# Welcome!

## *Consolidated and Further Continuing Appropriations Act of 2012:*

## Required Underwriting & Developer Capacity for HOME Homebuyer Projects

June 14, 2012

Office of Affordable Housing Programs, HUD

# FY 2012 HOME Appropriations Law Requirement Series

| | |
|---|---|
| Posted Online | Overview of the FY 2012 Appropriations Law Requirements |
| Mon. June 4th | Recent IDIS Changes Affecting HOME PJs |
| Mon. June 11th | Market Analysis |
| **Thur. June 14th** | **Underwriting & Developer Capacity for Homebuyer Projects** |
| Mon. June 18th | Deadline for Sale of Homebuyer Units |
| Thur. June 21st | Underwriting & Developer Capacity for Rental Projects |
| Mon. June 25th | For PJs: Assessing CHDO Development Capacity |
| Mon. July 10th | For CHDOs: Understanding the CHDO Development Capacity Requirement |

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

COMMUNITY PLANNING DEVELOPMENT

# Welcome & Introductions

- HUD welcome
  - Ginny Sardone, OAHP
  - Marcia Sigal, OAHP
  - Mila Hernandez, OAHP

- Trainer introductions
  - Steve Lathom, Training & Development Assoc.
  - Monte Franke, Franke Consulting Group

# Goals

- Understand requirements in context
- Framework for required assessments
  - Market risk
  - Developer risk
  - Project risk
- Underwriting (development projects & buyers)
- Documentation requirements

# Legislative & Regulatory Context

- FY 2012 HOME Appropriation Law requirements
  - *Consolidated and Further Continuing Appropriations Act of 2012* (PL 112-55)
  - Statutory requirements—"law of the land"
  - Applies to activities identified as 2012 Consolidated Plan/Annual Action Plan projects
- CPD Notice 12-007 provides operating guidance
- Proposed HOME Rule
  - Despite similarities, essentially does not exist

# Project Certification Requirement

- Conduct assessment of:
  - Neighborhood market conditions;
  - Developer capacity & fiscal soundness; and
  - Project underwriting
- Prior to executing the written agreement
- PJ must certify when committing funds to 2012 HOME activities in IDIS
- Requires PJ to underwrite direct assistance to homebuyer (e.g. DPA)

# Certification Language

*"(iv) for HOME projects identified as 2012 Action Plan activities in IDIS, if the activity involves acquisition, construction, or rehabilitation of rental or homebuyer projects, including down payment assistance, **the Participating Jurisdiction has conducted an underwriting review, assessed developer capacity and fiscal soundness, and examined neighborhood market conditions to ensure adequate need for the project** for which these funds are to be drawn"*

# Overview
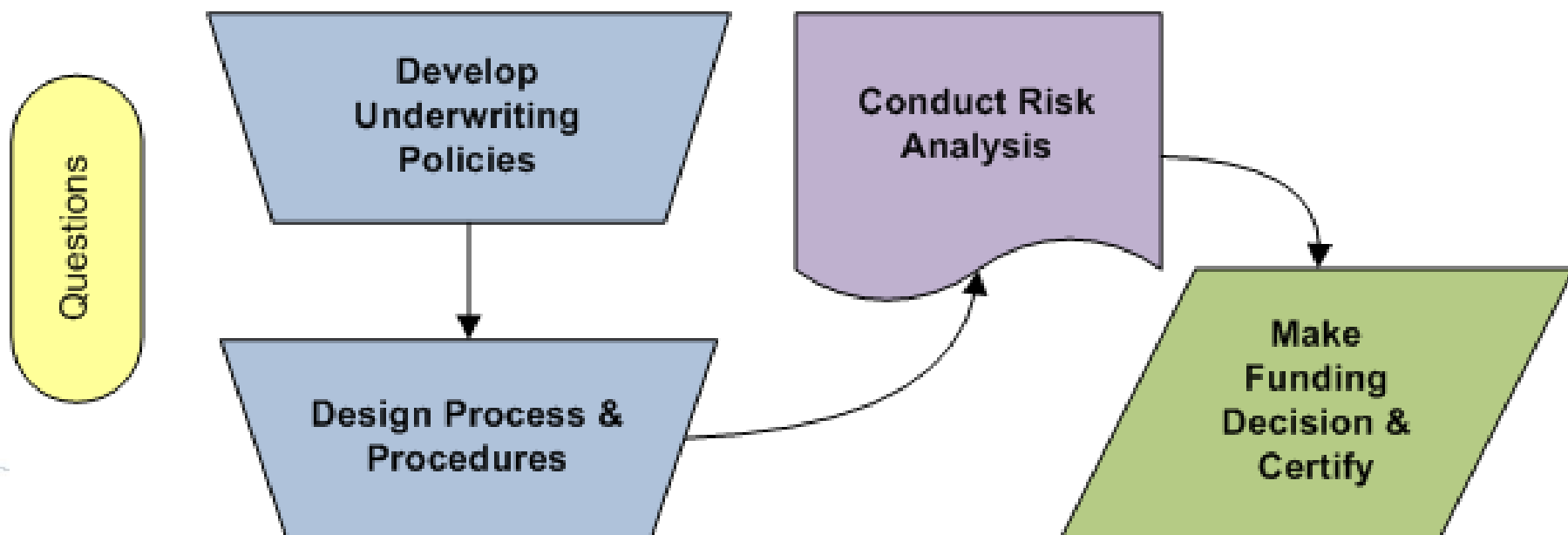
# Develop Policies

- Establish acceptable metrics
  - Variation by project size, scope, & complexity
- Key decisions include:
  - Maximum cost and HOME investment levels
  - Acceptable range of market, including floor based on funding available
  - Level and structure of homebuyer assistance
    - Project budget vs. specific household need
  - First mortgage suitability, including min/max lending ratios and acceptable terms/structure of first mortgage

# Design Process & Procedures

- Application articulates answers & provides supporting documentation
  - Assessment of market trends, competition, data supporting project
  - Marketing Plan
  - Development schedule, milestones, and assigned staff
  - Corporate & individual resumes, references, financial statements
  - Proforma, including construction period, cash flow, estimate of buyer mortgages
  - Plans, specs, cost estimates
  - As-completed appraisal, broker's price listing
  - Buyer income documentation, counseling, mortgage pre-approval
  - Commitments for leveraged funding

# Analyze Risk

- Market risk
  - What is the environment in which this project will compete?

- Developer risk
  - Is our partner credible, capable, and solvent?

- Project risk
  - What are the specific assumptions about cost, value, buyer funds, etc?

- Broader perspective also includes:
  - Portfolio risk—concentration by type, developer, etc.
  - Public considerations—subsidy layering & program performance

# Decide & Certify

- Document assessment & record decision
  - Balance risks & mitigating factors
  - Identify and explain waivers/exceptions to local policies and procedures
- IDIS Certification:
  - "{PJ} has conducted an underwriting review, assessed developer capacity and fiscal soundness, and examined neighborhood market conditions to ensure adequate need for the project."
  - Who certifies?

# Q&A: Requirements

- To submit a written question:
  - Click on the **Q&A tool** in the top menu bar.  Type your question in the text box provided and click "Ask"
- To ask your question verbally:
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Oakwood Shores Phase 2B Market Area and Comparable Properties

1. Mercy Hospital
2. Illinois Insitute of Technology
3. Lake Meadows
4. Woodland Park Apartments
5. Leontyne
6. Prarie Shores
7. Willard Square
8. Corner Stone
9. Madison Park Apartments
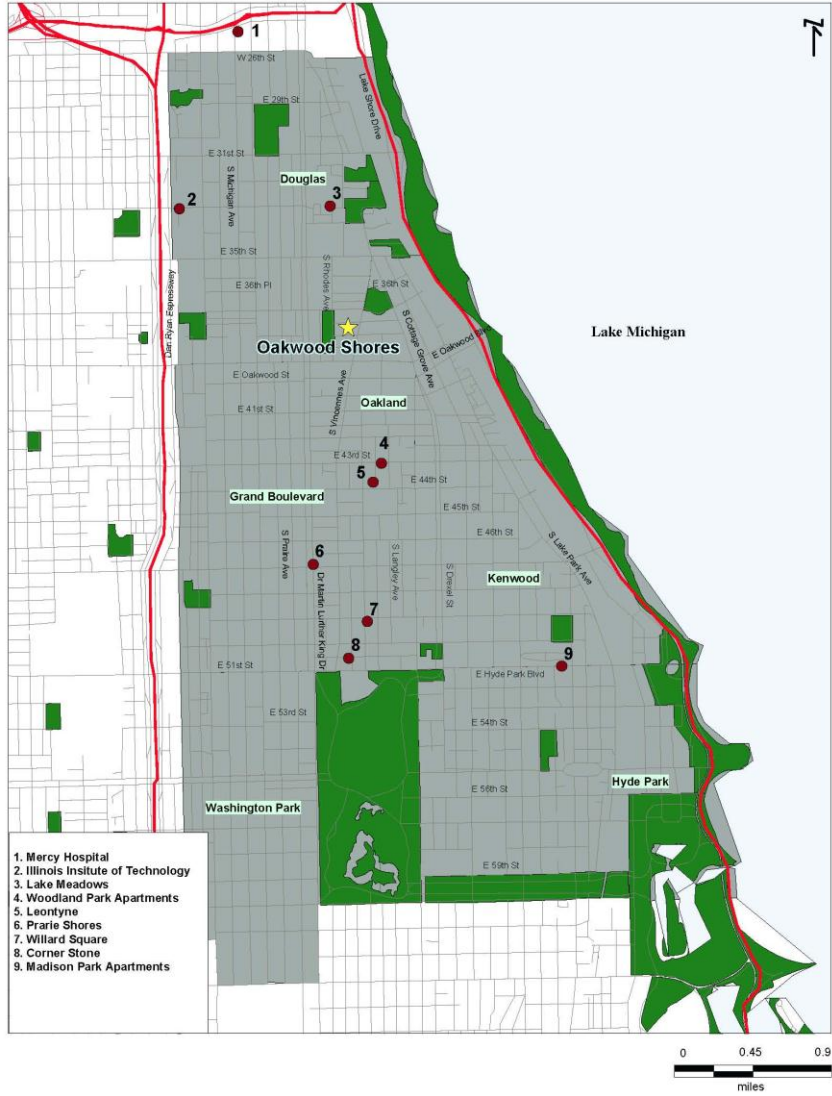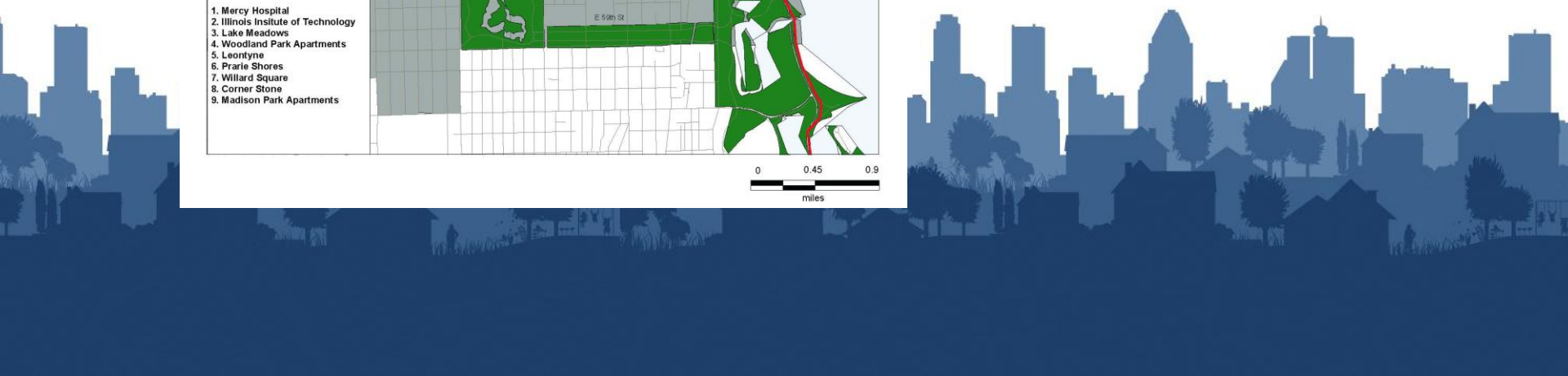
# Market Assessment

# Question to Answer for Certification Market Assessment

- Is there adequate demand for the proposed type and number of units to be "absorbed" within program deadlines?
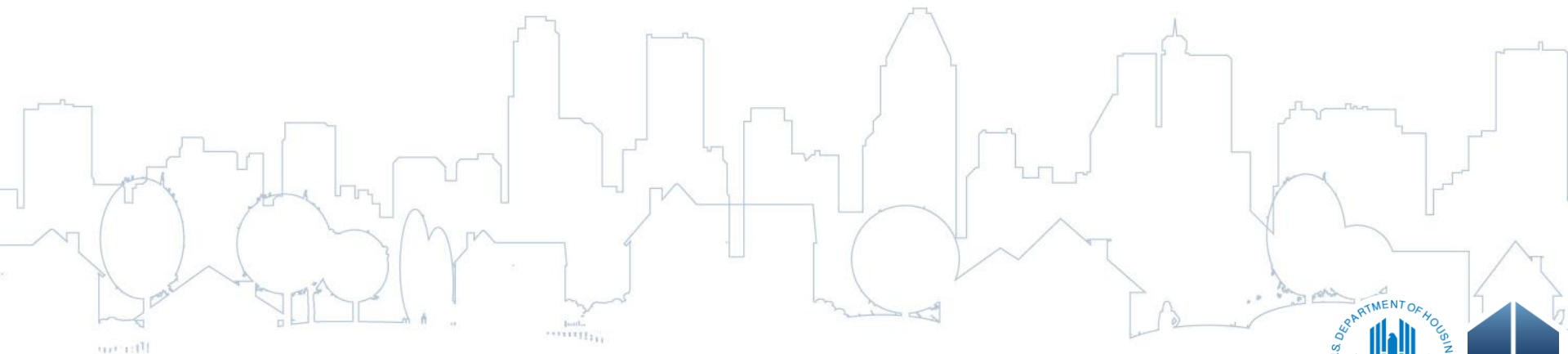
# Elements of Market Assessment



Market Trends

Competitive Analysis

Market Area

Market Analysis

Supply

Demand: Target Customers
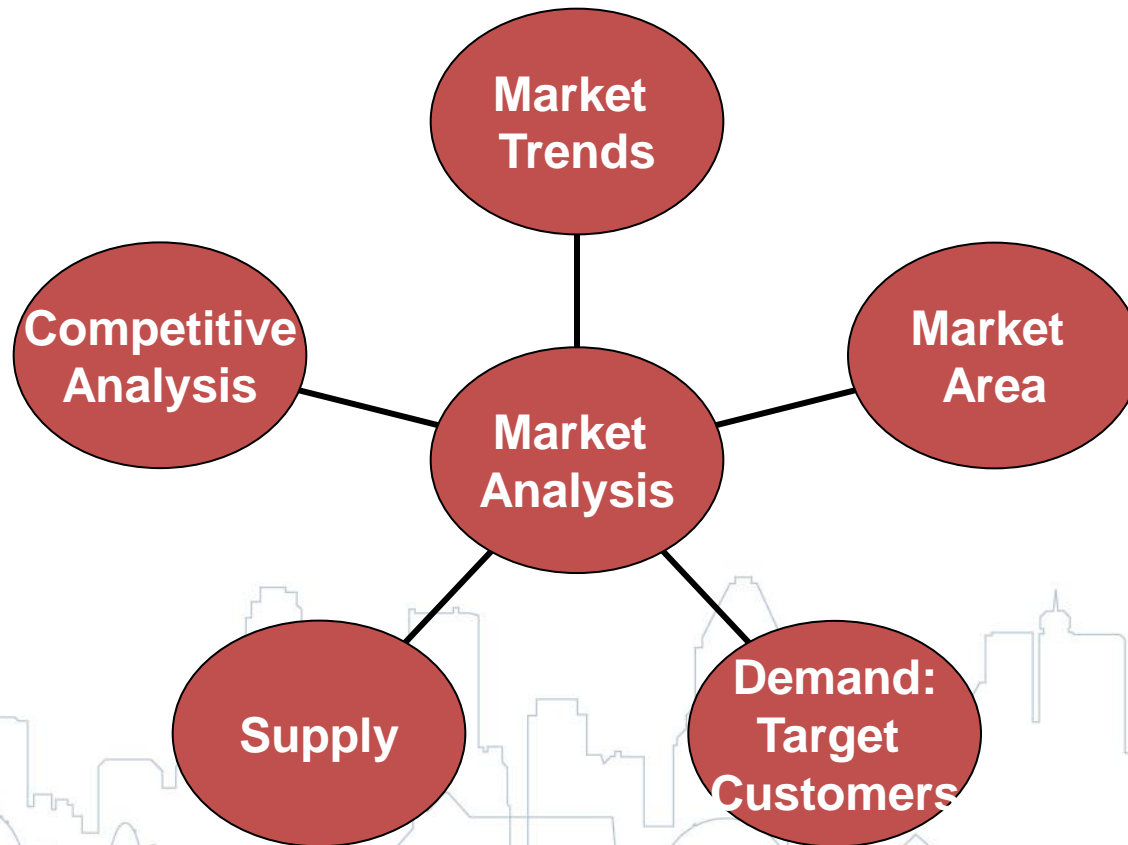
# Review the Market Assessment

- Don't always need an independent market assessment, but developer must demonstrate understanding of the market:
  - Market trends – What are the general housing and economic trends in the local market?
  - Demand – Who do they seek to serve, where will buyers come from, and how many fit the profile?
  - Supply – What products fit their needs and how do the proposed units compare?

# Policy Decisions
# Market Assessment

- What will you require from developers to demonstrate adequate demand?
  - Presales?
  - Pool of screened and counseled buyers?
  - Evidence of healthy market?
- When will you require projects to get an independent market assessment?
- If no pre-identified buyers, how many homes will you allow on spec?

# Developer Capacity
# &  Fiscal Soundness

# Questions to Answer for Certification Developer Capacity & Fiscal Soundness

- Two elements:
  1) Developer capacity – experience, current capability and team;  AND
  2) Fiscal soundness – financial resources to pull it off

- Capacity assessment varies by:
  - Project – size, scope, complexity
  - Type of development entity: non-profit vs. CHDO vs. for-profit

# Review Developer Capacity

- Application should demonstrate full understanding of the work and challenges

- Resumes list experience, but not results – check references

- Review the current project load & status
  - Look for projects in trouble

- Team should collectively have skills, and previous experience as team is preferred

# Review the Marketing Plan

- Has the developer identified:
  - The "message" to buyers
    - Value/sales prices that are competitive
    - The home's features fit the target buyer
  - The methods to reach buyers
    - Use of realtor or marketing staff
    - Advertising methods, both paid and free
    - Direct promotion through local organizations, stakeholders, social media, etc.

# Review Fiscal Soundness

- Net worth – Developers should not owe more than they own

- Portfolio risks – Past developments should not be a current drain on the developer

- Pre-development funding – Developer needs to "front" cash for costs before closing

- Liquidity – Developer needs enough cash to pay the bills

# Policy Decisions
## Developer Capacity & Fiscal Soundness

- How many projects can one developer have?

- How much & what type of experience does the developer need vs. development team?

- What staffing levels are needed for project size & scope?

- What net worth & liquidity is needed to handle projects?

# Q&A: Developer Capacity

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# Homeownership Development Project Assessment

- Development projects:
  - Are the development costs necessary & sufficient?
  - Is there adequate funding to complete the project?
  - Is the project likely to be completed in a timely manner?
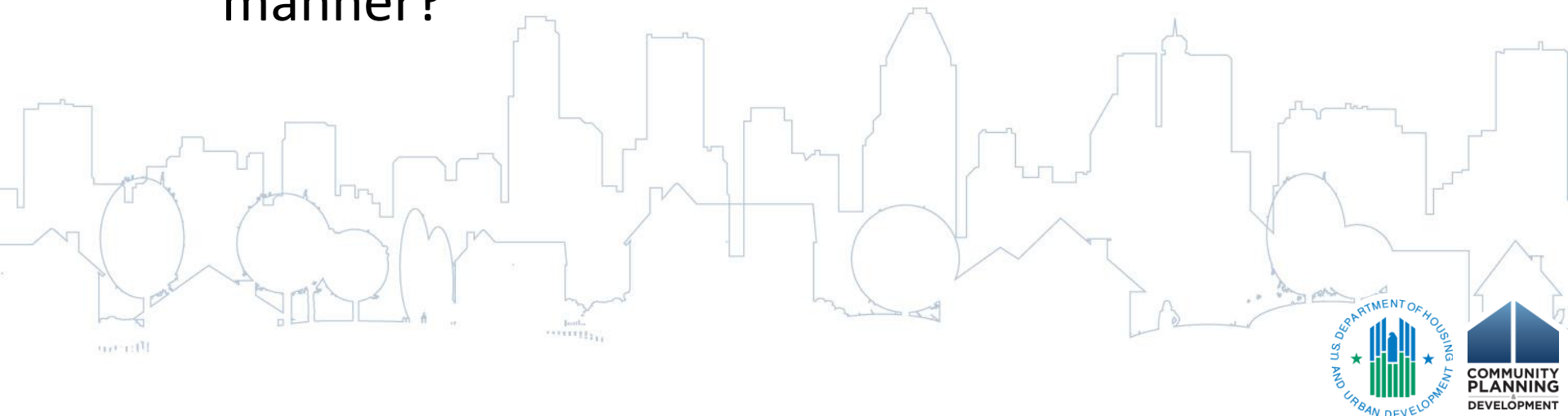
# Review Development Budgets

- Evaluate development budget for:
  - Cost reasonableness, but…
  - … adequate to build competitive product, effectively market, and margin to cover unexpected costs
  - Reasonable developer fees
  - Adequate financing
  - HOME funds needed for development are reasonable
  - Sales prices and projections are reasonable (and units can be sold within the 6 months sales deadline)

# Policy Decisions
# Homeownership Development Projects

- What property features balance marketability, sustainability, modest housing?

- Developer fees – amount & timing

- Soft costs – which are itemized, which paid from developer fee

# Assessing Direct Homebuyer Assistance

# Questions to Answer for Certification Direct Homebuyer Assistance

- Buyer assistance:
  - Are the units affordable to low-income buyers?
  - Is the amount of HOME assistance necessary and reasonable for buyers to sustain ownership?
  - Is the senior mortgage sustainable & affordable?

- Underwriting requirement applies to buyer assistance:
  - Buyer acquisition financing (HOME 1$^{st}$ or junior)
  - Downpayment/closing cost assistance (DPA/CCA)

# Home Mortgage Underwriting

| Four "C's" of Buyer Underwriting | Lender Metrics |
|---|---|
| Credit | Credit score |
| Capacity | Front/back ratios |
| Capital | Downpayment |
| Collateral | LTV |

# Review Direct Homebuyer Assistance

- PJs need to determine assistance amount is reasonable
  - Vary assistance by price and income levels
  - Apply minimum front ratios
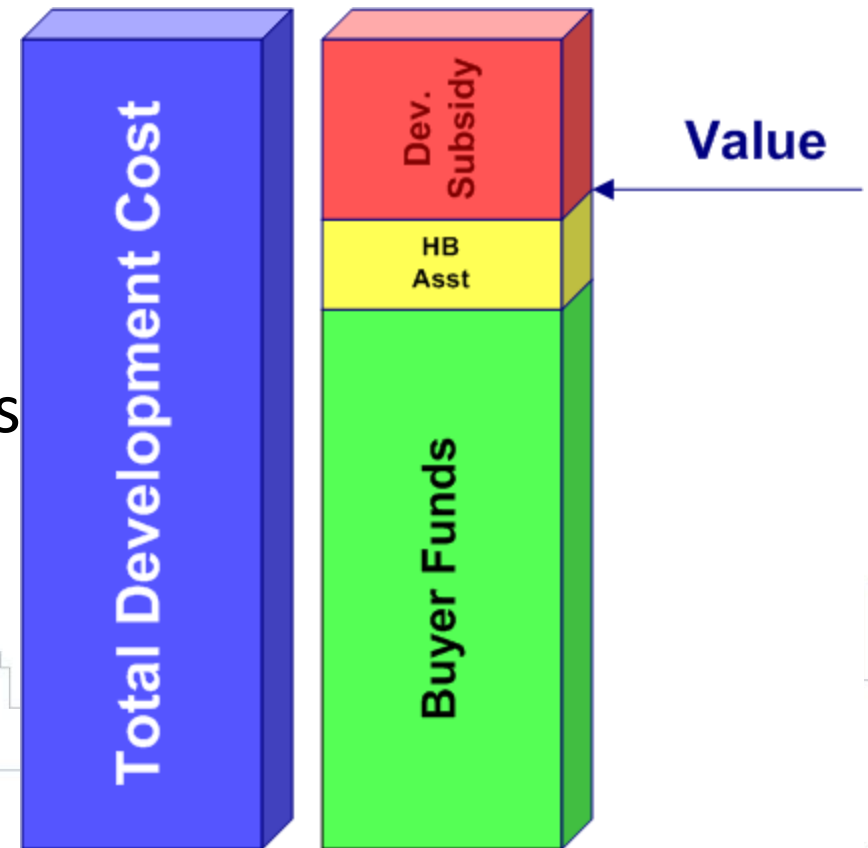
# Policy Decisions
# Direct Homebuyer Assistance

- What are acceptable (and unacceptable) 1$^{st}$ mortgage terms?

- How should buyer subsidy amount be determined?

  – Front/back ratios—floor and ceiling

  – Buyer cash investment—minimum & post-closing cash

  – Range of buyer assistance amounts

# Review of the Certification Process

# Revised Commitment Certification

# Final Thoughts

- Underwriting is about risk analysis:
  - Market risk:  the likelihood the units can be sold
  - Developer risk:  the likelihood that the developer can complete the project on time and budget
  - Project risk:  the adequacy and reasonableness of the costs and sources to complete and sell the project
- PJs implicitly do this, but we can do better
  - Clearer standards, more methodical review, proactive tracking, and better documentation
  - Process will be iterative;  start now, improve over time
  - Remember that markets change & you must adjust

# Available Resources

- Simple proforma:
  - How much mortgage can specific buyer afford?
  - How much income does a buyer need to afford specific house?
- Sample underwriting exhibit checklist
- Supplemental resources
- "Operating Guidance for Implementing FY 2012 HOME Appropriation Requirements" (CPD Notice 12-007): http://www.hud.gov/offices/cpd/affordablehousing/lawsandregs/notices/#2012

# Reminders

- Recording, presentation, and supplemental materials available for download now

- https://www.hometa.info/ will also include transcript & FAQs

- Please complete evaluations

- Direct highly specific questions to your Field Office

# Q&A: Project Underwriting & Remaining Issues

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# Evaluations & Adjourn

- Please complete evaluations

- Thanks to HUD staff

- Thank you for your:
  - Time

  - Contribution to learning

  - Work on behalf of communities & residents

I WANT YOU
to fill out the survey

# Additional Webinars

| | |
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