

HOME Underwriting

Introduction

North Dakota Department of Commerce/Division of Community Services (DCS) is responsible for the administration of the HOME Program for the State of North Dakota. The HOME program, established by the National Affordable Housing Act of 1990, is a federal program designed to create partnerships among government entities and the private sector in order to make affordable housing available to low-income persons.

Pursuant to the 2013 HOME Final Rule, DCS is required to adopt underwriting policies to analyze HOME projects. It is the policy of DCS, as a participating jurisdiction (PJ), to perform an underwriting analysis in accordance with §92.250(b) prior to a firm financial commitment to a HOME affordable housing project.

The HOME underwriting policy, as herein stated, promotes the selection of those properties that will address the most crucial needs of the state, within the guidelines and requirements established by the federal regulations. All projects will be evaluated for reasonableness and a need for subsidy. Projects with values outside the following guidelines must provide an explanation. Exceptions will be considered by DCS on a case-by-case basis based and will evaluate the information and supporting data justifying the need for such exception. Additionally, the guidelines for maximum values below may be utilized as a benchmark for determining over-subsidization. DCS may adjust or reject requests based on these benchmarks.

Threshold Requirements

When an application is received, it shall first be reviewed for eligibility for the HOME Program. In order to be eligible, the application must be complete and include the following information, *unless waived by DCS for good cause*:

1. Demonstrated Site Control: Evidence that the Applicant has, and will maintain from the start of the application review process until the land is acquired, direct site control. This will also include a sketch plan of the site as the site would look when developed.
2. Zoning Eligibility: Evidence that the appropriate zoning will be available must be provided (i.e., a letter from a city official stating that appropriate zoning is in place or forthcoming).
3. Utilities Availability: Evidence that appropriate utilities (water, sewer, electricity, natural gas) will be available to the project site and will have adequate capacity must be provided (i.e., a letter from a city official stating appropriate utilities are in place or forthcoming).
4. Identity of Interest: The applicant must disclose all relationships (generally based on financial interests or family ties) with others involved in the property. This disclosure is required for all parties which:
 - a. Have ownership, development, or financial interest in the property;
 - b. Have current or future management control of the property;

- c. Have any current or contingent financial or management liability for the property, including guarantees, letters of credit, take out agreements or support agreements; and
- d. Are involved in the property and have been debarred from any North Dakota program, or any federal program.

This disclosure requires the names and addresses of all parties, including corporate officials, if applicable. Repayment of HOME funds may result if this information is not adequately disclosed, or if the information changes. Applicants may apply for a waiver of this procedure.

The intent of this section is not to limit passive ownership, but to properly identify all parties that have a significant involvement in the development of the property.

- 5. Local Support Letter from a City-governing Body (Commission/Council): This letter of support shall identify the number and type of units requested and the exact location of the proposed property. Minutes approving project during (Commission/Council) meeting may also be used.
- 6. Ownership: The Applicant (CHDO) must be either the owner, developer, or sponsor of the property. In the sponsor role, the CHDO must be the sole managing member. The Applicant must disclose the intent to sell or transfer the property and, if known, the names and backgrounds of those who will purchase or receive the property. Failure to provide this information may result in repayment of HOME funds.
- 7. Ability: The Application must demonstrate that all members of the development team have the ability and financial capacity, in their respective roles, to undertake, comply, maintain and manage the property. Misrepresentation of the information about the experience or financial capacity of any development team member will be grounds for denial.
- 8. Firm Financial Commitment: DCS will not issue a financial award until all sources and uses have been documented, and firm commitments for all other funding sources, such as construction financing, are in place. All legal documents, including deed restrictions (LURA) and partnership agreements, must be included.

Project Requirements

- 1. Capital Needs Assessment: A Capital Needs Assessment (CNA) must be submitted with an application package involving rehabilitation (including adaptive reuse projects) of a project containing 26 or more units. The CNA must be completed by a competent, independent third party acceptable to DCS, such as a licensed architect or engineer. The assessment will include a site visit and a physical inspection of the interior and exterior of all units and structures. The assessment will consider the presence of environmental hazards such as asbestos, lead paint and mold on the site. The assessment will include an option to the proposed budget for recommended improvements, and should identify critical building systems or components that have reached or exceeded their expected useful lives.

If the remaining useful life of any component is less than 50 percent of the expected useful life, immediate rehabilitation will be required unless capitalized.

2. Housing Need: A project-specific market study is preferred but not necessarily required by DCS.

An assessment, at a minimum, of the current market demand in the neighborhood in which the project will be located is required. The neighborhood demand can be evidenced through the use of, but not limited to, Public Housing Authorities, Realtors, City Administrators, Planning Councils, apartment owner association, etc. DCS reserves the right to reject any of the items listed above and require a professional project specific market study.

If the assessment collected clearly demonstrates an unbiased market demand for all the units in the proposed project for a minimum of the affordability period/loan terms (whichever is greater), the project specific market study requirement will be considered by DCS in the application review. If this assessment is at all questionable by the applicant in their upfront underwriting analysis, a project specific market study must be completed to minimize the applicant's risk, and directed at DCS' discretion.

3. Financial Projections: A 20-year pro forma or the length of the loan term (whichever is greater) financial projection for the property shall accompany the application using the income, expenses, replacement reserves, and debt service as represented in the application. The rental income should reflect the vacancy rate as stated in the application.

The reasonableness of development and operating cost in relation to other similar developments will be assessed in evaluating the financial feasibility of applications.

4. Financing Costs: The rate of interest, points, fees and any other loans that are made for the project in conjunction with the HOME program must not exceed a reasonable market rate of interest, points, fees, and other charges for loans of similar maturity, terms, and risk.
5. Development Budget: The development budget must be complete and include all costs associated with the project, including but not limited to, hard and soft costs, marketing costs, construction loan interest, developer fees, real estate taxes, insurance, all loan fees, building permits, relocation and consulting fees. The development budget shall meet all required minimums for operating and replacement reserves established for general project underwriting. The development budget should reflect the total costs as presented in the HOME Application.

Development costs will be reviewed to ensure that they are necessary and reasonable. This determination will be based upon a comparison to housing costs established by previous, similar and recent local development projects. DCS establishes subsidy limits, as outlined in the HOME Program Allocation Plan. The Project Cost Limits, which are maximum cost limits (not target or average cost), are determined by DCS to be sufficient for development of affordable housing projects. The qualifications of the cost estimators for particular budget line items will also be considered. Major discrepancies will be noted and reasons

for cost variances provided. Consideration will be given for special needs of the project as may be applicable, such as type of development activity, type and quality of construction, needs of the population served, energy-efficient upgrades, etc. Cost discrepancies that are not justified will require adjustments to the development budget.

A debt coverage ratio (DCR) of 1.2 will be used by DCS to meet project sustainability and repayment terms. At DCS's discretion and with adequate justification from the developer, DCS may raise the DCR to 1.25.

6. Rent Assumptions: On a rehab project, vacancy rates can be determined by the projects past performance and/or market demand study. On a new construction project, the minimum required first year vacancy performance rate must be no less than 7 percent. The second year will be determined by Net Operating Income (NOI). Rent cannot exceed HOME rent requirements.
https://www.hudexchange.info/resource/reportmanagement/published/HOME_RentLimits_State_ND_2015.pdf

In projects of five or more HOME-assisted units, at least 20 percent of the HOME-assisted rental units must be occupied by families who have annual incomes that are 50 percent or less of median income. These very-low-income tenants must occupy units at or below the HOME Low Rent level.

Projects with fewer than five HOME-assisted units do not have to restrict any units to the Low HOME rents or limit occupancy to tenants at 50 percent or below of area median income.

7. Expense assumptions of a minimum of 3 percent escalation will be required.
8. Rent increases should be estimated at an increase of 2 percent escalation per year.
9. Homebuyer Projects: The application must identify upfront qualified buyers. Appropriate subsidy levels will be identified by assessing what the family can afford versus subsidy. The applicant must ensure that the family is not receiving excessive subsidy given needs. The applicant will identify appropriate level of down payment and Loan to Value requirements for the buyer. The applicant must provide homebuyer education upfront. Homeowner education may be requested by the homeowner, DCS, or CHDO throughout the period of affordability. Ratios are set at 28/36; however, ratios can be waived by DCS with documented circumstances. All requests for subordination due to a cash-out refinance will be denied, unless being used for HQS repairs. Rate and term subordination requests will be reviewed for consideration by DCS. DCS must review final underwriting on all projects prior to closing.
10. Project Costs: Taking into consideration the geographic location of project development conditions, and other non-financial characteristics, DCS will determine whether a project's costs as reflected in such project's development budget, are reasonable in accordance with federal project cost guidelines per [§92.206](#) (Eligible Project Costs).

11. Maximum Developer Fee: Developer’s fees will be limited to 15 percent of development costs for projects with 40 or fewer units, and 12 percent for projects of 41 or more units. Fees paid to consultants must be justified and approved by DCS and will be included in the 15 percent limitation. The developer fee for the acquisition portion of an acquisition/rehabilitation property cannot exceed 5 percent. The fees of all parties with an Identity of Interest with the Developer in the property will be taken in consideration when calculation the Developer’s maximum fees. The market value of donated or discounted land, labor, and materials will not factor into development costs. The developer fee calculation does not include acquisition, contingency, permanent financing costs, or reserve capitalization.

12. Maximum Builder/Contractor Fee: Builder/General Contractor fees may not exceed the following limits:

Builder/General Contractor’s Profit	6 percent of hard construction costs
Builder/General Contractor’s Overhead	2 percent of hard construction costs
General Requirements	6 percent of hard construction costs

Fees in one area may exceed the stated percentage if other areas are not at their maximum, so long as they don’t exceed 14 percent collectively. Identity of Interest will not be considered when calculating maximum builder/contractor fees.

13. Professional Fees: Limited to a maximum of 10 percent.

14. Subsidies: The application package must include the full extent of all federal, state and local subsidies that are expected to apply to the property.

The applicant must ensure an appropriate HOME subsidy is documented to provide affordable housing:

- a. no more subsidy than necessary is invested,
- b. reasonable repayment period,
- c. at or below allowed HOME subsidy limit,
- d. at or below after rehab value (if applicable).

The current maximum based on the 2012 221 D(3) HOME investment (per project) subsidy limits are:

<u># of Bedrooms</u>	<u>Max HOME</u>
0	\$127,279
1	\$145,907
2	\$177,422
3	\$229,526
4	\$251,948

Note: HOME investment subsidy limits change as HUD updates.

15. Income and Rent Restrictions: Refer to the current applicable chart for:

Income -

https://www.hudexchange.info/resource/reportmanagement/published/HOME_IncomeLimits_State_ND_2015.pdf

Rent -

https://www.hudexchange.info/resource/reportmanagement/published/HOME_RentLimits_State_ND_2015.pdf

Note: HOME income and rent restrictions change as HUD updates.

16. Reserve Accounts: All properties will be required to maintain a replacement reserve account for the term of the compliance period. This account will be set aside in a federally insured financial institution. The replacement reserve requirement for new construction properties and substantial rehabilitation properties (rehab exceeding \$30,000 per unit) designed for seniors will be \$250 per unit per year. The requirement for all properties designed for families as well as rehabilitation developments with rehabilitation costs of \$30,000 per unit or less will be \$300 per unit per year. This account shall not be used for routine maintenance and upkeep expenses.

All properties will also be required to establish and maintain, until the property has achieved a minimum of five years of stabilized operations, an operating reserve equal to a minimum of 6 months, not to exceed 18 months, of projected operating expenses must-pay debt service payments and annual replacement of reserve payments. This requirement can be met with an up-front cash reserve; a personal guarantee from the developer with a surety bond to stand behind the personal guarantee. This operating reserve must be set aside at a federally insured financial institution and accounted for in a manner acceptable by DCS. Any HOME funds placed in an operating deficit reserve that remain unexpended after the period of project rent-up may be retained for project reserves if permitted by the participating jurisdiction.

If applicable, a tax escrow account must be maintained in a federally insured financial institution.

Note: HOME funds cannot be used to fund operating and replacement reserves.

17. Timing: At the time of DCS approval, the project construction must begin within 12 months.

- Rental units must be occupied within 18 months of project completion.
- All single family homes must have a completed sales transaction within 9 months.
- All funds must be expended within the approved project period per the financial award.
- CHDO operating funds must be spent within 24 months of CHDO receipting.

18. Period of Affordability:

HOME Assistance Per Unit	Minimum Period of Affordability
Less than \$15,000	5 yrs.
\$15,000 - \$40,000	10 yrs.
More than \$40,000	15 yrs.
New Construction	20 yrs.

Other Requirements

1. Legal Documents: An executed Land Use Restrictive Agreement (LURA) must be approved by DCS prior to execution. DCS must approve all terms of legal documentation prior to execution.
2. Fair Housing: A project, as proposed, must comply with applicable federal and state laws on fair housing and housing accessibility including, but not limited to, the Fair Housing Act, the Rehabilitation Act of 1973, the Americans with Disabilities Act of 1990, and the Architectural Barriers Act of 1969. The project must demonstrate how such project will be affirmatively marketed.
3. Section 3: All applicants must provide certification they have been educated in Section 3 requirements with application, and must provide Section 3 reports upon close out. http://portal.hud.gov/hudportal/HUD?src=/program_offices/fair_housing_equal_opportunity/section3/section3
4. Davis Bacon: If a construction contract includes 12 or more HOME-assisted units, the applicant must provide proof they have the ability to monitor Davis Bacon wage requirements.
5. Environmental Reviews: No funds may be committed to a HOME activity or project before the completion of the environmental review and approval of the request for release of funds and related certification. Committed means signing construction contracts.
6. Lead-Based Paint: Housing assisted with HOME funds is subject to the Lead-Based Paint Poisoning Prevention Act.
7. Relocation: When a project requires person(s) to be displaced from their dwelling unit(s) permanently or temporarily, relocation assistance must be provided.
8. Affirmative Marketing: Affirmative marketing steps consist of actions to provide information and otherwise attract eligible persons in the housing market area to the available housing without regard to race, color, national origin, sex, religion, familial status, or disability.

9. Financial Oversight: All projects containing 10 or more HOME units will have an annual financial review. Any HOME unit rent increases must be approved by DCS prior to implementing.
10. Tax Credit Projects: Projects previously funded with the Low Income Housing Tax Credit Program and HOME program will be underwritten if HOME debt remains at the end of the tax incentive period.