

**Vermont Housing & Conservation Board**  
**Policy & Procedures for Project Underwriting**  
**January 2015**

Careful examination of all aspects of an application for funding is critical to the future success of a project. The ability to document that such due diligence has been undertaken is critical to satisfying the requirements of state and federal administrative and funding entities. Therefore, the following document outlines the steps that the Vermont Housing & Conservation Board undertakes in assessing the viability of an application for funding, and insuring that funded applications are prepared for legal closing, construction, and subsequent occupancy and ongoing operation. Adoption of these Policies & Procedures constitutes a ratification by the Board of the underwriting standards and process.

**The Application**

VHCB, VHFA, and the VCDP use a common application with additional program specific supplements. In the case of VHCB, that supplement applies specifically to VHCB funding and the HOME Program. The common application consists of the following general sections:

1. Cover Sheet – containing summary information about the development and the project sponsor as well as a summary of the anticipated sources of funding, whether or not the project has received public funding in the past, and, for subsidized developments, the type of HUD or Rural Development assistance involved.
2. Narrative Summary Sheet – contains a succinct summary of the project, the request for funding, and what the money will be used for, along with other key points that the applicant would like to make.
3. Development Team Information – provides names and contact information regarding the project sponsor, architect, real estate attorney, development consultant if any, general contractor or construction manager, and property manager, as well as other vendors or professionals such as engineers, tax attorney, service providers etc.. Resumes must be attached for members of the development team who have not, within the previous two years, worked on any developments funded by the agencies. This section also asks about agreements between the applicant and the developer, in the case of turnkey projects, as well as direct or indirect financial interests between members of the development team.
4. Budgets – There are at least five budget documents that must be submitted. These include a) a summary of the development budget that includes information about the assumptions incorporated into the budget documents (i.e. vacancy rate, spread between income and expenses, type of tax credits etc.), b) a detailed sources and uses statement, c) an operating budget, and a multi-year pro-forma that makes projections for at least 20 years of operation, d) a rent chart that includes occupancy and affordability information, gross and

net rents, utility allowance, and identifies HOME, accessible, and adaptable units. In the case of homeownership developments, only a sources and uses statement is required.

5. Site Information – a description of the form of site control, acquisition price, description of various site features, proximity to services, location with a designated downtown, village center or growth center, eligibility of the property for the National Register of Historic Places or state historic register, floodplain information, information about the water and wastewater system, condition of roads, condition of existing infrastructure. This section also requires that a number of attachments be submitted. These include evidence of site control, a copy of the appraisal, documentation of location in a state designated special district, floodplain map, site plan indicating planned sites for housing, open space, significant natural resources and archeological features, and site location map.
6. Permit Information – information about any known permit issues, local and state permits required, description of any issues or obstacles anticipated, question about conformance with local and regional plans and zoning, information about zoning requirements. Required attachments in this section include documentation of conformance with local and regional plans and a copy of a Project Review Sheet from the Vt. Agency of Natural Resources, Dept. of Environmental Conservation.
7. Target Population, Market, and Regional Data – a description of the target population, urgency of need, how the need was determined, why the proposal is the best approach to meet the need and what other approaches were considered, and a description of the marketing plan. Required attachments include a market study.
8. Timetable – a summary timetable for major benchmarks such as property acquisition, start of construction etc., and a detailed timetable for funding commitments.

The VHCB/HOME Application Supplement has six additional questions pertaining to:

1. Importance of the resource in question
2. A narrative summary of the construction scope of work
3. Conformance with applicable policies adopted by the board
4. Whether or not the project meets the dual goals of housing and conservation
5. Contacts with local officials and other parties
6. Protection of investment in perpetuity

The supplement also requires completion of an Environmental Site Review Checklist that identifies the presence of high risk activities and previous use of the property.

### **Application Attachments**

Both the Common Application and VHCB/HOME Supplement require a number of attachments to be submitted at the time of application. They are as follows:

- A. Common Application
  1. Site Plans

2. Site Location Map
3. Floodplain Map
4. Preliminary Floor Plans
5. Building Elevations
6. Original Set of Color Photos
7. Current Appraisal (within six months prior to time of application)
8. Purchase and Sales Agreement or Other Form of Site Control
9. Agency of Natural Resources Project Review Sheet
10. Energy Efficiency Checklist
11. Resumes of Development Team
12. Market Demand Data (full independent market study if units are being added)
13. Evidence of Other Funding Commitments
14. Results of Tests for Lead Based Paint or Other Hazardous Materials
15. Capital Needs Assessment (for moderate rehabilitation projects)
16. Unit Price Schedule Including Unit Types and Designs (for Homeownership)
17. Homeownership Development Budget, if applicable

B. HOME & VHCB Supplement

Additional required application attachments include the following:

1. VHCB
  - a. Environmental Site Review Checklist. A Phase I Environmental Assessment may be substituted
  - b. Outline specifications
  - c. Independent cost estimate
  - d. Copies of State/Regional contact letters and any responses
  - e. Current list of Board of Directors, addresses, and affiliations
  - f. Most recent audited financial statement
2. HOME
  - a. Income verification forms and 3<sup>rd</sup> party documentation (for occupied units)
  - b. Relocation plan and budget
  - c. URA general information notices with delivery confirmation (for existing tenants)
  - d. HOME rent schedule (part of the budget documents)

Application checklists are attached to this policy for informational purposes. (Additional HOME requirements apply after application; see attached *Process Checklist for HOME Projects*)

### **Underwriting Process**

Project underwriting usually begins well before the application is received, most often at the time of initial contact with the applicant. VHCB staff undertakes a site visit in advance of receipt of the application and often discusses the proposed project with the applicant at that time. In order to obtain differing perspectives, at least two staffers usually visit the site. If the project involves

rehabilitation or adaptive reuse of an existing building, the Asset Manager is part of the site visit team.

When the application is received, one member of the housing staff is given primary responsibility for the project with a second staffer as back-up. Division of responsibilities is based on specific areas of expertise of various staff members (i.e. HOME Program, Homeownership, Service Supported Housing) and whether or not the particular staff member has recently underwritten multiple applications from a particular applicant. An attempt is made to ensure that staffers do not always work with the same developer. The lead staff person is responsible for familiarizing him or herself with the application, communicating questions and concerns with the applicant via email and phone during the underwriting process, gathering additional information, writing a recommendation for approval or denial to the Board, and being able to answer questions about the project from other staff and board members. The Asset Manager works in conjunction with all underwriters to provide advice regarding design, construction issues, energy efficiency, and operating and capital reserve budget issues.

Although one person is principally responsible for most aspects of the project, there are several opportunities for group input and questions. Prior to sending recommendations to the board, the housing staff meets as a team, along with the Executive Director, on at least two occasions to fully vet and ask questions about the project. The first meeting is a few weeks after receipt of application; the second is a couple of weeks before completion of memos to the board. To the greatest extent possible given time constraints, all members of the housing staff read each application for funding. However, in every case, the lead staff person, the secondary reviewer and Director of Housing Programs read and review individual project applications. The Federal Housing Programs Manager reviews HOME and other federal funding applications in order to flag any federal compliance issues. The Asset Manager reviews the plans and specs, capital needs assessment, and development pro-forma with an eye towards adequacy of projected replacement reserve deposits given the proposed scope of work. The lead staff person makes a brief presentation about the project at each meeting, highlighting issues and concerns. The rest of the staff ask questions and raise additional concerns and issues, if any, and help to craft award conditions designed to address issues that are not resolved through discussions between the lead underwriter and the applicant during underwriting. At the second meeting, a decision is made regarding which applications will be recommended to the board for funding and how much money will be recommended.

The lead staff person is also responsible for preparing a memo to the board recommending approval or denial of funding. Each memo presents basic information about the project, contains a HUD Layering Review, outlines project strengths and how the proposal meets various policies and priorities, and discusses issues and concerns. It also contains funding recommendations for both VHCB and HOME funds along with proposed award conditions both specific to the particular application and standard to all projects of a particular type. It also scores the application in three areas – Need, Impact, and Quality. The maximum score in each category is 10 points. An application must receive at least 21 points to be recommended to the board for funding. Attached

to the recommendation are two completed checklists, one that outlines which VHCB priorities and considerations the project meets and the other that outlines which priorities of the State's Consolidated Plan the project meets. These application evaluation checklists are attached to this policy for informational purposes. All applications must meet VHCB's thresholds; most applications recommended for funding meet at least two of the priorities. Each board memo is reviewed by the Director of Housing Programs, Federal Housing Programs Manager (if HOME or other federal funding is being recommended) Project Counsel, and the Executive Director prior to being sent to the board.

### **Major Underwriting Elements**

Staff reviews all of the information provided in the application and attachments. There are several major elements of underwriting outlined in greater detail below.

#### **1. Development Capacity and Fiscal Soundness of the Applicant**

In the vast majority of cases, staff evaluates the development capacity and fiscal soundness of the applicant as part of the Organizational Development Grant review process. The Organizational Grants Policy lays out in great detail what kind of information is received and evaluated. Major categories include: general staff capacity, capacity of the development staff, capacity of the financial staff, board capacity, organizational financial health, portfolio financial health, planning & coordination.

In addition, the VHCB Housing Policy and Service Supported Housing Policy both require that an inexperienced developer either partner with an experienced developer or employ an established development consultant. In addition to the information provided in the annual organizational grants process, VHCB receives annual audits and financial statements that are reviewed by financial staff. More frequent financial statements are required of organizations experiencing financial challenges. Recipients of organizational grants, which include most affordable housing developers in Vermont, provide periodic information on such topics as organizational finances, portfolio strength, development pipeline, and progress against established annual goals. In addition, VHCB staff has the opportunity to assess fiscal soundness and development capacity at the time of project and organizational monitoring (approximately every 18 months) and throughout the year through contact with individual grantees.

In addition to information about the developer, information is also gathered about other members of the development team to make sure that they have the experience and capacity necessary to undertake a project of the size and complexity proposed. Developers are checked for debarment prior to funding recommendations. Contractors are checked for debarment prior to contract execution.

#### **2. Project Location**

The VHCB Housing Policy and New Construction Guidelines both set forth criteria for project location. The site visit is key in accessing location, including such factors as

convenience to services, location in a downtown, village center or existing residential neighborhood, as well as the absence of negative factors such as neighboring industrial or heavy commercial uses, in a location that promotes sprawl, loud and frequent noise from traffic, airplanes, industry or other factors, and presence of pollution or other environmental concerns (either on the site or in the immediate neighborhood) that cannot be remediated.

3. Market Demand

In most cases a market study by an independent, experienced professional is required. That study must demonstrate that a market demand exists for the type of housing proposed in the particular location selected and at the projected rents or sales price proposed. There are two exceptions. The first is for properties that are already occupied and can demonstrate a solid rental history with few vacancies, and for which the developer(s) are not applying for low income housing tax credits. The second exception is for extremely small properties (i.e. 4 or 5 apartments) or service supported housing where the property will be occupied by clients of a social service agency. In all cases, the appropriateness of the proposal to meet a demonstrated need is evaluated.

4. Budget Documents

One of the most significant underwriting tasks is evaluation of the budget documents listed above. The proposed sources of funds are evaluated for the likelihood that they will be received in the amounts projected, whether there are other potential available sources, and whether or not the combined sources result in excessive subsidy (HUD Layering Review). Each line item in the Uses section of the Sources and Uses Statement is examined for adequacy and reasonableness given the information provided about the project. For example, construction cost, amount of contingency, soft costs including development fees, financing fees and other costs, and amount of pre-capitalized reserves. In some cases, such as development fees, there are maximum allowable amounts established by the funding agencies. Applicants are often asked to justify or explain individual line items. Total development cost and construction cost figures are compared against the cost of similar projects. The independent cost estimate is also examined and compared with the construction line items in the development budget to make sure that the estimate of construction costs is adequate to cover what is projected by the cost estimator.

The Operating Budget is examined to make sure that individual line items appear adequate and reasonable, yet not excessive. Applicants are often asked to justify their projected expenses or provide information about their assumptions. The annual contribution to the replacement reserve is examined to make sure that it is no less than \$50/unit/month or the amount reflected in a capital needs assessment. Staff evaluates whether the combination of funds in a pre-capitalized replacement reserve plus annual contributions will be adequate given the proposed level of building rehabilitation or the quality of materials in a new construction project. Prior to closing the developer must

obtain the signature of the property manager on the Operating Budget, indicating that s/he has examined the budget and believes it to accurately reflect anticipated operating costs.

The multi-year Pro Forma is examined to make sure that the spread between income and expenses is at least 1.5% (slightly lower in properties with project based rental assistance with rent levels tied to operating expenses) and that the vacancy allowance is at least 5%, or higher in a market that is not very strong. Staff also looks at a 20 year cash flow projection to make sure that the project will remain financially healthy for at least 15 years and that sufficient funds will be set aside in a project escrow or operating reserve to carry the property through at least 20 years. Staff also examines proposed deposits and a schedule of withdrawals from the replacement reserve to make sure that there is a reasonable likelihood that the property will have sufficient funds to meet its future capital needs for at least 20 years.

In the case of rental housing developments, the rent chart is reviewed to insure that the number of adaptable and accessible apartments meet state and federal requirements, that the number of HOME units reflect the amount of HOME funds requested, that rents do not exceed tax credit, HOME and other limits and that utility allowances are correct. In addition, affordability calculations and projected occupant incomes are checked to make sure that they meet state and federal requirements.

5. Plans & Specifications

Preliminary plans and outline specifications are received at the time of application with detailed specs and working drawings submitted at a later date. Plans are examined with an eye towards adequacy of space, efficiency of design, circulation patterns, aesthetics, and other considerations. Outline Specifications are reviewed for durability of design including expected useful life of any remaining building components, and to make sure that VHCB standards, including those for energy efficiency, will be met.

6. HUD Requirements if Federal Funds are Requested

Federal program staff carefully reviews federally required documents such as the HOME unit rent schedule, tenant income certifications and rent information for any existing tenants, relocation plan and budget, Uniform Relocation Act notices, Section 106 review, etc. to insure compliance.

7. Developer/Owner Profit Standard and Evaluation

VHCB applies several types of guidelines to assure that profit by developers and owners is not excessive:

- Developer fee is defined and limited to a percentage based on project costs and size. See VHCB's *Development Fee Policy for Affordable Housing Projects* for more information.

- Developers must identify all identities of interest. Where an identity of interest is identified, the profit for the associated firm is evaluated for reasonableness.
- If the developer is a for-profit owner/builder, profit within each segment of the budget is evaluated for reasonableness based on industry standards. Independent cost estimates are required and used along with industry standards to evaluate reasonableness of construction cost and profit.
- In accordance with VHCB's "Guidelines for Making Decisions Regarding Deferred VHCB and HOME Debt", loans provided to projects require repayment subject to the availability of ongoing cash flow, thus limiting undue profit during ongoing operations. Loan terms are typically 30 year 0% interest deferred.
- Tax credit investors' internal rate of return is determined according to standard computations per the Qualified Allocation Plan.
- Some developer/owners have an identity of interest by providing property management and/or other services to the project. Property management and/or other service fees and revenue are evaluated for reasonableness based on project size and type.

### **Award Conditions**

Each recommendation for funding made to the board contains suggested conditions specific to the particular application being considered. These conditions pertain to issues and concerns raised in the staff memo. Standard conditions for both VHCB and HOME funding are included as well. Those standard conditions may vary slightly depending on whether or not the project is utilizing tax credits, is a mobile home park, service supported housing, rental housing or a homeownership development. The conditions reflect requirements that must be met prior to closing or soon after completion of construction. Examples of such standard conditions are attached.

### **After Award of Funds**

Although most of the project underwriting is done prior to bringing a funding recommendation to the board, the lead staff person continues to follow the project through closing to make sure that all grant conditions and other funding requirements are met, questions answered and that the project is proceeding as expected. If major changes occur they must be reviewed and approved by staff and sometimes by the board itself. The Asset Manager receives and reviews 60% progress drawings as well as final working drawings and specifications for review and approval before the project goes out to bid. If bids come in over budget, grant conditions require VHCB review and approval of modifications to the scope of work such as value engineering.