

# CITY OF SOMERVILLE HOME SUBSIDY LAYERING GUIDELINES

## Introduction

The Cranston-Gonzalez National Affordable Housing Act and 24 CFR Part 91, the Consolidation Plan Final Rule requires a Participating Jurisdiction (a City) to provide a certificate with the consolidated plan to approve layering guidelines. This certificate asserts that prior to the commitment of funds to a project, the City will evaluate the project in accordance with the guidelines that it adopts for this purpose and will not invest more HOME funds in combination with other governmental assistance than is necessary to provide affordable housing. Governmental assistance including any loan, grant (including Community Development Block Grant), guarantee, insurance, payment, rebate, subsidy, credit, tax benefit, or any other form of direct or indirect assistance from the Federal, State, or local government for use, or in connection with, a specific project. Where available, the City will rely upon guidelines developed and evaluation conducted by other agencies pursuant to either applicable HUD regulations or the Internal Revenue Code. The City will keep the results of its required evaluation in each project file.

## Use of the Guidelines

While the evaluation requirement is predicated on the combination of HOME funds with other governmental assistance, this guidance will also be used when determining the level of HOME funds to be used in a project absent other government assistance. The evaluation may need to be updated if additional sources of funds, not originally contemplated, are added to the project. The City may rely upon the guidelines developed and evaluation conducted by other agencies when Low-Income Housing Tax Credits (LIHTC) are used, which in most cases is the **OneStop Low Income Housing Tax Credit Application (One Stop Application)**. The One Stop Application is required of all applicants for Commonwealth of Massachusetts resources including LIHTC and it can be accessed at the Massachusetts Housing Investment Corporation (MHIC) website (<http://www.mhic.com>). The One Stop Application is a comprehensive subsidy application package which includes Sources and Uses statement, development budget, operating pro-formas, and other exhibits to support the subsidy application.

## Low-Income Housing Tax Credits

The City may rely upon the State tax credit allocating agency's evaluation either the Commonwealth of Massachusetts Department of Housing & Community Development (DHCD) or MassHousing (which is conducted to determine whether there are excess tax credits in a project) to ensure the HUD subsidies are not greater than necessary to provide affordable housing when combining HOME assistance with the tax credits. Such State agencies have typically established project guidelines (based on project size, characteristics, location and risk factors) that determine appropriate projects costs and developer fees. An acceptable State agency certification is done pursuant to either applicable HUD regulations or the Internal Revenue Code. HOME Funds awarded by the City to a project will be conditional upon the receipt of a copy of evaluation conducted by the State tax credit allocating agency.

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## **Project Evaluation**

Before the City of Somerville invests HOME funds in a project, it will assess if other governmental assistance has been, or is likely to be, made available to the project. In performing this evaluation, the City will consider the aggregate amount of assistance from HUD and other sources that is necessary to insure the project's feasibility. These may include, but will not be limited to, past rates of returns (in that area for that type of project) to owners, sponsors and investors; the long-term needs of the project and its tenants; and the usual and customary fees in project development. Major emphasis will be given to the income level of the population to be served, the level of rent restriction to be recorded against the property, and time of duration of such restrictions. A copy of the City HOME subsidy layering guidelines shall be made available through the City's website and also be included in the City's Developer Kit for all applicants.

### **A. Certificate of Assistance**

The City will obtain a formal certification from each applicant concerning the governmental assistance provided or to be provided to the project. If no such assistance is to be provided at the time of application or in the future, the applicant(s) will need to certify to that fact. The applicant must also certify that should other governmental assistance be sought in the future, the City will be notified promptly.

### **B. Sources and Uses of the Funds Statement**

All applicants are required to submit a Sources and Uses of Funds statement for their project. This statement must be consistent with the project development budget (see below) and must list:

- All proposed sources (both public and private) of funds and the dollar amount for each source. The application must include documentation such as commitment letters from all funds sources.
- All uses of funds, (including acquisition costs, rehabilitation/or construction costs, financing cost and professional fees) required for the project.

The City will identify the types of documentation necessary to verify the sources and uses of funds indicated in the statement. The listing documentation will be provided to the application so that the documentation may be submitted alone with the Sources/Uses of Funds statement in the application for HOME funds.

#### **Sources of Funds**

The City will request the following: (1) commitment letters with all terms and conditions for all mortgages, grants, subordination agreements, bridge (interim) loans and investment tax credits (historical, low-income, if applicable) and (2) if applicant is a partnership, a copy of the partnership agreement, which will indicate the cash contributions by the general partner(s) and/or limited partner(s)

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## Uses of Funds

The City will request the following: (1) earnest money agreement, option or closing statement for land and/or building(s); (2) construction cost estimate; (3) construction contract or preliminary bid(s); (4) agreements governing the various reserves which are capitalized at closing (to verify that the reserves cannot be withdrawn later as fees or distributions); (5) appraisal (to substantiate the value of the land and the value of the property after rehabilitation or the structure being built); and (6) if low-income housing tax credit are utilized, documentation on the syndication costs (legal, accounting, tax opinion, etc.) from the organization/individual who will syndicate and see the offering to ensure that the project can support the fees necessary to syndicate/fund the project. All assumptions in the offering should be verified in the supporting documentation.

The applicant should also provide supporting documentation for all other costs as specified in the Sources/Uses of Funds statement. If the documentation is not adequate and does not support the costs as stated, the City will request additional documentation, a second opinion and/or reference from the appropriate source (i.e. another construction cost estimator, another architect or lawyer), or deny the project HOME funding. It should be noted that for projects with tax credit to be sold, the proceeds from the sale of these credits must be identified as a source of funding.

## **C. Project Development Budget**

In addition to the Sources and Uses Statement, applicants are required to submit a Project Development Budget. The budget should categorize cost in a manner consistent with the Sources and Uses Statement, and be presented in such a manner that the City can easily refer back to the Statement to determine the source of funding to be used for all costs. It should include all cost associated with the project regardless of funding sources. The budget line items may include, but should not be limited to: construction “hard” cost, soft cost (architectural, engineering, legal and appraisal fee) marketing cost, construction loan interest, developer fees, real estate taxes, insurance, all loan fees, building permits, relocation and commercial fees. The project development budget should reflect the total cost as the “Uses” section of the sources and Uses of Funds statement.

The City will review the budget to ensure that the cost being funded by the HOME program are eligible and the HOME funds per unit do not exceed the maximum per-unit subsidy limits.

In its review of the Development Budget, the City will focus on the quality of the end product, construction costs, architectural and engineering fees, and consulting fees. The City will determine what costs are customary and necessary depending on the type of development activity. For example, it will consider the demands of new construction as opposed to rehabilitation and senior housing as opposed to housing for large families. It will also determine if these costs are reasonable. The City’s determination of “reasonableness” will be based on all of the following factors:

- Costs of comparable projects in Massachusetts.
- The qualification of the cost estimators for the various budget line items;
- Comparable costs as published by recognized industry cost index services.

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## **D. Rate of Return on Equity Investment**

The City of Somerville will require the applicant to furnish a proforma (project income and expense statement) which should include achievable rent levels, market vacancies and operating expenses. It must also specify the consequences of tax benefits, if any, and any other assumptions used in calculating the project cash flow to determine the reasonableness of the rate of return on equity investment. The proforma must represent the term of the HOME affordability requirements or the term of other affordability requirement as mandated by other funding sources if longer. The proforma should not exceed the anticipated useful life of the facility. In general, adequacy of the proforma will be evaluated on the basis of industry standard as identified by HUD.

The City will examine the proforma to insure that cash flow projections are reasonable in light of present economic conditions, and are neither unduly conservative nor overly optimistic. It will also examine the proforma to determine that the projected rates of return are reasonable and that the applicants will not receive excessive profit or windfalls from the project. The City should not allow an excessive gain/profit to be derived from the project, in part due to the financing (low-income housing tax credits, low interest loans, tax abatements, etc). It will also establish specific standards for reasonable rates of return on the invested equity based on the project.

## **Single-Family Rental Housing (1-4 units)**

The concepts contained in all the above sections pertain to single-family rental housing of 1 to 4 units as well as multi-family rental housing (for example, income/expense, cash on cash and net operating income analyses). However, there are two questions a City must consider before applying these concepts: (1) is the rental project owner-occupied? and (2) is the owner-occupied unit being rehabilitated with Federal funds?

If the answers to both questions is YES, the rental income for the owner's units (had the project not been owner-occupied) must be excluded from the income analysis of the proforma. For example, in a four unit owner-occupied project, only the expected income of the three rental units is included in the income analysis. Similarly, expenses associated with the rehabilitated owner's units must also be excluded from the proforma. The exclusion of income and expense of the owner's units not only affects the net operating income and the cash analysis, but also influences the results of the proforma.

## **E. Documentation Of Layering Review**

For documentation of compliance to the Subsidy Layering each project file shall contain a Certificate of Federal Assistance, Sources and Uses statement, development budget (including updates) from the developer, copy of the State tax credit allocating agency's subsidy evaluation, and additional reviews and supporting documents requested by the City.