VERMONT HOUSING & CONSERVATION BOARD
Guidelines for Making Decisions Regarding Deferred VHCB and HOME Debt

Background

When VHCB makes an award of either state Housing & Conservation Trust Fund dollars or HOME funds to a development that is also obtaining equity from low-income housing tax credits, the VHCB awards are in the form of a loan so that the expenses covered by that loan can become part of tax credit basis. Providing funding as a deferred loan gives VHCB a role in the project stewardship and redevelopment and provides an opportunity to recapture and recycle funds in the future. From time to time, especially in the early years of VHCB's existence, the Board also made loans to developments that didn't utilize the tax credit, especially mobile home parks. VHCB loans are typically deferred for 30 years. Although within the last decade the interest rate on those loans has been set at 0%, earlier projects are carrying deferred loans with rates as high as 11.58% and frequently compounding quarterly because of a federal requirement that loans of federal funds carry an interest rate equal to the applicable federal rate (AFR). The government discontinued that requirement several years ago.

Many of those early projects have now reached the end of the 15-year tax credit compliance period and in some cases are being redeveloped and resyndicated. The amount of the deferred VHCB loan principal on the project's books along with accrued interest is, in many cases, quite significant and may pose a repayment challenge if affordability is to be maintained and displacement avoided. Early assumptions were that resident and project incomes would rise at a rate of at least the CPI. This has not happened. In a number of cases this accumulated debt is now presenting problems for the owner of the development and VHCB has begun to receive requests from grantees to write off some of the debt. These guidelines are intended to outline a structure for considering such requests.

Potential Courses of Action:

Projects will most likely fall into one of three categories:

(1) Those that appear to have the ability to repay all or a portion of the deferred debt

(2) Those that are unlikely to be able to repay but would not be harmed by continuing to defer the debt at least until year 30. In many cases, these projects would benefit from a reduction of the interest rate to 0%. An interest rate reduction might also improve the chances of collecting on the debt.

(3) Those that need to have a portion or all of the debt written off.

Therefore, there are four potential courses of action that VHCB could take. They are:

(1) Require repayment of the debt including both principal and interest when it is due in year 30, that is, 30 years after the original tax credit syndication.

(2) Continue to defer the debt but reduce the interest rate to 0% going forward. Make sure that this action does not harm the limited partner's financial expectations. In such a case, the project should not immediately be resyndicated, according to advice from legal experts. In most cases, the lower the interest rate the greater the likelihood of repayment.

(3) Write off a portion of the principal.

(4) Convert a portion or the entire loan, including any accrued interest to a grant. This should only be done in extremely rare circumstances in which analysis shows that the project has no possibility of ever being able to repay any of the debt if affordability is to be maintained.

In the case of potential actions (2) through (4) such action should only be considered if there is a public purpose for doing so.

Analysis to be Undertaken

VHCB staff shall analyze each situation on a case by case basis as a prerequisite to recommending a course of action to the board. Such analysis shall include but not be limited to the following:

1. Does the property have the ability to repay all or a portion of the debt – through monthly or quarterly payments? By refinancing or financial restructuring? If the property does not have the ability to repay all of the debt, what amount of debt would have to be written off to facilitate partial repayment?

   Objective: To receive repayment if the ability to do so exists. If debt must be written off to write off the minimum amount necessary to insure the health of the project and affordability to its residents.

2. What would repayment do to the rent levels and therefore affordability to those residents targeted by either the Housing Subsidy Covenant or various government sources of funds? Does the project have the capacity to impose a reasonable rent increase without jeopardizing affordability? Would an internal subsidy be needed to protect residents?

   Objective: To maintain rent affordability for the low and very low income residents of the property.

3. What would repayment do to the ability of the project to meet immediate capital needs and those expected within the next 15 years? What does the capital needs assessment indicate? What are the current replacement reserve levels?

   Objective: To insure that the project can reasonably be expected to meet its current and future capital needs.

4. Would repayment threaten the financial viability of the property, that is, its ability to pay its bills and meet its other financial obligations?

   Objective: To insure the financial health of the property.

5. Is the property in danger of default on its principal debt or foreclosure?

   Objective: To avoid default or foreclosure.

6. Would the property be harmed in some way if deferral of debt continues?

   Objective: To avoid physical, financial, or other type of harm to the property and its residents.

7. Has interest on the loan grown to such an extent that the face value of the principle and interest exceeds what could reasonably be expected to be received from the sale of the property should such a sale occur now or at some determined future date? In making such a determination the strength or weakness of the real estate market (both current and projected) in which the project is located should be taken into account.

   Objective: To keep debt at a level that is at or below the anticipated current or projected future value of the property.

8. Has the project paid off or made payments on other deferred loans such as VCDP loans or are there plans to do so in the future?

   Objective: To receive payment on VHCB deferred debt before or at the same time that payments are made on other deferred loans.

In answering these questions VHCB staff should review cash flow projections under various debt scenarios, Housing Subsidy Covenants and government program requirements that restrict household income and/or rent level or affordability, capital needs assessment that projects current and future capital needs of the property, amount of money in the replacement reserve coupled with projected annual reserve deposits, status of payments to principal lender(s), strength or weakness of the market in which the property is located.

Process for Taking Action

VHCB shall follow the process outlined below when deciding to take action on a request for change of the terms of a loan or conversion to a grant.

1. VHCB staff shall make recommendations to the full board or its designee (board chair or a committee) on a case by case basis. Recommendations shall be based on the objectives outlined above as reflected in answers to the questions also outlined above that will enable staff to determine if repayment is possible or will seriously harm the project or its residents.
2. If debt is to be forgiven either by the full board or its designee, the portion to be forgiven should be the minimum necessary to meet the public purposes such as affordability, financial health, capital needs etc. and to insure that the value of the property is sufficient to repay the debt should the property be liquidated. Written documentation shall be created that outlines the reasons that a decision was made to forgive all or a portion of the debt or to change terms of the loan (such as maturity date, interest rate, payment requirements, etc.).
3. In order to minimize this problem in the future, all new VHCB and HOME loans shall be non-interest bearing unless an interest rate is required by another government funding source, and VHCB shall, whenever feasible, make awards in which VHCB funds are granted in an amount up to the value of the land (which doesn’t go into tax credit basis) with any remaining portion of the award to be loaned. In addition, the board may consider, as appropriate, granting state funds to the non-profit general partner who could then loan the funds to the partnership.

Potential Payments on Deferred Loans during the First 30 Years of Project Operation

In certain rare circumstances as described below, the Vt. Housing and Conservation Board may modify the payment provisions of its 30-year deferred loans to require payments prior to the due date of 30 years. Grantee shall be obligated to notify VHCB if any of the following circumstances occur.

1. If all reserves are funded and other project obligations met, after the first 15 years of project operation VHCB has the right to collect 20% of any incentive management fee to apply on VHCB debt with the remainder going to the general partners or the owner.
2. During the first 15 years of project operation there will be certain triggers for reviewing project performance and determining whether payments can be made on the VHCB deferred loan(s) including the following:
    a. resyndication or recapitalization of the project
    b. transfer of the property from the partnership to a related party
    c. repayment in full of the primary debt
    d. repayments are proposed to begin on Vt. Community Development Program loan from the municipality; or
    e. refinance of the project with the owner taking cash out.
3. If all reserves are funded and other project obligations met and there is excess cash the following process shall occur:
    a. If during the 15-year tax credit compliance period, incentive management fees or return on equity equal to or greater than 10% of the operating expenses plus reserves plus debt service are made to the owner or general partners then VHCB shall be notified of such payments.
    b. If the owner or general partners receive, for 3 consecutive years, incentive management fees or return-on-equity equal to more than 20% of the operating expenses plus reserves plus debt service then VHCB shall reserve the right to review and potentially restructure the payment terms of its deferred loan(s).
    c. In the case of a property with project based rental assistance, if project cash flow is such as to generate surplus cash or residual receipts at a level that, in the opinion of the Vermont Housing Finance Agency, said surplus cash is in danger of recapture by HUD, VHCB reserves the right to demand that payments be made on its deferred loan(s). Nothing herein shall preclude the establishment of a Debt Reserve Account during the 15-year tax credit compliance period. If such account is established, at the end of the partnership VHCB would assess whether or not sufficient funds exist in the account to allow for payments on the VHCB loan(s) without harming the financial or physical viability of the project.