



HOME and HTF Underwriting and Subsidy Layering Guidelines

Revised March 2020

Introduction

The West Virginia Housing Development Fund (the Fund) supports the rehabilitation and new construction of affordable rental housing for low-, very low-, and extremely low-income households with its annual funding allocations from the U.S. Department of Housing and Urban Development's (HUD) HOME Investment Partnerships Program (HOME) and Housing Trust Fund (HTF) (jointly Federal Assistance). HOME was created under Title II of the Cranston-Gonzalez National Affordable Housing Act of 1990 with implementing regulations at 24 CFR Part 92, as amended; HTF was established under section 1338 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended. The Federal Assistance regulations, as amended, require the Fund to conduct underwriting and subsidy layering reviews of each project prior to committing Federal Assistance. The Federal Assistance regulations also identify minimum elements the Fund must consider and require the Fund to establish specific guidelines against which projects will be evaluated.

Underwriting is more than a technical requirement, and the term itself is used in several different ways. Depending on the context, underwriting is sometimes used in a limited fashion to refer primarily to the financial review of a potential transaction. Other times, the term underwriting is narrowly understood as a check the box set of static technical reviews resulting in a determination that a project does or does not meet a certain formula. In both cases, these uses of the term are too limited.

In practice, underwriting is a reflexive process. Every project involves risk, and even the best project can fail due to unforeseen factors. The goal of underwriting is to both identify and mitigate risk across a series of perspectives. In other words, the underwriting process is not an up or down review, but it often changes the project itself by imposing requirements to improve viability.

In this sense, the Fund's approach to underwriting is informed not only by traditional lending perspectives and minimum requirements of the Federal Assistance, but a holistic approach to balancing the various risks inherent in any real estate transaction and the public purposes the Fund seeks to support – not the least of which is producing safe, decent, affordable housing that will be an enduring community resource.

Underwriting Overview

In reviewing applications for Federal Assistance, as required by 24 CFR §92.250(b), §24 CFR 93.300(b), and prudent business practices, the Fund's underwriting framework includes, but is not limited to, evaluations of:

- **Regulatory requirements** applicable to the project, including compliance with affordability period restrictions, property standards, and cross-cutting federal requirements;
- **Market risk**, including whether sufficient demand exists for the project, the anticipated lease-up period, and whether general economic conditions and other competition supports ongoing viability;
- **Developer risk**, focusing on whether the owner/developer (including but not limited to the underlying owners of special-purpose and/or single-purpose entities) has/have the technical capacity to develop and operate the project and the financial capacity to safeguard public funds and backstop the project in the event of poor financial performance; and
- **Project risk** (or financial underwriting), testing the economic and financial projections for the transaction including both sources and uses as well as ongoing operating assumptions. This

includes confirmation that all sources of project financing are available, commercially reasonable, and have been appropriately maximized prior to awarding Federal Assistance.

In addition to the above, the Fund will, at a minimum, also perform a collateral evaluation and assess environmental conditions to determine that the proposed project is suitable and viable for a project requesting Federal Assistance.

Market Assessment

All Federal Assistance project applications must include a market study prepared in a manner consistent with RFP requirements. Market studies must be less than six months old at the time of application for Federal Assistance. The Fund reserves the right to request an updated market study, if required. Proposed rent levels must be supported by the applicant's market study and be within regulatory limits.

Additionally, the market study should demonstrate the following:

- All units, including any market rate units as well as any units with income/rent restrictions imposed by other programs such as LIHTC, must demonstrate viability within the primary market area taking into account any known rent concessions being offered by competing properties;
- Achievable occupancy rates, based on a comparison of comparable properties in the primary market area, must be at or above 95% (physical occupancy); and
- Capture and absorption rates must be realistic and achievable.

For projects not meeting these standards, the Fund, in its sole discretion, may also consider the following:

- For projects targeting special needs populations (e.g., homeless households, domestic violence victims, veterans, or other specific subpopulations), the Fund may accept higher capture rates if data from the local Continuum of Care and/or service providers specializing in the targeted populations (e.g., VA service centers) suggests an adequate pipeline of eligible renters exists and will be consistently referred to the development.
- For existing projects being rehabilitated, the Fund will consider the recent operating history of the project in terms of actual rents charged/received, eligibility of in-place tenants, and the like for evidence that the development's projections are supported by actual performance.

Developer and Development Team

Developer Technical/Professional Capacity

In evaluating the capacity of the developer, the Fund will use the term more loosely to refer collectively to the underlying corporate entities and individuals that will own and control the single-purpose entity (excluding the investor member/limited partner), if applicable. Additionally, and as necessary, the Fund will require various guarantees and indemnities from all of the underlying corporate and/or individual owners of the various limited partnership or limited liability corporation entities involved in the ownership and development of the project.

Developers should demonstrate:

- Recent, ongoing, and successful experience with the development of similarly regulated and similarly sized affordable housing; and

- The presence of adequate staff, with specific experience appropriate to their roles in the project, to successfully implement and oversee the project. This includes the assembly and oversight of the development team.

The Fund requires applicants to provide lists of real estate owned (including partnership/membership interests) by the developer as well as all projects underway. The Fund may review the performance of those projects, including financial factors like net occupancy, actual DCR, cash flow received, outstanding loan balances, net equity of individual projects, and the developer's overall portfolio.

Applicants may also be required to provide descriptions of the role played by specific staff members relative to the proposed project along with resumes or other similar information demonstrating experience appropriate to the assigned staff member's role.

Financial Capacity

Developers must also demonstrate the financial capacity to support the proposed project both during construction and lease-up as well during ongoing operations. This includes not just that the applicant has sufficient financial resources, but that it has adequate financial systems in place to appropriately manage project funding, accurately account for all project costs, and provide reliable reporting to the Fund and other project funders.

At minimum, and as applicable, the Fund will review audited financial statements, contingent liabilities, interim financial statements, and individual personal financial statements to ensure that:

- The primary development entity's most recent audit demonstrates compliance with Generally Accepted Accounting Principles (GAAP) and does not express material weaknesses in the entity's system of internal controls or financial management systems; and
- Financial ratios and trending are acceptable.

Development Team

The Fund will also review the capacity of the development team including, but not limited to, the general contractor, architect, engineer, market analyst, management company, accountant, attorney, and any other specialized professionals or consultants, as applicable.

As a whole, the development team should have the skills and expertise necessary to successfully complete and operate the development. Inasmuch as possible, on balance the development team should have worked successfully on other projects in the past. That is, while a developer may identify new development team members from project to project, an entirely new team may present added risk.

In no case, may any owner/developer/applicant or any member of the development team be a suspended, debarred, or otherwise excluded party.

Identity of Interest Relationships & Costs

Applicants must disclose all identity of interest relationships/contracts and/or costs involved in a transaction, including during the development period and following completion of the project. The Fund reserves the right to review any such costs further to ensure they are reasonable and consistent with the costs expected from arms-length relationships.

An Identity of Interest (whether or not such term is capitalized) is any relationship based on family ties or financial interests between or among two or more entities involved in a project-related transaction which reasonably could give rise to a presumption that the entities may not operate at arms-length. The Fund will take a broad approach to defining identities of interest and expects all applicants to err on the side of disclosure. That is, if there is any question about whether an identity of interest may exist, the relationship should be disclosed and explained to the Fund.

Beyond this general definition, an identity of interest relationship will be deemed to exist if:

1. An entity, or any owner of any direct or indirect ownership interest in such entity, or any family member of any such owner is also an owner, through a direct or indirect ownership interest, or an officer, director, stockholder, partner, trustee, manager, or member of the counterparty; or
2. Any officer, director, stockholder, partner, trustee, manager, member, principal staff, contract employee or consultant of an entity, or any family member of thereof, is an owner, through any direct or indirect ownership interest, or an officer, director, stockholder, partner, trustee, manager or member of the counterparty.

For purposes of this definition, family member means the spouse, parents or stepparents, children or stepchildren, grandparents or step-grandparents, grandchildren or step-grandchildren, aunts, uncles, parents-in-law, and siblings-in-law (or their children or stepchildren). It also includes any other similar relationship established by operation of law, including but limited not to guardianship, adoption, foster parents, domestic partnerships, and the like.

Financial Analysis

As noted in the introduction, the Fund views underwriting as more than just the financial review of a project. However, a review of the underlying financial assumptions is still a critical and core part of underwriting. In reviewing projects and as a public funder, the Fund must balance two potentially competing perspectives.

Projects must be viable; that is they must have sufficient allowances for all costs to maximize the chances the project can meet or exceed its financial projections and thereby succeed in the marketplace. In other words, the project must represent a safe investment. However, taken to an extreme, a safe or overly conservative projection can also result in a project that is over-subsidized and risks providing excessive returns to the owner/developer.

As a steward of very limited Federal Assistance for affordable housing, the Fund also must ensure that costs are reasonable, they represent a “good deal” to the public, and returns to the owner/developer are fair but not excessive. In seeking to balance these perspectives, the Fund has established the following review factors and principals.

Development Costs

In general, the Fund will review the entire project budget to confirm all costs are reasonable and the budget is sufficient to complete and sustain the project. All line items, whether or not paid directly with Federal Assistance, must be necessary and reasonable.

The Fund will consider the cost of both specific line items as well as the total development cost on a per unit and per square foot basis, comparing costs to other projects from the Fund’s portfolio.

Selected Development Cost Items

Acquisition – Acquisition costs must be supported by an independent third-party appraisal¹ prepared by a state-licensed appraiser. The purchase price must be at or below the as-is market value of the property. In the event an applicant has previously purchased land prior to submitting an application to the Fund, the project budget may only reflect the lesser of the actual purchase price or the current as-is market value. Standard closing costs from the acquisition may be included; acquisition reimbursement is governed by Federal Assistance regulations.

Applicants who purchased property prior to submitting an application to the Fund, or following environmental releases under NEPA but prior to closing, may not charge or include financing costs associated with interim financing, whether from third-party or related lenders.

Collateral Evaluation – For all projects, whether new construction or rehabilitation, the loan to cost and loan to value ratios must be appropriate and acceptable to the Fund¹.

Fund Soft Costs – The development budget for each project must include an allowance for the Fund's internal project-related soft costs as specified in periodic RFPs issued by the Fund. Similar to lender due diligence or lender legal costs, the inclusion of soft costs allows the Fund to recoup its staff and overhead costs directly related to carrying out the project as permitted by 24 CFR 92.206(d)(6) and 24 CFR 93.201(d)(6). These costs will be included in the Federal Assistance and will be drawn directly from HUD by the Fund rather than via payment requests from the project owner.

Construction Interest – Any budgeted line item for construction interest must be supported by developer-prepared cash flow projections, modeling the actual expenditure of development costs and the anticipated pay-in of equity, Federal Assistance, and other construction period sources. For projection purposes, only interest from the date of initial closing through the end of the month in which the building(s) are placed in service (i.e., approved for occupancy) may be included as construction interest. Additional interest following that date and prior to the conversion to (or closing on) permanent debt must be separately itemized and modeled. In most cases, this should be included in the lease up reserve noted in the Reserves Section.

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¹ The Fund engages the appraisal process so that appraisals are prepared for and addressed to the Fund. The owner/developer is responsible for expenses associated with the appraisal. Appraisals, at a minimum, will include the following values: (a) for rehabilitation projects: as-is, after-rehabilitation cost approach, and after-rehabilitation income approach; (b) for new construction projects: land value, after-construction cost approach based on plans and specifications, and after-construction income approach based on the project's projections. The Fund's thorough review of an appraisal includes determination of appropriate Loan to Value and Loan to Cost limits.

Contractor Fees – Contractor fees are limited as a percentage of net construction costs as further identified below. Net construction costs exclude the contractor fees, any budgeted contingency, if applicable, and (even if otherwise included in the construction contract) permits and builder's risk insurance.

- **Contractor Profit:** 6% of net construction costs
- **General Requirements/General Conditions:** 6% of net construction costs. General requirements include on-site supervision, temporary or construction signs, field office expenses, temporary sheds and toilets, temporary utilities, equipment rental, clean-up costs, rubbish removal, watchmen's wages, material inspection and tests, all of the builder's insurance (except builder's risk), temporary walkways, temporary fences, and other similar expenses.
- **Contractor Overhead:** 2% of net construction costs.

With prior approval of the Fund, contractor fees may vary from the limits above provided the gross contractor fees do not exceed 14% of net construction costs.

Contingencies – Applicants should include a contingency (inclusive of hard and soft costs) related to the amount of risk involved with the project. The contingency will be measured as a percentage of hard costs (including the construction contract plus any separate contracts for off-site work but excluding contractor fees).

- New construction projects should include a contingency of 5% to 10% of hard costs;
- Acquisition/rehabilitation projects, including adaptive reuse projects, should include a contingency of up to 10% of hard costs; the Fund may consider a higher contingency based on the size and complexity of the rehabilitation or adaptive reuse.

The Fund may consider higher contingencies based on identified risk factors such as the known need for environmental remediation or poor subsurface soils.

The Fund does not permit a contingency to be included within a property's construction estimate or construction contract, unless such contingency is required in writing by HUD, another governmental agency, or an independent third party.

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Developer Fees – Developer fees are intended to compensate a developer for the time and effort of assembling a project, overseeing the development team, and carrying a project to fruition. Developer fees are also intended to compensate for the risk inherent in the development process, including that not every potential project proves viable and that developers must necessarily advance funds for their own operating costs and various third-party predevelopment costs prior to closing (or in some cases for projects that never proceed). Therefore, the Fund allows the inclusion of developer fees as follows:

For projects requesting Federal Assistance and Low-Income Housing Tax Credits (LIHTC): The LIHTC Developer Fee Schedule will be used (<http://www.wvhdf.com/programs/low-income-housing-tax-credit-program>).

For projects requesting Federal Assistance and no LIHTC:

Developer's fees for properties that have not been occupied as residential rental housing at any time during the year preceding the date of the option, purchase contract, or deed for the subject property, which is furnished with the initial application with respect to site control

Identity of Interest Does Not Exist	Identity of Interest Does Exist
<i>The Developer's Fee included in Property Costs and Adjusted Basis must be less than or equal to:</i> 18% of Adjusted Basis*	<i>The Developer's Fee included in Property Costs and Adjusted Basis must be less than or equal to the lesser of:</i> 18% of Adjusted Basis*; and (22% of Adjusted Basis*) minus Builder's Profit

Developer's fees for properties that have been occupied as residential rental housing at any time during the year preceding the date of the option, purchase contract, or deed for the subject property, which is furnished with the initial application with respect to site control

Identity of Interest Does Not Exist	Identity of Interest Does Exist
Acquisition	Acquisition
<i>The Developer's Fee included in Property Costs and Adjusted Basis must be less than or equal to:</i> 10% of Acquisition Adjusted Basis*	<i>The Developer's Fee included in Property Costs and Adjusted Basis must be less than or equal to:</i> 10% of Acquisition Adjusted Basis*
Substantial Rehabilitation	Substantial Rehabilitation
<i>The Developer's Fee included in Property Costs and Adjusted Basis must be less than or equal to:</i> 15% of Substantial Rehabilitation Adjusted Basis*	<i>The Developer's Fee included in Property Costs and Adjusted Basis must be less than or equal to the lesser of:</i> 15% of Substantial Rehabilitation Adjusted Basis*; and (18% of Substantial Rehabilitation Adjusted Basis*) minus Builder's Profit

* Adjusted Basis, which by definition, excludes land and any other costs which are not capitalized and depreciated, and which, for the purposes of the Developer's Fee formulas provided above also excludes property costs in excess of the Fund property cost limits, and the Developer's Fee itself.

The maximum Developer's Fee is further limited to the amount of Developer's Fee that is actually paid, or otherwise earned or recognized as income, from one unrelated individual, entity, or both to another individual, entity, or both as compensation for the work, costs and risks associated with the development of a property.

The equations used to determine the maximum amount of Developer's Fee apply to the total of the amounts listed in the application for Developer's Fee, and to any separately-listed Consultant's Fees or other costs relating to the development work and costs associated with the development of a property.

Additional Developer Fee information:

- “Double dipping” the Developer's Fee is not permitted. For projects requesting multiple sources from the Fund (e.g., LIHTC and Federal Assistance), the combined Developer Fee must be within the developer fee schedule, as noted herein.
- The developer fee schedule, as noted herein, provides a calculation for the maximum allowable developer fee. The maximum allowable developer is not a guaranteed amount. During underwriting, the Fund will determine an appropriate and acceptable developer fee.

Reserves – Capitalized reserves to facilitate the initial start-up and to protect the ongoing viability of the project will include the following:

- **Deficit Reserve:** The Fund anticipates that in most cases, developments with predicted deficits during the affordability period would not be funded. However, in the event a development's long-term operating proforma projects actual cash deficits during the affordability period, an operating deficit reserve must be included in the development budget in an amount sufficient, taking into account any interest on reserve balances, to fully fund all predicted deficits through the affordability period.
- **Lease-Up Reserve:** A lease-up reserve intended to cover initial operating deficits following the completion of construction but prior to breakeven operations may be included. Any such reserve must be based on lease-up projections/cash-flow modeling and the lease-up (or absorption) period identified in the project's market study. In evaluating the appropriateness of any lease-up reserve, the Fund will consider whether the development budget includes specific line items for other start-up expenses that otherwise are typically part of the ongoing operating budget for a development. This may include budgets for marketing, working capital, etc.
- **Operating Reserve:** If required by the Fund, an operating reserve in an amount acceptable to the Fund, anticipated to be six (6) months of underwritten operating expenses, reserve deposits, and amortizing debt service, must be included in the development budget. The operating reserve is intended as an unexpected rainy day fund and will only be accessible after a project has achieved stabilized occupancy.
- **Replacement Reserve:** A capitalized replacement reserve may be included in the development budget. The capitalized replacement reserve should be funded at (i) an amount that realistically covers the cost of replacing covered items; and (ii) for rehabilitation projects, the amount determined by a capital needs assessment approved by the Fund. An expensed replacement reserve, as outlined in the Operating Costs section, must be included in the development budget.

- **Preservation Reserve:** Following the completion of construction, at a minimum and if required by the Fund, project owner shall make annual deposits and/or annual contributions of 50% of surplus cash to a preservation reserve.
- **Other:** The Fund may consider other specialized reserves as appropriate based on unique features of the project and/or requirements of other funding sources. These may include special security reserves, supportive service reserves, or transition reserves for projects with expiring project-based rental assistance contracts, etc.

Operating Revenues

The Fund will review an applicant's projection of operating revenues to ensure they are reasonable and achievable both initially and throughout the affordability period. In evaluating operating revenues, the Fund will take into account the (i) project-specific market study; (ii) actual operating performance from other comparable projects including those from the applicant's existing portfolio of real-estate owned; and/or (iii) data available from comparable projects in the Fund's portfolio.

For purposes of the long-term operating proforma, operating revenue projections cannot be increased by more than 2% per year. The Fund reserves the right to stress proposals for underwriting purposes to assess the impact of lower inflationary increases, such as modeling the impact of only 1% rent increases for the first three to five years of a project's affordability period.

Rents

All rents should be supported by the market study and within regulatory limits.

Non-Rental Revenue

Non-rental revenue must be fully explained and conservatively estimated. In general, no more than \$60 per-unit, per-year may be budgeted in "other revenue" including that from tenant fees (such as fees for late payment of rent, nonsufficient funds, laundromat fees, pet fees, interest on operating account balances, etc.). Exceptions may be considered by the Fund based on the operating history of an acquisition/rehabilitation project, normalized operations, or other comparable properties in the same market area.

Vacancy

Total economic vacancy includes physical vacancy (a unit is unrented), bad debt (a unit is occupied but the tenant is not paying rent), concessions (a unit has been leased for less than the budgeted rent), and loss to lease (a pre-existing lease is less than the most recently approved annual rent but will be adjusted upward at renewal).

In all cases, based on the market study or other data available to the Fund, the Fund reserves the right to require higher vacancy projections. This may include higher vacancy rates for small developments (e.g., less than 20 units) where standard percentage assumptions about vacancy may not be appropriate. Minimum allowances for vacancy must include:

- 5% for projects where all units are supported by a project-based rental assistance contract with a term equal to or in excess of the affordability period (e.g., project based Section 8); or
- 7% for all other projects.

Operating Costs

The Fund will review an applicant's projection of operating expenses to ensure they are reasonable and adequate to sustain ongoing operations of the project throughout the affordability period. In evaluating a proposed operating budget, the Fund will compare the project's costs to (i) actual operating expenses of comparable projects in the applicant's existing portfolio of real-estate owned (insomuch as possible, comparable projects will be in the same vicinity and operated by the same management company); and/or (ii) actual operating expenses of other comparable projects in the Fund's portfolio.

For purposes of the long-term operating proforma, operating expenses, including reserve deposits, will generally be inflated at no less than 3% per year. The Fund reserves the right to stress proposals for underwriting purposes to assess the impact of higher operating cost factors, such as modeling the impact of higher inflation rates in general for specific items of cost (for example, assessing the impact of high rates of increase for insurance or development paid utility costs).

Selected Items of Operating Cost

Fund Federal Assistance Monitoring Fee – Pursuant to 24 CFR §92.214(b)(1)(i) and §93.204(b)(1), the Fund assesses an annual Federal Assistance Monitoring fee. The operating budget for each project must include an allowance for the Fund's Federal Assistance Monitoring Fee as specified in periodic RFPs issued by the Fund.

Property Management Fees – A realistic property management fee should be included. In the event an excessive management fee is proposed, the Fund will lower it.

Property Taxes – Applicants must provide detailed explanations of property tax projections and, as applicable, provide documentation that any anticipated partial or full exemptions or payments in lieu of taxes (PILOT) have been approved by the appropriate tax assessor. The Fund, at its option, may require confirmation from the tax assessor of the applicant's projection.

Replacement Reserve Deposits – Unless otherwise approved by the Fund, the operating budget must include minimum replacement reserve deposits of:

- New Construction: \$350 per-unit, per-year
- Rehabilitation: The greater of (i) \$350 per-unit, per-year; or (ii) a higher amount established by a CNA approved by the Fund.

Note: The Fund will reserve the right within a project's transactional documents to require periodic CNAs for all projects and to adjust ongoing replacement reserve deposits based on the results of the CNA and other factors to ensure that the replacement reserve is sufficient to address all anticipated needs for the project's affordability period or the term of the Fund's loan, whichever is longer.

Items Payable only from Surplus Cash

Certain costs, sometimes identified by project owners as operating costs cannot be included in the operating budget and will only be payable from surplus cash (aka cash flow). These include:

- **Incentive Management Fees** payable in addition to the allowable management fees noted above, whether paid to related party or independent third-party management fees.
- **Asset Management Fees** payable to any investor, general or limited partner, or member of the ownership entity.

- **Deferred Developer Fees**
- **Operating Deficit Loan Payments** made to any related party including any investor, general or limited partner, or members of the ownership entity.
- **Other payments** to investors, general or limited partners, or members of the ownership entity, however characterized, including but not limited to negative adjusters, yield maintenance fees, etc.

Ongoing Economic Viability

The Fund will review the ongoing economic viability of all projects, taking into account long-term projections of revenues and expenses. Projects must demonstrate they can be expected to remain viable for at least the affordability period, taking into account trending assumptions noted above, as well as any other changes in operating revenues or expenses that can reasonably be anticipated based on other information available to the Fund or other project funders. In particular, the Fund will review the debt coverage ratio and operating margin as outlined below.

Debt Coverage Ratio

Projects must demonstrate a positive debt coverage ratio (DCR) (DCR is Net Operating Income divided by amortizing debt service) through the affordability period.

Operating Margin

In addition to considering the DCR, the Fund will review the operating margin (surplus cash divided by total operating expenses and amortizing debt service). The operating margin must remain at an achievable and realistic amount.

Other Funding Sources

Prior to committing Federal Assistance, all other funding sources necessary for a project must be identified, committed in writing, and consistent with both the Fund's underwriting requirements and the affordability restrictions of the Federal Assistance. In general, developers must make all reasonable efforts to maximize the availability of other funding sources, including conventional mortgage debt and tax credit equity (as applicable), within commercially available and reasonable terms.

Additionally, restrictions or limitations imposed by other funding sources cannot (i) conflict with any applicable Federal Assistance requirements; and (ii) in the discretion of the Fund, create undue risk to the Fund.

Senior Mortgage Debt

Any amortizing mortgage debt that will be senior to the Fund's Federal Assistance loan must:

- Provide fixed-rate financing;
- Unless otherwise approved by the Fund, have a term equal to or in excess of the Federal Assistance affordability period. The affordability period will generally be 15 years beyond the date of project completion for HOME rehabilitation projects, 20 years for HOME new construction projects, and 30 years for all HTF projects. In practice, the date of project completion will not be the same as placed in service date for tax purposes, but for most projects will occur prior to permanent loan conversion following property stabilization. Insomuch as possible, the first mortgage should have the longest amortization period available but cannot balloon prior to the expiration of the affordability period; and

- As applicable, allow the Fund's Federal Assistance covenant running with the land (i.e. the deed restrictions imposing the Federal Assistance affordability requirements) to be recorded senior to all other financing documents such that the Federal Assistance covenant is not extinguished in the case of foreclosure by a senior lender. Note the Fund's Federal Assistance lien itself may be junior to USDA RD or HUD amortizing loans; only the deed restrictions must be senior, as applicable.

Tax Credit Equity

Projections of tax credit equity must be documented by letters of intent or other similar offers to participate in the transaction by the proposed tax credit investor. Prior to committing Federal Assistance, the applicant must provide the proposed limited partnership agreement or operating agreement, as applicable, documenting the terms of the equity investment, including the pay-in schedule.

The Fund will review proposed equity pricing and pay-in schedule against information from other projects in the region to assess whether the pricing and terms are reasonable.

Deferred Developer Fee

It is common for projects to include deferred developer fees as a financing source. The Fund will generally require that:

- Projections of surplus cash available (after any cash-flow contingent payment due the Fund) be sufficient to repay the deferred fee within 15 years (notwithstanding other waterfall provisions in the partnership or operating agreement, the Fund will assume that all surplus cash distributions will be credited against the developer fee);
- Following the initial application to the Fund, the level of deferred developer fee will remain fixed (in nominal dollar terms) in the event Fund underwriting identifies cost reductions, increases in other funding sources, or other changes that result in a net reduction of the gap to be filled with Federal Assistance; and
- Any net savings (or increased funding sources including but not limited to upward adjusters for tax credit equity) at project completion and cost certification will be used in equal parts to reduce the deferred developer fee and the Fund's permanent Federal Assistance loan. In the event savings are sufficient to eliminate the deferred fee in this manner, any remaining net savings will be used to further reduce the Fund's Federal Assistance loan, or in the sole discretion of the Fund, to increase the operating reserve or preservation reserve.

Exceptions and Interpretation

The Fund has developed these guidelines for several reasons. Not only are they required by HUD as part of the Fund's role in awarding Federal Assistance, but more generally they are intended to provide clarity to applicants on what the Fund expects and transparency about the rules of the road. However, the Fund recognizes that it cannot pre-emptively identify every possible special circumstance that may warrant an exception to its general requirements, nor can it identify every possible loophole whereby a creative presentation of costs or other projections might subvert the general need to balancing of viability and reasonable returns risk to the Fund and public benefit.

Consequently, the Fund reserves the right to waive specific underwriting criteria for specific projects when, in its judgment, the purposes of the Federal Assistance can be better achieved without taking on

undue risk. When waiving any given requirement, the Fund may impose additional special conditions or business terms that are not otherwise typically applied to all projects.

For administrative ease, the Fund may also align its underwriting standards with those required by other public funders involved in a given transaction, particularly if those standards are more restrictive or conservative than the Fund's. However, the Fund retains the right, in its sole discretion, to decide whether to accept alternative standards.

The Fund also reserves the right to reject any element of a transaction that, despite not being specifically prohibited, was not anticipated by these guidelines or such an element or business term otherwise creates unacceptable risks, excessive returns to the owner/developer, or otherwise undermines the public purposes of the Federal Assistance.

Insomuch as is reasonable, the Fund will update and clarify these guidelines over time to account for exceptions, waivers, or additional restrictions it imposes.