction due to consumer debt/back end ratio

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Estimate Affordability Gap

1. Estimate range of buyer mortgage amounts
   – Fixed rate; use likely lender terms
   – Apply maximum PITI to avoid mortgage burden
   – Apply minimum PITI (avoid excessive debt subsidy)
2. Determine minimum required downpayment
3. Determine affordability gap

Sales Price
Minus: buyer funds (1st mortgage & cash down)
= Affordability Gap

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Assessing Range of Buyers

- Often development involves known house, unknown buyer… what is possible?
- Example:
  – $120,000 value, maximum homebuyer assistance of $15,000, $5,000 of that will be closing costs
  – Buyer must obtain mortgage of $110,000
  – P&I (4% interest/30-year term) = $525/month
  – T&I projected at $155/month
  – PITI = $680 ÷ 28% front end ratio x 12 = $29,142 min income needed
  – If assuming ratio of 25%, min. income = $32,640

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Buyers Drive the Deal

- Follow the market, don’t try to lead it
- Know your market, must understand
  - Income band served
  - Purchasing power of target market
- Structure financing around buyer purchasing power

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- Session Objectives
  - Regulatory issues driving PJ review of rental
  - Packaging a rental project – a play in five acts

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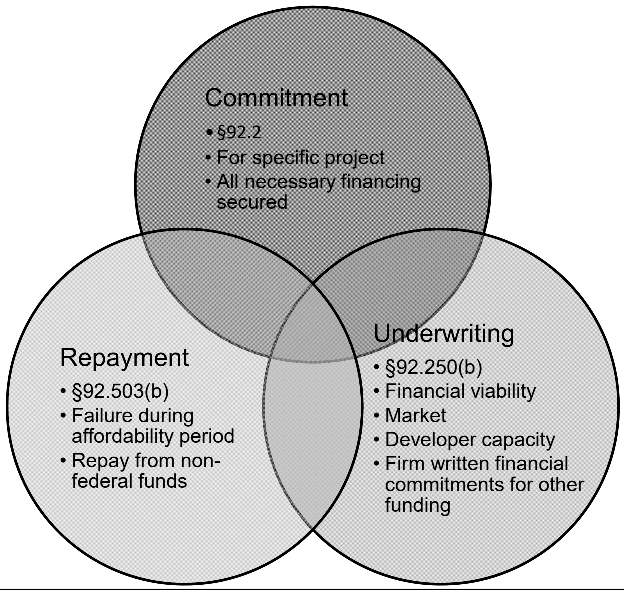
Regulatory Drivers for PJs



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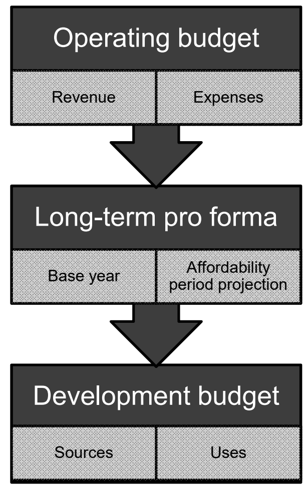
Not Just the Regulation

- Opportunity Cost
  – Needs so great, can’t tie up money in projects that aren’t ready or aren’t viable
- Organizational survival
  – Can’t help anyone if project pulls you down
- Affordable housing eco-system
  – Getting by isn’t enough, PJs need strong partners

4

Packaging a Project in 5 Steps

1. **Revenue** - Who does your organization seek to serve and how much will they pay?
2. **Operating Expenses** - What will it cost to operate?
3. **Long-term Proforma** - Will it remain viable over time?
4. **Development Uses** - What will it cost to develop?
5. **Sources** – Where does money originate?



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Rents & Revenue

- HOME sets maximum rent
  - Doesn't mean they can pay it
  - Doesn't mean they will pay it
- Market analysis
  - Understanding income band
  - Competition/supply and unmet demand
- Rent schedule ≠ revenue
  - Total economic vacancy
    - Physical + bad debt + concessions

6

What Can Market Analysis Tell Us?

- Market area: geography of primary customers
- Demand pool
  - Number of households in target income range and target household demographics
- The competition
  - Rents in comparable projects (assisted/unassisted)
  - Vacancy rates
  - Competitive advantages or disadvantages
- How quickly new units are absorbed

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Affordability Example

- Low HOME Rent limit based on income limit of $30,000/yr = $2,500/month x 30% = $750 rent
- $750/45% = $1,667/month = $20,000/yr
- Effective range of target market: $20K - $30K

- Single-parent with 2 kids – needs 3 bedroom unit
- Working full-time at $12/hour
- $12 x 2080 hrs = $24,960/year = $2,080/month
- 40% x $2,080 = $832
- High-HOME rent for 3 bedroom unit, Washington County IN = $874

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Projecting Revenue

- Gross Potential Rent: Potential revenue if all units full at scheduled rents
  - aka Gross Rent Potential
- Total Vacancy: Adjust for rent not collected
  - Physical vacancy—no tenant, no rent
  - Bad debt—tenant in place, not paying any
  - Concessions—tenant in place, discounted rent
- Effective Gross Income: Expected revenue

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Key Operating Costs

- Formats vary, but key elements include:
  - Administration and Management
  - Operating and Maintenance
  - Taxes, Utilities, and Insurance
  - Escrows and Reserves
  - Debt Service
- Summary versus itemization
  - Closer your organization gets to the property, the more detail you should see

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Advice on Operating Costs

- Budget completely
- Budget realistic costs
  - Not "how much do I have to work with?"
  - Use comparable properties and industry averages or underwriting standards
- Budget a margin for error
  - Variance from budget is normal and expected
  - Don't budget for "optimal" scenarios

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Base Year

- Base year for projection is annual "stabilized occupancy" & full ongoing operating expenses
  - Not including the "rent-up" period
  - Expected normal occupancy & turnover
  - Normal year marketing expenses, not 1^{st} year
  - Not 1^{st} year maintenance costs (when everything is new & under warranty)

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Trending Assumptions

- Expenses increase faster than rents
  – But debt service shouldn't change
- Straight-line projections
  – Reflect "average"' expected increases
- Industry rules of thumb:
  – 1–2% rents; but median income changes at low end of range
  – 3–4% expenses
  – Do these rules of thumb make sense?

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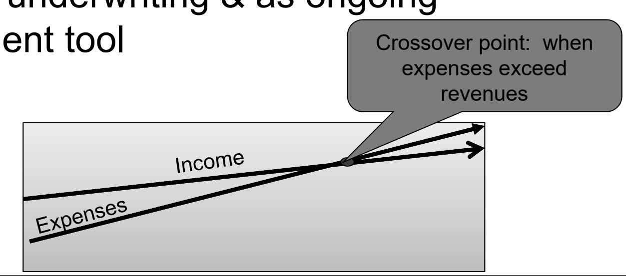
How Projections Help Us?

- Project revenues v. expenses (+ debt service) to analyze viability over the affordability period
  – Cross-over point: when expenses > revenues
  – Project expected changes (e.g., debt service)
  – Examine reserves
- Useful for underwriting & as ongoing management tool



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When Cash Flow Turns Negative

- Does your deal go negative?
  - When? By how much?
- Can you:
  - Adjust rents or cost assumptions
  - Increase initial improvements to control maintenance costs
  - Capitalize a reserve (“sinking fund”)
  - Recapitalize the project during the period

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Development Costs

- Costs to develop and occupy the project
- Formats vary, but key categories include:
  - Acquisition
  - Site improvements and infrastructure
  - Hard costs of construction or rehabilitation
  - Soft costs and fees
  - Pre-funded escrows and reserves
- Must be comprehensive and complete
  - Not listing a cost does not make it disappear

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Keep in Mind

- Budget contains all development costs
  - HOME will be allocated to HOME-eligible costs
  - HOME-ineligible costs: off-site infrastructure, non-residential structures, most reserves
  - Limits on pre-commitment costs
- Basic cost principles apply
  - All costs must be reasonable, necessary, allocable, documentable
  - All costs contribute to gap, so subject to PJ review

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Escrows & Reserves

- Initial tax/insurance escrows
- Capitalized reserves
  - Rent-up (initial operating deficit, up to 18 months) – for deficits during lease-up/stabilization
  - Operating reserve – unexpected rainy day
  - Operating deficit reserve – predicted deficit
  - Replacement reserve – capital repairs
  - Others: services, security, tenant subsidy, etc.
- Only rent-up is HOME-eligible

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Major Types of Sources

- Equity
  - Typically only in Tax Credit projects
  - Nonprofit contributed property or other grants
- Hard debt
  - First mortgage or other amortizing financing
- Soft debt to fill the "gap" between total uses and equity and hard debt
  - HOME & other public sources

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Getting to the Gap

Development Budget

Sources

Equity
Debt
Subsidies _____

Uses

Acquisition/SI
Construction
Soft Costs
Working Capital _____
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The "Gap"

Operating Budget

Revenue

Gross Pot Rents
Vacancy/CL _____
Eff. Gr. Income

Op. Expenses

Admin/Mgt
Maintenance
Taxes/Util/Insur
Reserves _____

NOI
Debt Service
Cash Flow

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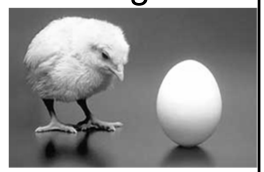
Commitment Timing



- HOME commitment requires all other financing be firmly committed in writing
  - May be contingent upon HOME award
- PJ must determine that:
  - Terms/amounts consistent w/ underwriting
  - Sources compatible with HOME requirements
  - Reasonably expected to close before disbursement of HOME funds
- Low Income Housing Tax Credits
  - Reservation from allocation agency
  - Good faith offer of equity investment

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- Session Objectives
  - CHDO role as owner, developer, or sponsor
  - Core capacity requirements
  - Development team selection and management

2

Eligible Projects

- Transitional or permanent rental housing
  - Acquisition, rehabilitation/reconstruction, conversion and/or new construction
- Mixed-income & mixed-use
- Group homes, transitional housing, SROs
  - Tenants must have written lease
- No facilities or temporary housing
  - Shelters, dormitories, half-way houses
- No student housing, public housing

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CHDO Roles: Rental Projects

- To receive funds from set-aside, CHDO must have effective project control
- 4 rental roles defined in §92.300(a)
  - Project **owned** by CHDO
  - Project owned and **developed** by CHDO
  - Project developed by CHDO, turnkey to another nonprofit = "**sponsor – turnkey**"
  - Project owned & developed by CHDO affiliate = "**sponsor – affiliate"**

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CHDO as Rental Owner

- CHDO itself acquires and owns housing
  - Development not required-acquisition of standard units
  - If development required, CHDO hires/oversees project manager or contracts with developer for rehab or construction
- CHDO must be sole owner in fee simple or have long-term ground lease during development and affordability period
  - May contract for property mgt. services

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CHDO as Rental Developer

- CHDO itself owns and develops housing
- CHDO arranges financing and is in sole charge of construction or rehab
- CHDO must be sole owner in fee simple or have long-term ground lease during development and affordability period

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CHDO as Rental Sponsor- Turnkey to Other Nonprofit

- CHDO develops rental housing on behalf of another non-profit & transfers title upon completion
  - Conveyed at pre-determined time to pre-identified nonprofit
  - Other nonprofit cannot be created by gov't entity, but can be another CHDO
- If transfer does not happen, CHDO maintains ownership for affordability period

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CHDO as Rental Sponsor- CHDO Affiliate

- Rental housing is "sponsored" by a CHDO if <u>owned</u> or <u>developed</u> by a:
  - For-profit or nonprofit that is a wholly-owned subsidiary of the CHDO; or
  - Limited Partnership (LP) where the CHDO or its wholly-owned subsidiary is the sole general partner
  - Limited Liability Company (LLC) where the CHDO or its wholly owned subsidiary is sole managing member

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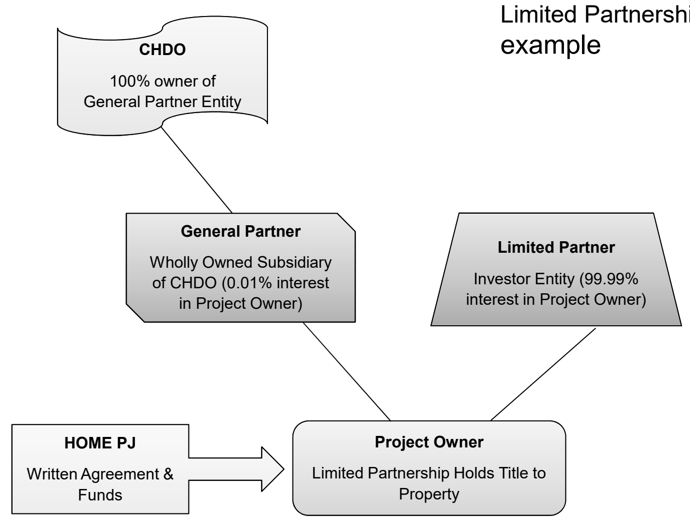
CHDO as Rental Sponsor- CHDO Affiliate, cont.

- Written agreement must be signed by PJ and the entity that will own the project
  - HOME funds (loan) must be provided directly to ownership entity
  - Grant to CHDO, Loan to LP/LLC structure not permitted
- If LP/LLC, documents must specify:
  - Removal of CHDO only permitted for cause &
  - CHDO must be replaced with another CHDO

9

CHDO as Rental Sponsor: CHDO Affiliate

Limited Partnership Example example



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Capacity Evaluation

- Regulatory requirements:
  - §92.2 CHDO definition, focus on staff capacity
  - §92.250(b)(2) requires consideration of developer's experience and financial capacity
  - §92.300 requires PJ to certify CHDO has the capacity to own, developer, or sponsor
- Capacity is not generic, must be judged in the context of:
  - Tenure type – rental or homebuyer
  - CHDO role – owner, developer, sponsor
  - Project needs – size, scope, complexity

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CHDO Owner Skills

- Overall project coordination
  - Inc. selection/oversight of contracted developer if applicable
- Legal/financial aspects of housing acquisition
  - Inc. understanding/negotiating written agreements/contract and closing process
- Oversight of property management
  - Inc. overseeing marketing, tenant selection, occupancy management, property maintenance, community relations
- HOME and federal req. compliance oversight
- Service coordination and delivery if applicable
- Asset management
  - Inc. ongoing financial oversight, capital planning, etc.

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12

CHDO Developer Skills

- Key role difference, CHDO is responsible for development. Adds:
- Oversight of project design
- Coordinating land use, zoning, other local government approvals
- Underwriting and negotiating project financing
- Contractor/builder selection and oversight
- Development team selection and oversight

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13

CHDO Sponsor

- Turnkey sponsor – developer role except ownership transferred
  - Requires additional coordination between CHDO and subsequent owner
- CHDO affiliate – subsidiary could be owner or developer depending on project
  - Adds legal complexity
- CHDO affiliate – project through LP/LLC will likely be development
  - Adds significant legal and financial structuring complexity

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14

The Core Developer Skills

- Technical skills
  - You can learn these or hire experts
- But CHDO staff must be able to:
  - Manage tasks: multi-tasking, scheduling, tracking
  - Manage people: Coordinate development team
    - Project team products
    - Contractor/construction oversight
    - Stakeholders: local approvals (community relations)
    - Lender/funder preparation for closing

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15

Who is Your Team?

- CHDO project manager leads the team
- Team members you need upfront
  - Market analyst
  - Architect/engineer
  - Legal and accounting
  - Property manager – involve early
  - Service providers, if applicable

- General contractor may come later
  - But early engagement can help value engineer

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16

Selecting the Team

- Experience
  – Similar projects, inc. w/HOME and other federal funding requirements
  – Other team members
- Trust but verify
  – Tour past projects
  – Talk to prior clients, esp. other affordable housing developers
  – Check in with PJ
- You get what you pay for
  – Use of pro bono services

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"Ex-officio" Team Members

- Development team works for you
- Don't forget players you don't control
  – Lenders and investors
  – Local officials – planning, building, etc.
  – Neighbors and stakeholders

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Developer Tools

- Market analysis: Keeping focus
- Critical path and schedule: Time is money
- Budgets: Manage the bottom line
- Team meetings: They work for you
- Disbursements: The Golden Rule!
- Lender/funder relations: Silence is not golden
- Neighbor relations: You can’t hide

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Indiana Housing Conference

Indiana's must-attend conference for affordable housing professionals.

Business Planning & Financial Management for CHDOs

August 26, 2016

ihcda

Indiana Housing & Community Development Authority

Welcome & Introductions

- Delivered by Steve Lathom, TDA Consulting
  - www.tdainc.org
  - slathom@tdainc.org
  - 517-203-4130
- Session Objectives
  - False tension between "mission" and "business"
  - Strategic business planning approach
  - Importance of financial mgt. to strategic planning
  - Survival strategies

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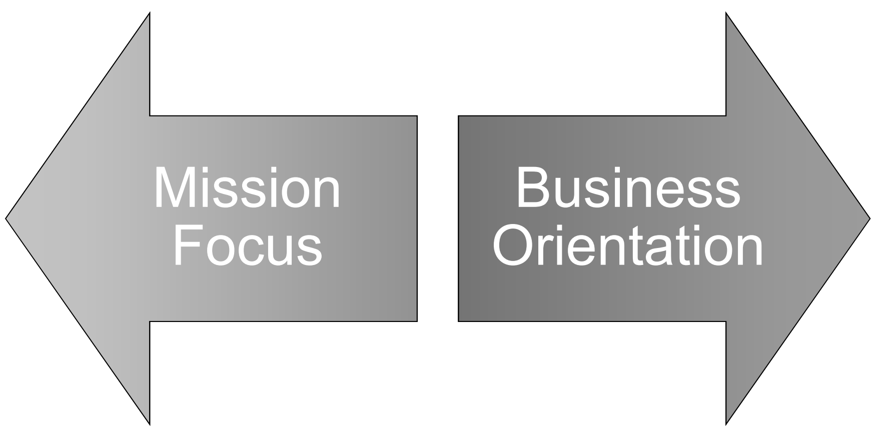
2

Cannot Survive on HOME Alone

- HOME drives key organizational issues
  - Governance/board structure
  - Development orientation
  - Staffing structure and capacity
- Not adequate to sustain CHDO “herd”
  - ~$1B; 642 HOME PJs
  - 268 PJs < $500K (42%)
  - 188 PJs $500 < $1M (29%)
- 2013 Rule changes <u>and</u> changing environment increase emphasis on capacity and viability
  - Both at project <u>and</u> organizational levels

3

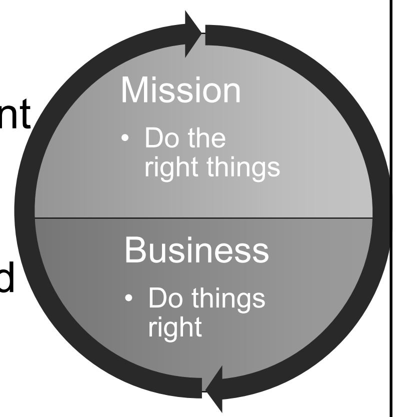
False Tension: Mission v. Business



4

Strategic Business Planning

- Balancing mission and viability
- Assess true cost of current and proposed activities
- Determine true cost of maintaining adequate and qualified staff



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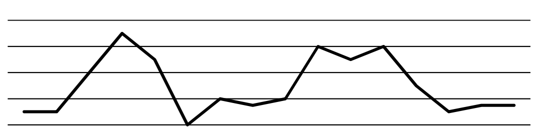
5

Planning in Times of Change

- In changing environments, strategic planning must be shorter-term
- "Strategic investments"
  - Expedited analysis & planning (2 – 3 months)
  - Time horizons of 6 – 12 months, not longer
  - Bursts of activity, analysis, and adjustment
  - Benefits: lower investment; adaptation skill



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6

CHDO Financial Management Standards

- Regulatory requirement in §92.2
  - CHDOs must meet 2 CFR 200.302 - 200.303 financial management and internal control standards
- As **developers**, CHDOs are not subject to the rest of 2 CFR Part 200
  - Federal audits, formal procurement, etc.
  - Unless a CHDO acts as a subrecipient on other (non-CHDO) HOME activities or other Federal funds

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7

Beyond the Minimum: Base for Planning

- Fund/activity accounting
  - Can you track staff time and other costs by project, activity area, etc.?
  - Do you?
  - Will be required in <u>subrecipient</u> role
- Which activities make/cost money?
- Example – "in house" property management; how much does it truly cost?
  - Even if not "allowed" in operating budget

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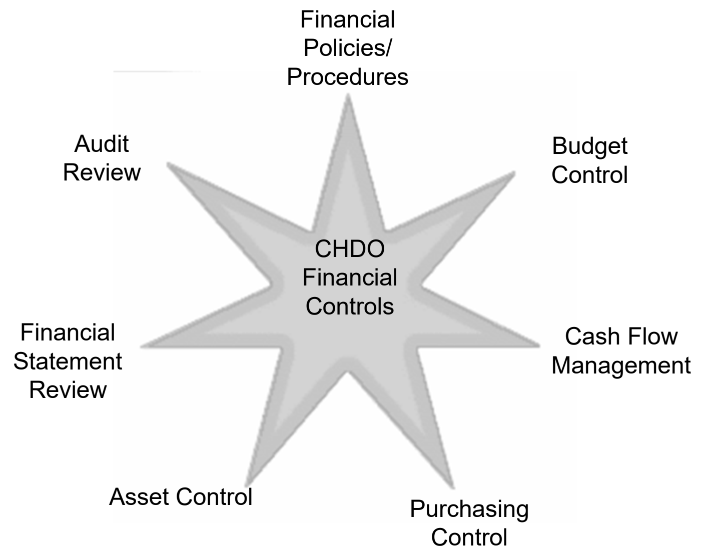
8

7 Points of Financial Control



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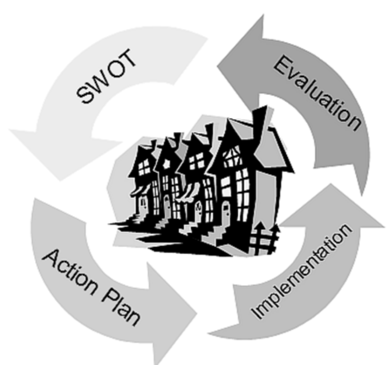
Evaluation Is Part of the Strategic Planning Cycle

- Evaluate the results
- Update the SWOT if changes
- Adjust the plan
- Implement!
  - Freedom to fail



Strategic planning is an ongoing management tool for continuously adapting to changes and refocusing on mission

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10

Evaluation Questions

- Are we doing things right?
  - The focus is on outputs
  - Total investment: Resources and staff time
  - Productivity and timeliness
  - Efficiency: Direct and administrative costs to produce
- Are we doing the right things?
  - The focus is on outcomes
  - Types of households assisted
  - Impacts on households and community

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11

Core Skill: Ability to Change

- **Adaptation reflex**: Instinctively adjusting to changing conditions
- **Anticipation impulse**: Proactively welcoming and leading change
  - **Focus** the board on its strategic role
  - **Empower** the staff to try to solve problems
  - **Get moving** and create momentum

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12

Strategic Goals: CHDO Survival

- Respond “strategically” to emerging needs and opportunities
  - But **be opportunistic**, not opportunity-driven
- Make current operations work better
  - **Increase revenues**
  - **Focus on core competencies**
  - **Reorganize for better customer service**

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Survival Strategies

- **Grow** portfolio to optimal scale
  - Achieve economies of scale
  - Correct unprofitable operations/activities
- Consider expanding geographic footprint
  - CHDO defines its own service area
  - Can be regional, not statewide

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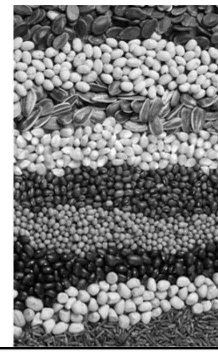
Survival Strategies

- **Diversify** the "portfolio"
  - – Find new ventures and niches
- HOME roles beyond the set-aside
  - – Subrecipient – fully subject to 2 CFR 200
  - – Contracted services, e.g. counseling
  - – Non-set-aside development projects
    - Joint-ventures
- Other programs
  - – CDBG, Counseling, etc.



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5

Survival Strategies

- **Leverage** resources by partnering
  - – Create alliances and joint ventures
  - – Mergers and acquisitions
- Can you "sell" services to others
  - – Property management, general contractor
  - – Turnkey sponsor role

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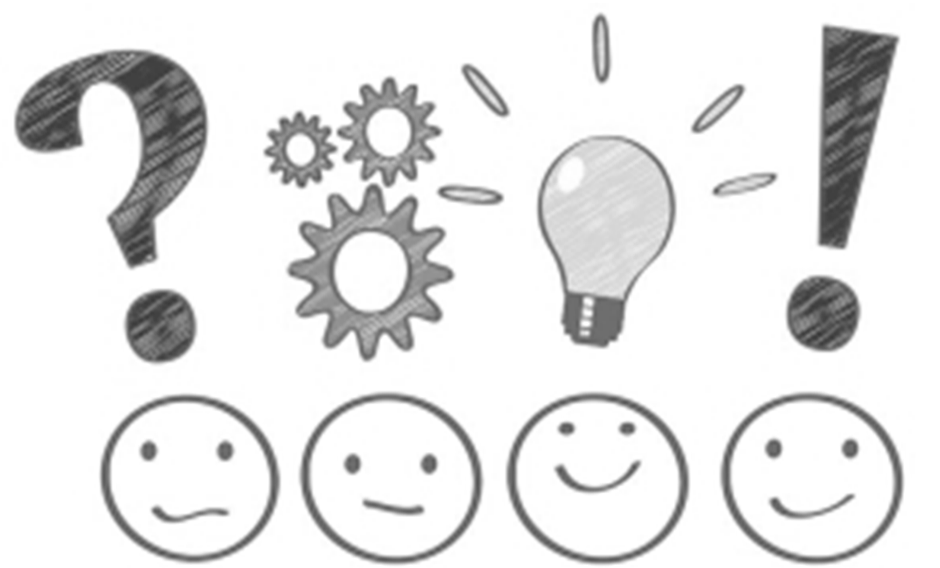
16

Final Thoughts

START WHERE YOU ARE.
USE WHAT YOU HAVE.
DO WHAT YOU CAN.

ARTHUR ASHE

17



CHDO Requirements Checklist

Before committing CHDO set-aside funds to an organization, the PJ must certify that the organization:

1. Meets the definition of a ''community housing development organization'' in §92.2;
2. Has a project eligible for the set-aside that the organization will own, develop, or sponsor in accordance with §92.300(a); and
3. Has paid staff with demonstrated experience appropriate to the role the organization will play for the project being funded.

Additionally, before committing funds for CHDO predevelopment loans under §92.301 or CHDO operating expenses under §92.208, the PJ must certify that the organization meets the definition of a "community housing development organization" in §92.2 and that other requirements, outlined in Sections 6 (predevelopment) and 7 (operating) below, have been satisfied.

CHDO Requirements	Rule Citation	Requirement satisfied & documented
ORGANIZATIONAL REQUIREMENTS		
1. Legal structure		
1.1. The organization is organized under state or local law.	§92.2 CHDO Definition ¶ (1)	☐
1.2. The organization has among its purposes the provision of decent housing that is affordable to low-income and moderate-income persons.	§92.2 CHDO Definition ¶ (7)	☐
1.3. The organization has no part of its net earnings inuring to the benefit of any member, founder, contributor, or individual.	§92.2 CHDO Definition ¶ (2)	☐
1.4. The organization is not under the control or direction by any individual or entity seeking to derive profit or gain.	§92.2 CHDO Definition ¶ (3)	☐
1.5. The organization has one of the following IRS tax exempt statuses: 1.5.1. Exemption under 501(c)(3) or 501(c)(4); 1.5.2. Subordinate of a central nonprofit under IRC Section 905; or 1.5.3. A private nonprofit that is a wholly owned subsidiary of an organization that has 501(c)(3) or (c)(4) status and meets the CHDO definition.	§92.2 CHDO Definition ¶ (4)	☐
1.6. The organization is not a governmental entity (any of the following: participating jurisdiction, other jurisdiction, Indian tribe, public housing agency, Indian housing authority, housing finance agency, or redevelopment authority).	§92.2 CHDO Definition ¶ (5)	☐
2. Independence		
2.1. Public officials & employees of a governmental entity may comprise no more than 1/3 of the board.	§92.2 CHDO Definition ¶ (5)	☐
2.2. Officers and employees of a governmental entity cannot be officers (e.g. CEO, CFO, or COO) or employees of a CHDO.	§92.2 CHDO Definition ¶ (5)	☐

CHDO Requirements	Rule Citation	Requirement satisfied & documented
2.3. If the organization was created by a governmental entity, then the governmental entity that created the organization may not appoint more than 1/3 of the board members and board members appointed by the governmental entity may not appoint remaining 2/3.	§92.2 CHDO Definition ¶ (5)	☐ Applicable
2.4. If the organization was created by a for-profit entity, then 2.4.1 through 2.4.4 apply:		☐ Applicable
2.4.1. The for-profit entity that sponsored or created the organization may not have as its primary purpose the development or management of housing, such as a builder, developer, or real estate management firm.	§92.2 CHDO Definition ¶ (3)(i)	☐
2.4.2. The for-profit entity that created the organization may not appoint more than 1/3 board members, and for-profit-appointed members may not appoint remaining 2/3 of board.	§92.2 CHDO Definition ¶ (3)(ii)	☐
2.4.3. Officers and employees of the for-profit entity that created the organization cannot be officers or employees of the CHDO.	§92.2 CHDO Definition ¶ (3)(iv)	☐
2.4.4. The organization must be free to contract for goods & services with others.	§92.2 CHDO Definition ¶ (3)(iii)	☐
3. Accountability to the Low Income Community		
3.1. The organization must have a designated service area (i.e. the "community" in which it produces housing). A community can be a neighborhood or neighborhoods, city, county, metropolitan area, or multi-county area (but not the entire State).	§92.2 CHDO Definition ¶ (8)(i)	☐
3.2. At least 1/3 of the board members are: 1) low-income; 2) residents of a low-income neighborhood; or 3) elected representatives of a low-income neighborhood organization.	§92.2 CHDO Definition ¶ (8)(i)	☐
3.3. The organization has a formally adopted process for low-income beneficiaries to advise it on decisions regarding design, siting, development, and management of housing.	§92.2 CHDO Definition ¶ (8)(ii)	☐
3.4. The organization has at least 1 year of serving the community, or, if it is formed by local churches, service organizations, or neighborhood organizations, its parent organization meets this requirement.	§92.2 CHDO Definition ¶ (10)	☐
4. Capacity		
4.1. The organization has financial management systems that conform to 2 CFR 200.302 and 200.303	§92.2 CHDO Definition ¶ (6)	☐

CHDO Requirements	Rule Citation	Requirement satisfied & documented
4.2. The organization has paid employees with demonstrated experience relevant to the CHDO's role in undertaking the HOME activity to be funded. (Note: this does not include volunteers, board members, donated or shared staff, or consultants – except as described in 4.1.1. below.)	§92.2 CHDO Definition ¶ (9)	☐
4.1.1. During the first year of an organization's funding as a CHDO only, capacity can be demonstrated through a contract with a consultant who has housing development experience to train appropriate key staff of the organization.	§92.2 CHDO Definition ¶ (9)	☐
CHDO ROLE		
5. CHDO set-aside project CHDOs can undertake either homebuyer or rental projects, as described below, with CHDO set-aside funds:		☐ Applicable
5.1. Homebuyer projects in accordance with §92.254 To qualify under CHDO set-aside, must meet 5.1.1 and 5.1.2:		☐ Applicable
5.1.1. Developer: The organization is or will be the owner in fee simple and the developer of new or rehabilitated units for sale to low-income buyers	§92.300(a)(6)	☐
5.1.2. The organization will control the development process including, at a minimum, arranging financing for the project and being in sole charge of construction.	§92.300(a)(6)(i)	☐
5.2. Rental projects in accordance with §92.252 To qualify under CHDO set-aside, must meet one of the following:		☐ Applicable
5.2.1. Own: The organization is or will be owner in fee simple absolute (or will hold a long term ground lease) for at least the period of affordability. If project involves rehabilitation or construction, organization will oversee all aspects of development.	§92.300(a)(2)	☐
5.2.2. Develop: The organization is or will be owner in fee simple absolute (or will hold a long term ground lease) for at least the period of affordability, and will be in sole charge of all aspects of the development process.	§92.300(a)(3)	☐
5.2.3. Sponsor: Must meet one of the following:		☐ Applicable
5.2.3.1. The organization will own and develop project that it will convey at a predetermined time after completion to a designated private nonprofit (that was not created by a governmental entity).	§92.300(a)(5)	☐

CHDO Requirements	Rule Citation	Requirement satisfied & documented
5.2.3.2. The project will be owned and/or developed by an eligible CHDO affiliate, including: • A wholly owned subsidiary of the CHDO; or • A limited partnership of which the CHDO or its wholly owned subsidiary is the sole general partner; or • A limited liability company of which the CHDO or its wholly owned subsidiary is the sole managing member.	§92.300(a)(4)	☐
CHDO PREDEVELOPMENT		
6. CHDO pre-development loan If a project specific pre-development loan is being provided, in addition to meeting CHDO qualification listed in Items 1 – 4 above and having a set-aside eligible project under Item 5, the predevelopment loan must designated as one of following two loan types:		☐ Applicable
6.1. TA/site control loan: The loan is for allowable costs specified in §92.301(a)(2) for planning an eligible set-aside project.	§92.301(a)	☐
6.1.1. Document the environmental exemption under 24 CFR 58.34(a) and/or 58.35(b).	§92.352	☐
6.2 Seed money loan: The loan is for allowable preconstruction costs specified in §92.301(b)(1) for planning an eligible set-aside project.	§92.301(b)	☐
6.2.1 Document the environmental exemption under 24 CFR 58.34(a) and/or 58.35(b).	§92.352	☐
CHDO OPERATING		
7. CHDO operating expenses If CHDO operating expenses are being provided, the organization must meet the CHDO qualification requirements listed in Items 1 – 4 above, or the organization must meet requirements in 1-3 and item 4.1 above and be receiving the operating funds specifically to hire staff to meet the requirements in 4.2 above. In addition, the CHDO must meet the following requirements	§92.208(c)	☐ Applicable
7.1. The organization is funded from the set-aside for a project under development, or is reasonably expected to be funded from the CHDO set-aside within 24 months	§92.300(e)	☐
7.2. The operating expense funds will be used for eligible operating costs that are reasonable and necessary	§92.208(a)	☐
7.3. Operating expense funding (including from other PJs and any Pass-Through funding) in the fiscal year will not exceed the greater of $50,000 or 50% of the organization's total operating expenses in that year	§92.300(f)	☐

CHDO CERTIFICATION
8. CHDO Certification ☐ The organization meets **all** CHDO regulatory thresholds, AND one or more of the following: ☐ The organization has a project meets the project eligibility requirements of 92.300 for a reservation of CHDO set-aside funds. ☐ The organization has a project that qualifies for a pre-development loan for eligible costs under 92.301. ☐ The organization qualifies for Operating Expenses. Signature ________________________________ Date ____________________ Name __________________________________ Title __________________________________

CHDO Toolkit Series
Issue Brief

Providing Homebuyer Assistance Through CHDOs

Description: This issue brief discusses the rules and practices around providing direct homebuyer assistance (e.g. DPA) through CHDOs. Buyers of CHDO-developed HOME-funded housing receive direct buyer assistance via pass-through funding from the development costs allocated to the CHDO, limited additional funding from the CHDO set-aside (that was not allocated as development costs), or additional direct buyer assistance from the "entitlement" portion of a PJ's HOME allocation. This issue briefs explains each of these options and provides answers to frequently asked questions.

Source Documents Provided by: Original document drafted for HUD by TDA Consulting, Inc.

CHDO Toolkit Series: This resource is part of the *CHDO Toolkit*. View the entire toolkit here: [link]. For additional information about CHDOs in the HOME program, please contact a CPD representative at your local HUD Field Office.

Disclaimer: This document has not been reviewed by HUD for legal compliance with federal statutory and regulatory guidelines. It is provided for informational purposes only. Any binding agreement should be reviewed by attorneys for the parties to the agreement and must conform to state and local laws.

Providing Homebuyer Assistance Through CHDOs

The development of homebuyer housing is eligible as a CHDO set-aside activity. HUD requires that the bulk of the set-aside funds be used initially by the CHDO for development costs and activities – such as acquisition, construction/rehabilitation and soft costs – but ultimately some or all of that assistance may be used to assist the homebuyer.

Buyers of CHDO-developed properties can be assisted with HOME funds at closing in the following ways:

- Pass-through assistance that is an allocation of the HOME funds initially used by the CHDO for development costs;
- Additional CHDO set-aside funding (that was not used initially for development costs) provided at closing to the buyer; and/or
- Additional HOME buyer assistance (not originally used for development costs) that is provided by the PJ (or its subrecipient).

The total amount of homebuyer assistance from all of these sources is determined through underwriting of the individual buyer following the underwriting guidelines established by the Participating Jurisdiction (PJ) pursuant to §92.254(f). However, §92.300(a)(6)(i) limits set-aside funding used exclusively for direct buyer assistance (i.e. not initially used for development costs) to no more than 10% of the "HOME funds for development of the housing." This limit is to ensure that CHDO set-aside funds are used primarily for development purposes.

Pass-through Assistance

When a developed property is sold, the PJ and CHDO must account for the ultimate use of the CHDO funds, which can be one or more of the following uses:

- Development subsidy – Some of the CHDO development funding may be allocated to cover the development costs that are in excess of the fair market sales price of the property, and thus not recovered in the sale of the home. This use of CHDO funds is called "development subsidy."
- Pass-through buyer assistance – After any development subsidy is accounted for, the remaining CHDO funds must be reflected in the sale, either as buyer financing (e.g., a soft second recapture mortgage) or as funds recovered from the sale. The funds that are allocated to assist the buyer to purchase – that is, any assistance to the buyer to cover the gap between the fair market sales price and the amount that the buyer can provide through downpayment and the first mortgage – are often called "pass-through" assistance.
- Program income or CHDO Proceeds – Any funds that are actually recovered from the sale and remain after all other financing and closing costs are paid must be accounted for as either Program Income or CHDO Proceeds, at the discretion of the PJ.

A separate explanation and worksheet have been made available as part of the CHDO Toolkit to assist PJs and CHDOs with the calculation of CHDO funds allocated to development subsidy, pass-through assistance, and Program Income or CHDO Proceeds.

Additional Direct Buyer Assistance at Closing

In many projects, the pass-through funding will be sufficient to meet the financing needs of the buyer as determined through underwriting. However, in some cases, a low-income buyer will need additional assistance beyond what the CHDO is able to pass through from its set-aside development funding. In those instances where additional financing has been determined to be necessary under the PJ's buyer underwriting guidelines, the PJ or CHDO may provide additional assistance to the buyer with funds that were not initially used by the CHDO for development costs.

This additional buyer assistance at closing is permitted with CHDO set-aside funds, but only to a limited extent. As noted above, §92.300(a)(6)(i) limits the additional direct buyer assistance from set-aside funds at closing to no more than 10% of the set-aside funds provided to the CHDO for development costs. For example, if a PJ provided $50,000 in CHDO set-aside funds to the CHDO as project development assistance to pay for acquisition and construction costs, and the buyer needs additional direct assistance at closing, at most only $5,000 more can be provided from the CHDO set-aside, for total set-aside funding of $55,000.

This provision only limits CHDO set-aside funds that are not first used by the CHDO for development activities. It does <u>not</u> limit either:

- The amount of pass-through financing that a CHDO provides to the buyer from set-aside funds used originally for development costs; or
- Buyer assistance provided by the PJ or a subrecipient using HOME funds that are not part of the CHDO set-aside.

Regardless of the source(s), the total amount of HOME or CHDO buyer assistance must be determined to be reasonable and necessary following the PJ's buyer underwriting guidelines (as required by 92.254(f)).

Q&A

Below are answers to some common questions about this additional direct homebuyer assistance provision and its use in relation to pass-through funding.

1. *Does §92.300(a)(6)(i) limit the total amount of buyer assistance that can be funded from the CHDO set-aside?*

   No. §92.300(a)(6)(i) only limits the amount of "additional" direct buyer assistance provided at closing that can be funded from the CHDO set-aside. It does not limit how much of the CHDO funds originally used for development costs can be "passed through" to the buyer. The total amount of HOME and/or CHDO assistance to assist an individual buyer is determined through the PJ's underwriting guidelines as required by 92.254(f).

2. *Does §92.300(a)(6)(i) limit only the funds that are expressly provided as downpayment funds? What about set-aside funds that are used directly for purchase money second mortgages, closing cost assistance or other types of direct assistance to the buyer that are not expressly "downpayment" assistance?*

   The use of the term "downpayment assistance" in this section of the HOME Final Rule broadly encompasses any form of set-aside financial assistance that is provided directly to the buyer at closing, not just the funds that are specifically recorded as being part of the downpayment. It includes assistance used for the buyer's closing costs, soft second purchase money mortgages, mortgage buydowns, or any other form of set-aside assistance that is provided directly at closing to help the buyer purchase the home. To avoid confusion, HUD expects to make a technical correction to

§92.300(a)(6)(i) to use the term "direct homeownership assistance" which broadly addresses downpayment, closing cost, and direct financing assistance.

3. *Does §92.300(a)(6)(i) limit all HOME funds for direct homeownership assistance?*

   No. The provision applies only to use of the CHDO set-aside funds that are provided at closing and are not used initially for development costs. This provision does not limit pass-through assistance or the use of additional non-set-aside HOME funds for the CHDO project.

4. *How do I determine how much "pass-through" assistance the CHDO can provide a buyer?*

   The amount of "pass-through" assistance is calculated for each buyer prior to closing. It is determined through buyer underwriting, taking into account project costs, the sales price, buyer funds, and other funds provided to the project.

   For example, assume the total development cost of a project is $150,000. $50,000 was provided from the CHDO set-aside and the remaining $100,000 is funded through a bank construction loan. If the home has a value upon completion of $150,000, and the buyer can only afford a cash down payment and a first mortgage loan totaling $100,000, the CHDO could pass through all of the $50,000 in HOME development funding as direct homebuyer assistance (e.g. a HOME second mortgage) at closing. If the buyer could afford $110,000 in downpayment and mortgage, the need for pass-through assistance would only be $40,000 (leaving $10,000 on the table as either Program Income or CHDO Proceeds).

   Pass-through funds can be limited by the use of set-aside funds for development subsidy and by PJ policy. In some cases, the entire set-aside investment is devoted to excess development costs as development subsidy, so no set-aside funds are available to pass through as buyer assistance. Also, a PJ may implement a cap on how much buyer assistance can be provided (e.g. up to $30,000), which may limit what the CHDO can provide to a given individual buyer.

5. *What if an individual buyer needs more assistance than a CHDO can provide through its original CHDO set-aside funding?*

   If it is determined through underwriting that a buyer needs additional assistance beyond the pass-through funding and the 10% limit on additional set-aside funding, the PJ can provide additional assistance, but not from the CHDO set-aside. It must come from the PJ's regular HOME (entitlement) funds or other sources.

   In the example above (i.e., the $150,000 home with $50,000 provided for development uses from the CHDO set-aside), if the buyer was determined through underwriting to need a total of $65,000 in assistance, at most $5,000 may be provided from the CHDO set-aide (10% of the $50,000 in set-aside funds provided for development costs), and the remaining $10,000 in gap financing would have to come from the PJ's "entitlement" portion of its HOME award or other sources.

OKLAHOMA SMALL SCALE RENTAL POLICY WORKING GROUP

Underwriting & Management of Small Scale HOME Rentals

Background & Context: While HOME Participating Jurisdictions (PJs) have always invested in the production of affordable rental housing, recent market, funding, and regulatory trends have combined to increase the production of "small scale" rental housing. These include:

- Dramatic changes to the for-sale housing market following the nation's financial and foreclosure crises. Many local markets have an oversupply of for-sale housing, and tighter lending standards make it harder for many low and moderate income households to qualify for mortgages.
- Demographic and economic trends have increased the demand for rental housing as former homeowners need to rent, many younger households prefer the mobility that comes with renting, and others simply prefer not to buy while the market is still weak and in flux.
- Reductions in HOME (and other HUD) funding streams mean that many PJs simply do not have the resources to support more traditional and larger multifamily developments.
- Legislative and proposed regulatory changes to HOME require that HOME-funded for-sale homes that do not sell within 6 months of construction completion be converted into HOME rentals.

Smaller scale projects, however, present unique challenges for developers (including CHDOs) and their PJ funders. Without the efficiency of scale that comes with larger developments, such projects can be more expensive to operate and maintain over time. Further exacerbating these challenges, such developments are usually made up of detached single family homes on scattered sites.

On the other hand, small scale rental projects also provide opportunities. Properly developed and managed, they can help stabilize distressed neighborhoods, and they can be integrated into the fabric of existing neighborhoods more easily, providing affordable housing opportunities in healthy neighborhoods that may not accommodate larger developments. Single family homes can provide affordable rental housing to larger families whose needs are not met in many traditional apartment complexes, and these types of projects can more easily be converted to homeownership later when neighborhood needs or local market conditions change.

Whether developed intentionally or converted to rental when sales prove infeasible, small scale rental projects will likely represent a larger share of HOME investment than in the past. PJs and their partners need tools to help evaluate these projects initially and track them over time.

This document, along with the accompanying resources, is intended to help Oklahoma PJs fill that need. It represents a group effort, facilitated by Training & Development Associates (TDA) and representatives from several Oklahoma PJs. It is our goal that this can form a common basis for approaching small scale underwriting and ongoing oversight in Oklahoma, allowing PJs with similar interests and markets to learn from one another and reduce the administrative burden of developing several different sets of local reporting tools. CHDOs and other participants will benefit too from a more consistent reporting framework that is shared across the PJ partners, reducing the administrative burden on multi-jurisdiction owners.

Listing of Tools: The package of tools being provided has been assembled using example documents provided by Oklahoma PJs including the Oklahoma Housing Finance Agency and the City of Tulsa as well as publicly available model documents in the NSP Resource Exchange, including *NeighborWorks America's* Scattered Site Rental Toolbox. Other documents have been produced by Training & Development Associates specifically for this effort. The package of model documents includes:

- An underwriting Proforma specifically designed to evaluate developments made up of small scale and scattered site projects;
- A Sample underwriting checklist highlighting due diligence items that PJs should consider reviewing as part of their underwriting of proposed projects;
- An Owner's Annual Report with both narrative components in MS Word format and financial portions in MS Excel; and
- A simple Capital Needs Assessment report designed for small projects.

Small Scale Underwriting Challenges: Once a competent developer and healthy market are identified, underwriting a rental project ultimately involves trying to answer four key questions:

- Who do you seek to serve, and how much rent can you expect to collect?
- What will it cost to operate the project?
- How will revenues and operating costs change over time?
- How will the project be funded?

In each of these areas, small scale rental projects differ from larger multifamily rental projects in several respects, and those differences require PJs to evaluate small projects differently, often with a more critical eye. Before addressing those unique features, however, it is important to establish a working definition of small scale projects.

For purposes of this document, small scale rental projects are:

- Primarily made up of single family homes, occasionally with structures containing 2-4 units;
- Typically made up of 1-4 total units at a time, that is while an owner may build a larger portfolio of units, each development phase will usually be only a handful of units;
- Usually developed by community based nonprofit organizations, including CHDOs, often as part of neighborhood revitalization effort;
- Located on scattered sites, in some cases spread across a jurisdiction and in others even dispersed across multicounty service areas; and
- Financed without low income housing tax credits or significant hard financing from conventional lending sources.

When defined in this way, small scale projects have several structural challenges. Key among them are the following:

1. The lack of scale increases both development and operating costs as certain fixed costs—for example making sure that a staff member is adequately trained in Fair Housing, affirmative marketing, and tenant selection requirements—must be spread over a limited number of units, increasing the per unit cost for such items.

2. Geographically dispersed locations also increase costs and make effective management more challenging as travel time between units. Additionally, units that are "out of sight" can more quickly get "out of control" when there are problems, causing not only financial losses but creating negative neighborhood influences.

3. Single family homes have higher capital costs over time, and the lack of uniformity between units further increases both capital and maintenance costs.

Small Scale Underwriting Perspectives: Ultimately, each of these challenges can be mitigated when PJs and their partners carefully and conservatively underwrite small scale projects, building in room to maneuver and margins for error at each step along the way. Based on the experience among Oklahoma PJs and CHDOs and those from HUD staff and technical assistance providers, the following tips and best practices can improve the quality of small scale projects moving forward, allowing them to meet their intended purpose without becoming burdens on their owners or the neighborhoods in which they are located.

Target Population & Rents: To maximize the market range for small scale homes, PJs should strongly consider allowing High-HOME units to serve tenants all the way to 80% AMI. Many PJs traditionally limit all HOME rental units to 60% AMI and below both to manage the "program rule" and for policy reasons, making affordable rentals available to lower income households. However, allowing small scale rentals to serve tenants between 60-80% AMI, even if only limiting the initial tenant to 60% AMI for program rule purposes, increases the pool of eligible tenants. Additionally, tenants between 60-80% AMI are more likely to afford units close to the High-HOME rent limit without being rent-burdened, increasing revenue and reducing bad debt and turnover.

For underwriting purposes, PJs should seek to structure rents 10% below estimates of market rents in the neighborhood (or 10% below the applicable HOME rent when market rents are higher). This allows a cushion in the event rents are not as strong as anticipated, and it can leave room for rent growth if HOME rents remain flat due to economic conditions. Even when underwriting to a lower rent, PJs can allow owners to test the market and try to achieve higher rents when actually marketing units provided those rents are still within HOME rent limits.

Unless supported by very strong services, small scale and scattered site projects are generally not particularly appropriate for special needs populations or for extremely low income populations. The geographic dispersion of units makes services harder to support and can isolate tenants who need additional supports to successfully maintain housing. And the hidden added costs of living in single family homes—especially of tenants are expected to provide lawn maintenance and/or snow removal—can be particularly challenging for very low income tenants.

Site Selection & Scope of Work: To offset the structural challenges associated with scattered sites and lack of uniformity, developers should seek to concentrate and standardize their units within reason. By selecting sites within the same neighborhood, the costs of travel between sites can be mitigated. Better still if sites can be found near the owner, for example in the same neighborhood as a CHDO's office, so that oversight of the units on a regular basis is more likely to occur.

Developers should also seek to standardize units as much as possible, using the same appliance packages, furnaces, water heaters, floor coverings, plumbing fixtures, etc. Using standard building components will reduce maintenance costs by limiting the different types of parts owners may need to buy and increase the effectiveness of maintenance staff (whether in-house or contracted) who do not have to learn and respond to as many different systems.

PJs should carefully review scope of work, and if in doubt, more work should be done rather than less. In particular, when rehabilitating existing units, PJs should seek to ensure that the building envelope and all systems will have a useful life equal to or in excess of the HOME affordability period.[1] Particular attention should be paid to using highly durable components and finishes to reduce maintenance costs over time. For example, while more expensive initially, solid surface flooring that can be refinished will cost less over time than installing carpet that might need to be replaced every 3-5 years depending on turnover and the intensity of use by tenants.

Reserves: While critical to the success of a project, capitalized reserves are one of the most challenging items to fund in any rental development, and this is even truer in small scale projects without tax credits or conventional loans. PJs should consider several means of addressing this critical issue and should put protections in place that allow the PJ some control over withdrawals from reserve accounts.

To fund reserves, PJs can consider:

- Requiring sponsors to fund reserve accounts using non-federal funds. This could include a developer's own equity that, if not needed to fund deficits or un-funded capital needs later, could be returned at the end of the compliance period. In other cases, PJs can ensure that developer's fees are adequate and fully funded (i.e. not deferred) if developers agree to reinvest some portion of the fee into reserves protecting the long-term viability of the development.
- Allowing CHDO sponsors to use CHDO Proceeds from other projects—including homebuyer projects they have sold or rental units that are subsequently sold to tenants under the provisions of 24 CFR 92.255—to establish or increase funding in reserves for small scale rental projects.

[1] Proposed changes to the HOME rule would require PJs to consider the useful life of such components for all rehabilitation projects. While the final HOME rule changes have not been published as of this writing, this perspective is critical to the success of small scale projects even if it is not yet "required" by regulation.

- Deferring payment on HOME, CDBG, or other local loans to small scale projects, allowing cash flow in early years of a project's affordability period to increase reserve funding.

Additionally, PJ funders should include provisions in their written agreements that limit an owner's ability to take cash disbursements from a development unless all escrow and reserve accounts are adequately funded. To determine if reserves are properly funded, the Capital Needs Assessments (CNAs) should be completed periodically (every 3-5 years depending on the age and condition of the property) and the Annual Financial Report's Long Term Cash Flow sheet should be used to assess the sufficiency of Operating Deficit Reserve balances.

Finally, PJs should consider requiring reserves be established in accounts that require joint approval for withdrawals. This can help ensure that struggling owners cannot easily "rob Peter to pay Paul" by using reserves for unapproved purposes.

Model Underwriting Assumptions: PJs should always be cautious of relying exclusively on "rules of thumb" but should instead review their underwriting assumptions based on actual performance within their portfolio, changes in local economic conditions, and new information that becomes available. With that important caveat, small scale rental developments require different underwriting metrics than larger multifamily projects.

In many cases, this is a function of the lack of scale, where "standard" percentages used for apartment complexes make little sense when applied to a single unit—for example a 5% vacancy rate on a duplex rental means that a single unit could be physically or economically vacant (i.e. occupied but not paying rent) for only 5 weeks per year. So in most cases, percentage figures need to be higher than in larger projects.

- Vacancy rates, including both physical and economic vacancy, should typically be no less than 12-15% for small projects;
- Unless supported by strong waiting lists within the existing portfolio, rents at underwriting should be set $50-100 or at least 10% below the lesser of the "market" rent for the unit or the applicable HOME rent;
- Operating costs projections may be substantially higher than for multifamily projects—absent data from an owner's existing portfolio, PJs should plan for operating costs 50-75% higher than for similarly sized units in nearby multifamily complexes; this may equate to operating expenses of $4,500 to $6,000 per unit per year;
- Replacement Reserves should be budgeted at no less than $750 per unit per year, and if cash flow allows owner should be encouraged to set aside more. Capital Needs Assessments should be used to evaluate reserve balances, both at initial underwriting of rehabilitation projects and periodically during the affordability period for all project types;
- Since small projects typically have little or no hard debt, PJs should review the "operating margin" rather than a debt coverage ratio. The operating margin is the ratio of "cash flow" to total operating costs, reserve deposits, and any debt service payments. Ideally, projects will show an 8-12% margin, such that for cash flow provides an adequate cushion over expenses.

- Initial operating reserves, where feasible, should be established equal to 6 months of projected operating costs—i.e. if per unit operating costs are $5,000 per year, an initial reserve of $2,500 per unit should be established—and cash flow distributions should be restricted until operating reserve balances equal 6 months of current annual operating expenses (e.g. in year 5, if operating expenses are $6,500 per unit per year, distributions should only be allowed if the operating reserve balance is $3,250 per unit);
- Initial underwriting should assume that rents increase at 2% annually and that expenses increase at no less than 3.5% annually;
- Developer's fees should be fully funded at between 12-18% depending on the complexity of the projects involved (i.e. projects with multiple funding sources that must balance several regulatory schemes or projects involving historic rehabilitation or extraordinary environmental conditions might merit fees at the higher end of the scale while simpler projects involving acquisition of new homes from a private builder, for example, have less risk and merit fees at the lower end of the scale).

Use & Limitations: This document and the accompanying tools were developed through a partnership between several HOME PJs in Oklahoma, the Oklahoma City HUD Field Office, and Training & Development Associates. Contributing PJs include the Oklahoma Housing Finance Agency the Cities of Lawton, Norman, Oklahoma City, and Tulsa.

These materials and the insights and best practices identified in this report may be used freely by other Oklahoma PJs and their partners, but each PJ is ultimately response to HUD for the operation of its own program—including the development of policies and procedures, underwriting of projects, and the oversight and monitoring of HOME activities during development and the compliance period. So, individual PJs not only may, but should adapt these materials and standards for their own use, adding items to address local program design issues, and applying lessons learned from the ongoing management of their programs.

Additionally, while every effort has been made to ensure that these materials are useful and accurate, they are not intended to address all HOME issues that PJs may encounter or fully address all aspects of underwriting or managing small scale projects over time. Rather, the purpose of this project was to provide a solid starting point from which PJs and their partners can begin to approach small projects.

Those wishing to suggest changes, share additional information, or otherwise contribute to the ongoing sharing of information among Oklahoma HOME PJs on this matter should contact the Small Scale Rental Policy Working Group co-chair:

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CHDO Toolkit Series
Issue Brief

Assessing Staff Capacity by CHDO Role

Description: This issue brief provides guidance to Participating Jurisdictions (PJs) on assessing staff capacity under the 2013 HOME Final Rule, identifying varying core skills required based on a CHDO's role as owner, developer, or sponsor and the type of housing being produced. It also describes how PJs can approach staff capacity determinations outside of project-specific commitments, particularly when considering CHDO predevelopment loans and operating cost awards.

Source Documents Provided by: Original document drafted for HUD by TDA Consulting, Inc.

CHDO Toolkit Series: This resource is part of the *CHDO Toolkit*. View the entire toolkit here: [link]. For additional information about CHDOs in the HOME program, please contact a CPD Representative at your local HUD field office.

Disclaimer: This document has not been reviewed by HUD for legal compliance with federal statutory and regulatory guidelines. It is provided for informational purposes only. Any binding agreement should be reviewed by attorneys for the parties to the agreement and must conform to state and local laws.

CHDO Designation: Assessing Staff Capacity

Paragraph (8) of the CHDO definition in §92.2 requires an organization to have paid employees with demonstrated housing experience relevant to the prospective CHDO's role as the owner, developer, or sponsor of the project for which it seeks CHDO set-aside funds.

To certify that a nonprofit organization has sufficient capacity to qualify as a CHDO, a PJ must determine that the CHDO's employees collectively have sufficient experience and capacity to effectively manage a proposed project. While most projects will involve various third-party professionals such as architects, attorneys, etc. (i.e. the development team), a CHDO's employees must have core competencies that enable a CHDO to exercise control over a project and the development team.

To determine whether a CHDO meets this requirement, a PJ must answer three distinct questions:

1. *What skills are required of CHDO staff to oversee a proposed CHDO set-aside project based on project type and CHDO role?*
2. *Does a CHDO have paid employees to oversee the proposed CHDO set-aside project?*
3. *Does an organization's paid employees have relevant experience and sufficient capacity to undertake and oversee the proposed project?*

Critical Staff Skills by Project Type & CHDO Role

While certain core competencies—such as general project coordination or basic understanding of HOME Program rules—are common across any HOME project, specific skill sets necessary to successfully complete a project will vary based on:

- tenure type – rental or homeownership;
- CHDO role – owner, developer or sponsor; and
- project size, scope, and complexity.

CHDOs may undertake a variety of projects and play various roles as permitted by §92.300(a)(2) – (6). PJs evaluating a CHDO (and CHDOs requesting funding) must ensure that the experience and skills of a CHDO's staff are aligned with the requirements of a respective role.

While there is significant overlap, critical staff roles, skills, or experience required vary based upon the type of project (homebuyer or rental) and a CHDO or its affiliate's role (owner or developer).

- <u>"Owner" Rental Projects</u> – meeting the definition at §92.300(a)(2)
    - Overall project coordination, including project selection and acquisition, and procurement/oversight of contracted project manager, if applicable
    - Legal and financial aspects of housing acquisition, including understanding and/or negotiating written agreements/contracts and requirements for closing
    - Oversight of property management, including the ability to manage marketing, tenant selection, occupancy management, property maintenance, and community relations
    - HOME Program and federal requirement compliance and oversight

- Service coordination and delivery (if applicable)
- Asset management, including ongoing financial oversight and long term capital planning

- "Developer" or "Sponsor" Rental Projects – meeting the requirements of either §92.300(a)(3), (4) or (5)
  - Overall project coordination, including project selection, planning, financial packaging, and development team management
  - Oversight of project design
  - Oversight of land use, zoning, and other state and local government approvals
  - Legal and financial aspects of housing acquisition and development, including negotiating written agreements/contracts
  - Understanding of loan underwriting and project financing, particularly the funding sources relevant to the proposed project
  - Contractor/builder procurement and contract negotiations
  - Managing team oversight of construction
  - Oversight of property management, including the ability to manage marketing, tenant selection, occupancy management, property maintenance, and community relations (this may not apply to sponsor projects that are transferred to another nonprofit organization under §92.300(a)(5)
  - HOME Program and federal requirement compliance oversight
  - Service coordination and delivery (if applicable)
  - Asset management including ongoing financial oversight and long term capital planning

- "Developer" Homebuyer Projects – meeting the requirements of §92.300(a)(6)
  - Overall project coordination including project selection, planning, and development team management
  - HOME Program and federal requirement compliance and oversight
  - Design, land use/zoning, and other local government approvals
  - Legal and financial aspects of housing development including negotiating written agreements/contracts
  - Underwriting and project financing
  - Contractor/builder procurement and ongoing construction oversight
  - Marketing and sales
  - Homebuyer relations including counseling, income verification, and lender coordination

While CHDO staff are not required to have prior experience with the exact type of project proposed and need not have every technical skill or experience listed, staff must have a preponderance of the management skills needed to oversee the development team and the planning and implementation of the project. All developers use a team of professionals to plan and implement projects. CHDO staff are not required to have all of the technical skills, but must possess sufficient skills to oversee the team and manage the process to ensure delivery of the project. Since a PJ is at risk for repayment of CHDO set-aside funds for projects that do not meet the HOME Program requirements, a PJ must determine that paid CHDO staff have the capacity to oversee all elements of a project.

Paid Staff

Based on the type of project and role, a CHDO must identify one or more paid staff persons who are directly assigned to perform the oversight of a project and have relevant capacity. Key CHDO staff counted toward the capacity requirement must be paid directly by and accountable to a CHDO. Key CHDO project staff cannot be contracted through, contributed by, or cost-allocated from another entity. Consultants, volunteers or board members cannot be counted toward this requirement. The use of consultants to demonstrate capacity is ONLY permitted during the first year of funding as a CHDO and a consultant's role must be primarily to train staff to build capacity.

Usually, staff will be "employees" for tax purposes. CHDOs will pay payroll and unemployment taxes on the wages paid and will withhold employee income and payroll taxes. The receipt of a W-2 can be considered definitive evidence of being a "paid employee".

However, there are other contract or term employment situations that may not be subject to the taxes, withholdings, and W-2 requirements, but an individual may still be considered eligible as an employee rather than as a consultant. Absent a W-2, a PJ must review the employment contract and determine that a person will be directly paid by a CHDO and that a CHDO determines r when, where, and how work is completed for the person to be considered a contract employee.

Staff Capacity

In assessing whether an organization's paid employees have sufficient experience and capacity, PJs must consider factors including, but not limited to:

- the specific roles each CHDO staff member will play in a proposed project;
- the skills required for a particular role; and
- the availability of all CHDO staff to devote time and energy to a project, including whether a person is employed full-time or part-time and his/her other responsibilities within an organization.

The HOME Program rule does not require a CHDO to have full-time employees, and in some circumstances, part-time employees are acceptable, if the level of effort available from an individual is appropriate to the scale of a project. For example, a part-time construction manager may be acceptable for a small CHDO building two single family homes, but entirely inappropriate for a CHDO with three different multifamily construction projects underway.

In other situations, assigned staff may have relevant experience, but one's time is fully committed to other responsibilities within an organization, including those related to other housing projects in a CHDO's existing portfolio or planned pipeline of projects. In this instance, a PJ may likely conclude that an organization does not have the capacity to administer a project as a CHDO.

Assessing Capacity Outside of Project-Specific Commitments

The 2013 HOME Final Rule aligns CHDO designation (including determination of CHDO staff capacity) to the funding of specific projects from a PJ's CHDO set-aside. However, HUD also expects a PJ to determine that a CHDO is eligible prior to awarding either a CHDO pre-development loan under §92.301 or a CHDO operating assistance award under §92.208. Both awards may precede a project-specific commitment and ultimate designation as an eligible CHDO.

- <u>CHDO Pre-development Loans</u>—A CHDO pre-development loan may be issued when exact details of a project are still undetermined. The pre-development financing is to assist CHDOs in determining what is feasible. At such an early planning stage, it may not be possible to determine a CHDO's role or the specific skills required of CHDO staff.

  While some specific features may not be known at the pre-development stage, the general character of the project should be clear. For example, if a potential CHDO is exploring the feasibility of a multi-family project of 50-70 units serving elderly households, a PJ should be assessing the organization's capacity to develop and/or own a rental project, even if a market study that a pre-development loan will support may lead to changes in the exact project size and unit mix. Consequently, a pre-development loan should only be made if the paid CHDO staff is known to have relevant skills in doing projects of this type, but the final determination of capacity may be reserved for the commitment of CHDO set-aside funds.

- <u>CHDO Operating Funds</u>—CHDO operating funds can be awarded to a CHDO with a CHDO set-aside project or a project that a PJ reasonably expects to fund from the CHDO set-aside within 24 months. In the latter scenario, CHDO operating assistance may be awarded specifically to develop staff capacity needed to meet the CHDO definition. A PJ and CHDO will have a general concept of the type of project under consideration—the neighborhood being targeted, the tenure type, and the general size and character of a project. In determining whether to designate an organization as a CHDO for purposes of awarding operating assistance, a PJ should evaluate whether staff has sufficient capacity for a project of that type or will have capacity after expending the operating assistance, such as hiring additional staff with necessary skills or training existing staff.

- <u>Affordability Period</u>—HUD requires an organization to be designated as a CHDO at the time it is funded from the CHDO set-aside and expects a CHDO to maintain its status–including appropriate staff capacity–through the implementation of a project, including the affordability period for rental projects. A CHDO originally funded as a "developer" that is no longer developing additional housing units would not be required to maintain staff capacity to build new housing, but should have staff with experience appropriate to its ongoing ownership and operation of a HOME-assisted project.

CHDO Toolkit Series
Issue Brief

CHDO Sponsorship of Low Income Housing Tax Credit Developments

Description: This issue brief discusses how CHDOs can receive set-aside funding for low income housing tax credit (LIHTC) projects under the 2013 HOME Final Rule. The brief defines HOME expectations applicable to the various entities that may be involved in these types of projects. It also provides a basic overview of the process for syndicating tax credits and notes how projects not meeting HOME requirements for CHDO set-aside funding can still access non-CHDO HOME funds.

Source Documents Provided by: Original document drafted for HUD by TDA Consulting, Inc.

CHDO Toolkit Series: This resource is part of the *CHDO Toolkit*. View the entire toolkit here: [link]. For additional information about CHDOs in the HOME program, please contact a CPD representative at your local HUD Field Office.

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CHDO Sponsorship of Low Income Housing Tax Credit Developments

The development of rental housing is an eligible CHDO set-aside activity, and the Low Income Housing Tax Credit (LIHTC) program is a common source of capital financing in HOME-assisted rental projects. Projects involving LIHTC use ownership entities that pass tax benefits to investors while allowing day-to-day operational control to be retained by the developer, including CHDOs.

CHDOs have always been eligible to receive funding from the set-aside to undertake LIHTC projects, but there has been confusion among PJs, CHDOs, and LIHTC industry professionals regarding the ownership and control of LIHTC projects with CHDO set-aside funding. The 2013 HOME Final Rule clarifies requirements for the use of CHDO set-aside funding in projects that involve LIHTC at §92.2300(a)(4):

> *(4) Rental housing is "sponsored" by the community development housing organization if it is rental housing "owned" or "developed" by a subsidiary of a community housing development organization, a limited partnership of which the community housing development organization or its subsidiary is the sole general partner, or a limited liability company of which the community housing development organization or its subsidiary is the sole managing member.*
>
>> *(i) The subsidiary of the community housing development organization may be a for-profit or nonprofit organization and must be wholly owned by the community housing development organization. If the limited partnership or limited liability company agreement permits the community housing development organization to be removed as general partner or sole managing member, the agreement must provide that the removal must be for cause and that the community housing development organization must be replaced with another community housing development organization.*
>>
>> *(ii) The HOME funds must be provided to the entity that owns the project.*

The Rule language established three essential parameters of LIHTC projects funded with the CHDO set-aside:

- A CHDO can participate in LIHTC projects either directly or through a wholly-owned subsidiary.
- Regardless of the project ownership type (a limited partnership or limited liability company – see below), the CHDO or its wholly-owned subsidiary must be in <u>sole</u> control of the development and the ongoing operations, and joint ventures are not permitted.
- The set-aside funds must be loaned by the PJ directly to the entity that owns the project, not the CHDO itself.

Basic LIHTC Structure

Tax credits are awarded to an owner of rental property. In return for following certain income and rent restrictions, an owner receives an allocation of tax credits determined by the eligible project costs, or depreciable basis. The credits are claimed over a 10-year period and offset federal income taxes otherwise due from the owner.

Since most rental project owners (including CHDOs, which are by definition tax-exempt) do not have sufficient tax liability to use the tax credits, LIHTC-funded projects commonly use a syndicated ownership structure where the entity that owns the property is co-owned by one or more investors and the developer. The investor provides up-front capital funding, or equity, in return for the anticipated tax credits, while the developer continues to control the day-to-day responsibilities. Typically, ownership of the entity is split 99.99% to the investor(s) and 0.01% to the developer, allowing the tax benefits to flow principally to the investor(s).

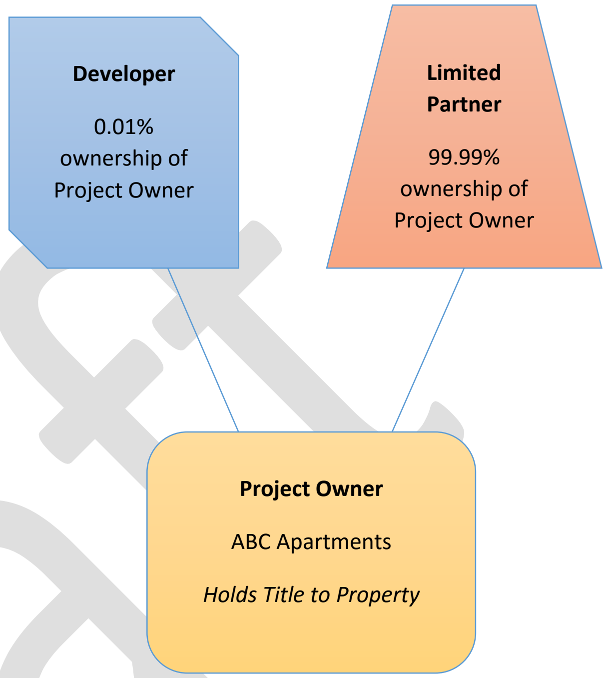
Visually, the ownership structure is often represented like in the Figure 1.

The ownership entity in a LIHTC project usually takes one of two common forms—a limited partnership (LP) or a limited liability company (LLC). While similar in many respects, the roles have different labels:

- A limited partnership is made up of “partners”—usually a general partner (the developer) and one or more limited partners (the investor(s))—and is governed by a partnership agreement.

- A limited liability company is a corporation comprised of “members”—one of whom (the developer) is designated as the “managing member”—and is governed by an operating agreement.

Figure 1: Basic Syndicated Ownership Structure



Thus, the ownership structures of the two ownership entities are depicted below in Figures 2 and 3. While these figures represent the most basic common forms of syndicated LIHTC ownership entities, other variations can exist, including multiple participants and additional roles.

Figure 2: Basic Limited Partnership Structure

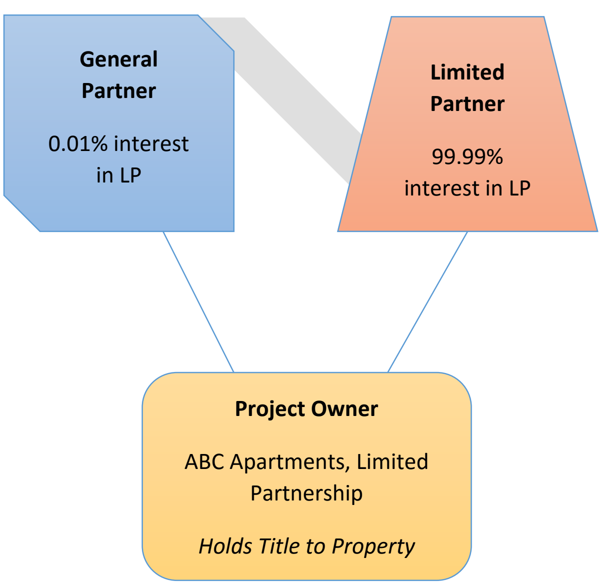
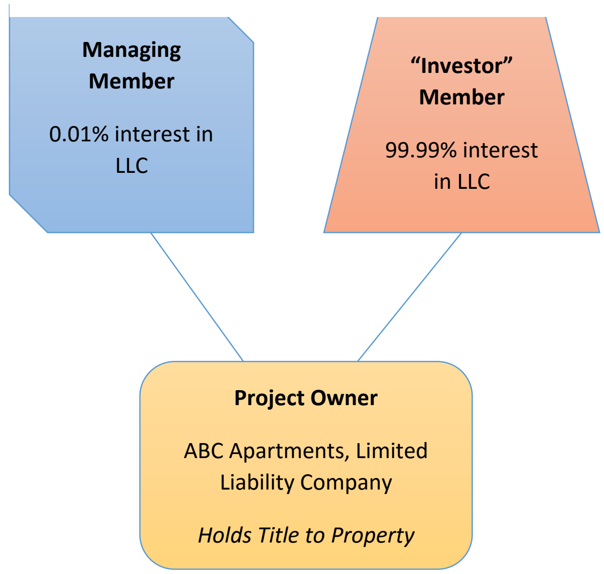


Figure 3: Basic Limited Liability Company Structure

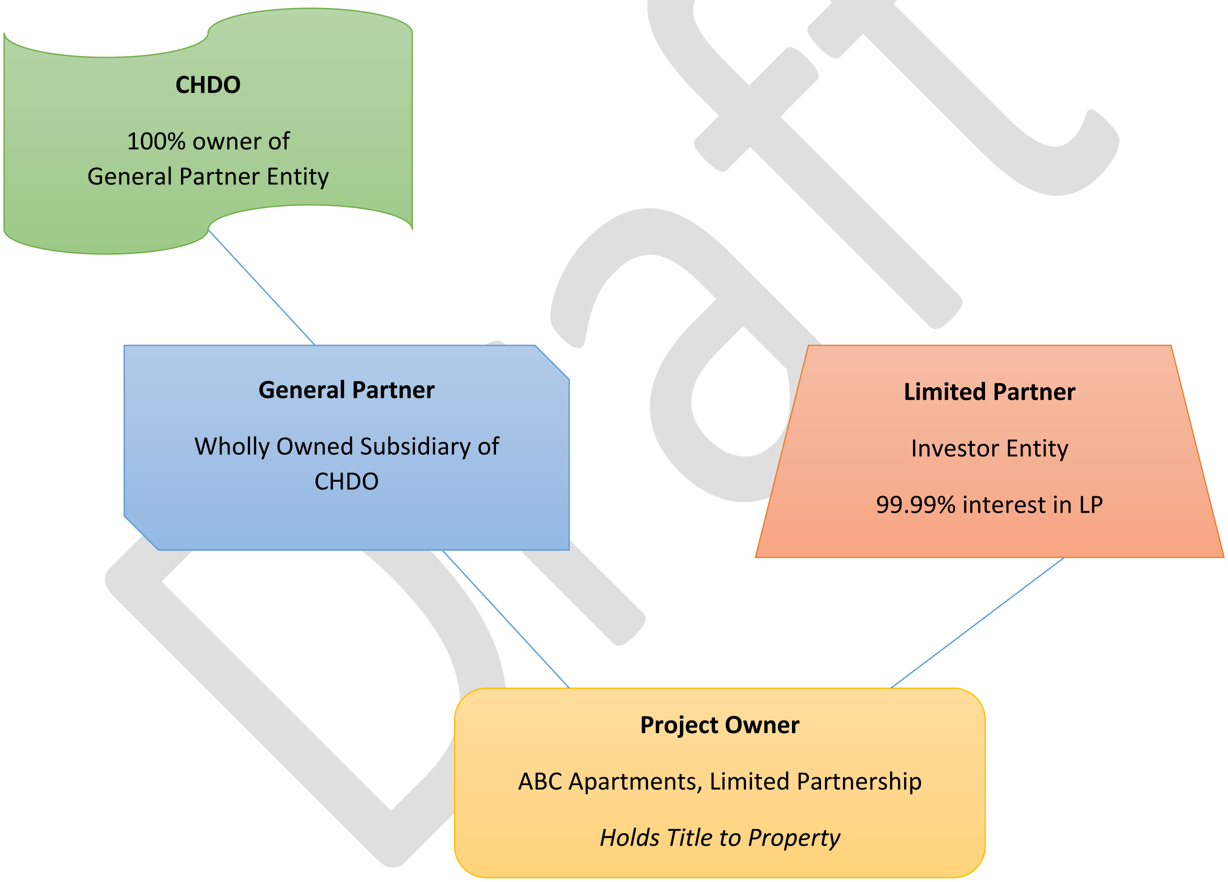


Qualifying for the CHDO Set-aside: Under the 2013 HOME Final Rule, a CHDO can be the "sponsor" of a LIHTC project that uses either the LP or LLC ownership structure. To qualify for set-aside funding however, the CHDO itself or a wholly-owned subsidiary of the CHDO must be either the:

- Sole general partner of the LP that owns the project; OR
- Sole managing member of the LLC that owns the project.

While the rule permits a CHDO itself to act as the sole general partner or managing member, it is common for CHDOs (and other developers beyond the CHDO set-aside) to establish a wholly owned subsidiary to act in such a capacity. The LP ownership structure in such a case is depicted in Figure 4.

Figure 4: General Partner Entity Wholly-Owned by CHDO

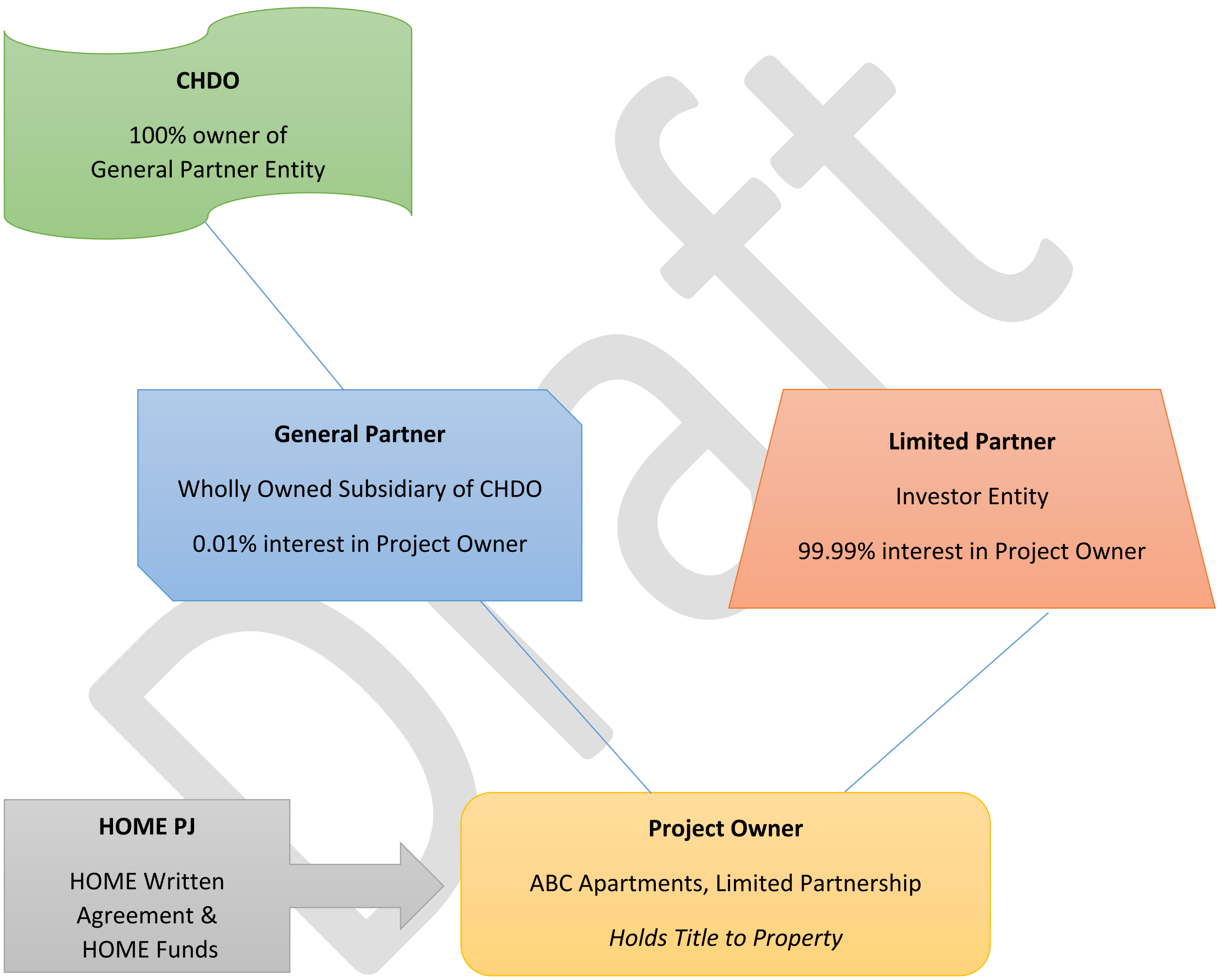


Some HOME participants previously believed that a project could qualify for the set-aside as long the CHDO had a "controlling interest" in the general partner entity—for example, the CHDO was 51% owner of the general partner entity, while a for-profit developer had a 49% interest. This "joint venture" structure is NOT eligible for funding from the CHDO set-aside. The CHDO or its wholly-owned subsidiary must be the sole general partner or sole managing member.

Written Agreement and Disbursement of HOME Funds

In the LIHTC entities described above, the CHDO has effective control of the project on a day-to-day basis, but the CHDO itself does not own the HOME-assisted real estate. The HOME Rule (§92.2 definition of commitment) requires a PJ to execute the HOME written agreement with the "project owner." Therefore, §92.300(a)(4)(ii) requires the PJ to provide HOME funds directly to the "entity that owns the project" as depicted in Figure 5.

Figure 5: Provide HOME Funds Directly to Ownership Entity



In the past, some PJs funded CHDO LIHTC projects by granting the HOME funds to the CHDO, which then loaned them to the LP/LLC that owned the project. Such a funding structure is not permissible under the 2013 HOME Final Rule.

CHDO Control through the Affordability Period

The CHDO set-aside is intended for projects that will be under the control of a CHDO throughout the HOME affordability period. §92.300(a)(4) requires that the partnership agreement for an LP property owner or the operating agreement for a limited liability company owner ensure that the project will remain under the control of the CHDO by providing that:

- The CHDO (or its wholly owned subsidiary) can only be removed from its role as the sole general partner or managing member for cause; AND
- If removed, the CHDO (or its wholly owned subsidiary) must be replaced by another CHDO. While not within the text of the rule language, HUD would allow the replacement CHDO to use a wholly owned subsidiary.

Funding LIHTC Projects Outside of the CHDO Set-aside

A project that does not meet the various requirements for funding from the CHDO set-aside may still be eligible for HOME funding outside of the set aside. For example, many non-profits find that for their first LIHTC project it is useful to establish a joint-venture with a for-profit developer where ownership of the general partner/managing member entity is shared. This can be a useful development strategy—allowing the CHDO to learn by doing while being supported by both the experience and financial capacity of its for-profit partner—but would require the PJ to fund the project from the entitlement portion of the PJ's HOME award from HUD.

CHDO Toolkit Series

CHDO Organizational Capacity Assessment Tool

Description: This tool can be used by CHDOs and PJs alike to assess the overall capacity of a CHDO. Going beyond specific criteria in the CHDO definition at §92.2, this tool is expanded to address the overall organizational capacity, taking into account items like recent performance, organizational governance, fiscal soundness, and stakeholder relations. CHDOs can use this tool as part of a self-assessment, while PJs may wish to apply these broader perspectives when assessing overall "developer capacity" as required by §92.250.

Source Documents Provided by: Original document drafted for HUD by TDA Consulting, Inc.

Caveat: This is an informational tool and/or template that should be adapted to each PJ's specific program design.

CHDO Toolkit Series: This resource is part of the *CHDO Toolkit*. View the entire toolkit here: [link]. For additional information about CHDOs in the HOME program, please contact a CPD representative at your local HUD Field Office.

Disclaimer: This document has not been reviewed by HUD for legal compliance with federal statutory and regulatory guidelines. It is provided for informational purposes only. Any binding agreement should be reviewed by attorneys for the parties to the agreement and must conform to state and local laws.

CHDO ORGANIZATIONAL CAPACITY ASSESSMENT TOOL (FOR CERTIFICATION & UNDERWRITING)	
Past & Current Performance	☐ Has the CHDO performed adequately in the past in HOME, CHDO, and/or other real estate development activities? ☐ Is the CHDO in good standing on all its development and administrative activities? ☐ Does it show the capacity to take on this additional activity and continue to manage its other projects and programs?
Past & Current Performance Conclusion [ ] Past & Current Performance demonstrates a likelihood of success with the proposed project. [ ] Past & Current Performance raises concerns about the proposed project. *Review Notes:*	

Organizational Structure/Governance	☐ Corporate/Legal Structure:
	    ☐ Can the current structure support housing development activities, or is there a need for a subsidiary or other organizational structure for future development?
	    ☐ Are there operations or activities that need to be organizationally separate from housing development activities and portfolios?
	☐ Management structure/practices:
	    ☐ Does the CHDO have a current strategic plan that guides its activities?
	    ☐ Does management have the capacity for additional development activities?
	    ☐ Are the corporate lines of authority for development activities clear?
	    ☐ Are policies & procedures in place governing development activities?
	    ☐ Does the organization have conflict of interest and/or ethics policies in place?
	☐ Pipeline/portfolio:
	    ☐ Does the CHDO have a clear picture of its current pipeline and program responsibilities?
	    ☐ Will it be able to handle the additional project proposed?
	    ☐ Are there other activities that may suffer or not be able to be pursued due to the development activities?
	    ☐ Does its portfolio of projects/properties evidence competent management?
	    ☐ Do the properties appear to have adequate funding?
	☐ Board expertise/skills:
	    ☐ Do board members have skills directly relevant to housing development (e.g., real estate, legal, architecture, finance, management)?
	    ☐ Has the board demonstrated the ability to make timely decisions?

<table>
<tr><td></td><td>☐ Is there a good relationship between board and staff?
☐ Does the board have a committee structure or other oversight of development?
☐ Has there been stability/continuity of board members recently?</td></tr>
<tr><td colspan="2">Organizational Structure/Governance Conclusion

[ ] Organizational Structure & Governance demonstrates a likelihood of success with the proposed project.

[ ] Organizational Structure & Governance raises concerns about the proposed project.

Review Notes:</td></tr>
<tr><td>Staff Capacity</td><td>☐ Are the roles/responsibilities of individual staff clear, esp. for the proposed project?
☐ Do assigned staff have appropriate experience relative to their role?
☐ Do assigned staff have adequate time to devote to new projects, taking into account whether they are full- or part-time and other ongoing responsibilities?
☐ Do staff have access to ongoing education/training to maintain/enhance skills?
☐ Are staff cross-trained, providing uninterrupted capacity in the case of turnover?</td></tr>
<tr><td colspan="2">Staff Capacity Conclusion

[ ] Staff Capacity demonstrates a likelihood of success with the proposed project.

[ ] Staff Capacity raises concerns about the proposed project

Review Notes:</td></tr>
<tr><td>Development Team Capacity</td><td>☐ Are all of the key development team roles filled with qualified individuals or firms?
☐ Does the CHDO have a need for a partner or a consultant to supplement its skills and help it to ensure success, while still maintaining development control?
☐ Do team members have prior experience directly relevant to the proposed project?
☐ Have the team members worked together before or demonstrated the ability to work effectively as a team?</td></tr>
<tr><td colspan="2">Development Team Capacity Conclusion

[ ] Development Team Capacity demonstrates a likelihood of success with the proposed project.

[ ] Development Team Capacity raises concerns about the proposed project

Review Notes:</td></tr>
</table>

Fiscal Soundness

- ☐ Financial management:
  - ☐ Is there evidence that the CHDO meets the federal financial management standards?
  - ☐ Does it do annual budgeting of its operations and all activities or programs?
  - ☐ Does it track and report budget v. actual income and expenses?
  - ☐ Does it have adequate internal controls to ensure separation of duties & safeguarding of corporate assets?
  - ☐ Is there sufficient oversight of all financial activities?
  - ☐ Is financial reporting regular, current, and sufficient for the board to forecast and monitor the financial status of the corporation?
- ☐ Financial stability:
  - ☐ Does the organization have a diversified and stable funding base for operations?
  - ☐ How regularly does it experience cash flow problems?
  - ☐ Does the organization have the ability to raise funds from the community and a history of meeting fundraising goals?
- ☐ Liquidity:
  - ☐ Does CHDO management manage its current cash position and maintain controls over expenditures?
  - ☐ Does the current balance sheet and budget indicate sufficient funds to support essential operations?
  - ☐ Does it have funds available for both pre-development expenses and working capital advances required for development?
- ☐ Audit:
  - ☐ Does the CHDO have an annual audit?
  - ☐ Is the most recent audit current?
  - ☐ Were there management or compliance findings in the last two years?
  - ☐ Are findings resolved?
- ☐ Portfolio & corporate liabilities:
  - ☐ Is its portfolio of properties in stable physical and financial condition?
  - ☐ Are there assets at risk of default?
  - ☐ Does it collect adequate revenues and management fees from the properties?
  - ☐ Does it maintain adequate insurance – liability, fidelity bond, workers comp, property hazard, & project?

Fiscal Soundness Conclusion

[ ] Fiscal Soundness reflects a likelihood of success with the proposed project.

[ ] Fiscal Soundness raises concerns about the proposed project

Review Notes:

Stakeholder Relations	☐ Community relations:
	  ☐ How strong are the current reputation of the corporation and the relationship with the community?
	  ☐ Can the CHDO reasonably be expected to overcome any NIMBY opposition in the service area?
	  ☐ Does the CHDO have effective channels to negotiate with the community and potential project opponents?
	  ☐ Does the CHDO have effective working relationships with other local organizations (e.g., community/neighborhood organizations, area nonprofits, Continuum of Care members and service providers, etc.?
	☐ Local government relations:
	  ☐ How strong is the CHDO’s relationship with the local government?
	  ☐ How strongly does local government support its housing activities?
	☐ Lender/funder relations:
	  ☐ Does the CHDO have good working relationships with lenders, especially those who might participate in the proposed project?
	  ☐ Does the CHDO have established relationships with other funders that might participate in the proposed project (e.g., state/local funding programs, equity investors, local foundations)?

Stakeholder Relations Conclusion

[ ] Partner Relations reflect a likelihood of success with the proposed project.

[ ] Partner Relations raise concerns about the proposed project.

Review Notes: