MULTIFAMILY AFFORDABLE HOUSING LOAN UNDERWRITING STANDARDS

Note: These application guidelines are intended to provide guidance and clarity on HOST standards for housing investment. Overall decisions may be based on the overall project rather than strict application of these guidelines.

These Underwriting Standards are part of HOST's loan application package, which also includes the HOST Housing Financing Application Instructions, HOST Application Template, HOST Application Information & Certification, and HOST 2020 Term Sheets. Included here are underwriting standards for:

1. **Developer Underwriting**
2. **Site and Project Review**
3. **Project Underwriting**
4. **Competitive Requirements for Debt and Equity**
5. **Supportive Housing**

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1. Developer Underwriting

1.1 Financial Strength

1.1.1 Sponsor or Developer must submit last three years of audited financial statements or tax returns plus current year-to-date unaudited financial statements for Sponsor and all partners of the Sponsor, including the parent, affiliate or affiliates, and high net worth individuals for the Sponsor and each partner.

1.1.2 The Sponsor or Developer financial statements must show current obligations, guarantees, contingent liabilities or other financial commitments which restrict the entity from providing completion guarantees, net worth requirements for construction completion, operating deficit and tax credit recapture guarantees of limited partner investors. If an individual person or persons is/are proposed to offer financial guarantees, the same audited financial statements or personally signed financial statements (certifying their accuracy and completeness) for that individual are required in addition to that of Developer.

1.1.3 Sponsor or Developer must show adequate net worth to provide the financial guarantees to lenders, investors and HOST as required for the project. HOST will consider the totality of the Developer's contingent liabilities. Liquid net worth should equal 10% of the construction loan amount to be guaranteed. HOST may consider reducing this standard for developers with strong project track records with HOST and/or Denver Housing Authority (DHA).

1.2 Development Experience and Track Record

1.2.1 Sponsor or Developer must have a successful track record of affordable housing developments completed and leased on time and within budget, with positive cash flow, compliance with regulatory agreements, maintenance of adequate operating and replacement reserves and adequate property maintenance standards.

1.2.2 In addition to general affordable housing track record, Developer or team member must have a demonstrated record in construction and operation of at least three projects of similar construction type, size and scope (e.g. Type V, Type I, structured parking, underground parking) as well as target resident population (family, senior, SRO, special needs) as the proposed project. HOST may reduce or waive this requirement for new or innovative housing types and projects.

1.2.3 For projects serving a population that may require services, Developer or Developer's chosen service provider partner must have demonstrated successful track record in providing social services to the targeted population, and adequate capacity to provide social services, or must contract with a service provider who does. This track record should be evidenced by documentation on project staffing levels, annual social service budget, sources of funds, types of services provided and contracts/agreements with third party service providers and/or social service agencies at existing projects.

1.2.4 Developer shall provide to HOST a list of all projects for which there are audited project financial statements for the last three years. HOST will pick, at its discretion, those projects for which HOST wants to see audited financial statements and, for tax credit projects, Colorado Housing and Finance Authority (CHFA) compliance audits. Project financial statements will be reviewed for positive cash flow, status and funding of operating and replacement reserves, sharing of residual receipts according to agreements with lenders, property management fees, and appropriateness of overall operating costs.

1.2.5 Developer shall provide for the proposed project an ownership diagram displaying the proposed ownership structure for the project, including the percentage ownership of each development partner or entity.

1.3 Joint Ventures

1.3.1 If the proposed development entity is a joint venture between a nonprofit developer and a for-profit developer, guarantors must submit the information required for Developer underwriting review as specified above. Additionally, the Developer should submit the joint venture agreement for evaluation of the quality of the joint venture based on the following standards:

1.3.1.1 equitable/appropriate fee sharing arrangements;

1.3.1.2 clear and non-redundant division of roles, including identification of which entity will be responsible for ongoing compliance;

1.3.1.3 local nonprofit acting as managing general partner;

1.3.1.4 identification of whether the nonprofit or for-profit developer partner holds the purchase option at the end of the compliance period; and

1.3.1.5 adequate length of time for the guarantor joint venture partner to provide necessary financing and net worth guarantees.

1.4 Developer Presence and/or Experience in Denver and Colorado

1.4.1 The Developer shall be in good standing with the City and County of Denver (as confirmed by HOST), DHA, DURA and CHFA.

2. Site and Project Review

2.1 Site Requirements and Priorities

2.1.1 The Project Site must be deemed suitable for affordable multifamily housing development, as determined by HOST staff. That staff determination may be based on proximity to multiple amenities including employment, schools, shopping, public transportation, medical services, or parks/playgrounds; conformance with the Denver Comprehensive Plan, density, neighborhood character and land use patterns; and no adverse impacts from slope, noise (e.g., railroad tracks, freeways), environmental hazards, flood plain, or wetland issues.

2.1.2 The Project Site should be reviewed with respect to other City and County of Denver policies that may affect site and target population selection.

2.2 Zoning and Parking Requirements

2.2.1 The Project must be consistent with zoning and parking requirements for the site. HOST reserves the right to provide conditional approval, conditioned upon meeting parking requirements.

2.2.2 The Concept Review and all amendments shall have the approval of Denver Community Planning and Development (CPD).

2.3 Accessibility

2.3.1 The Project Design must meet all accessibility requirements contained in Section 504 of the Rehabilitation Act of 1973 as well as State and local building codes.

2.4 Environmental Issues

2.4.1 If any RECs are found, the budget must include the cost for any remediation, to be completed prior to funding.

3. Project Underwriting

3.1 (Reserved)

3.2 Developer Compensation and Requirements

3.2.1 Developer Fee

3.2.1.1 HOST is entitled to review the final partnership agreement, operating agreement, or comparable agreement in advance of partnership closing.

3.2.1.2 The amount of the Developer Fee shall not exceed the maximum fee allowed by CHFA for LIHTC projects. The 2020 maximum fee is 12% for new construction and substantial rehabilitation projects and 17% for supportive housing (SH) projects eligible for CHFA's 5% Developer Fee boost. The Developer Fee percentage is calculated as a percent of total project costs less land, Developer Fees, consultant fees and project reserves. Consultant fees to a third party for performing tasks that a Developer would normally perform (e.g. prepare applications for tax credits and other funding sources, managing government approvals and acting as Owner's agent during project construction) must be included within the Developer Fee limit.

3.2.1.3 Interest to be paid on the developer fee may not exceed the rate of interest on the HOST loan. Exceptions to this policy must be approved by HOST Executive Director or designee (Deputy Director).

3.2.1.5 For tax credit projects, the deferred Developer Fee shall not exceed the amount that can be paid out of cash flow within the first ten years of operation, as demonstrated by a cash flow analysis submitted by the Developer, assuming annual escalation of income at 2% and operating costs at 3%, or such other rates as may be approved by HOST.

3.2.1.6 The Developer Fee may not be increased as a percentage of total development cost subsequent to City loan application. The lesser of at least 25% of the Developer Fee or the amount that can reasonably repaid from cash flow in 10 years must be deferred.

3.2.2 Property Management Fee

3.2.2.1 The property management fee should not exceed industry standards. Industry standard is 5% to 7% of gross rent for family housing; HOST staff will review CHFA, Denver, and DHA portfolio experience.

3.2.3 General Contractor Profit, Overhead, General Conditions

3.2.3.1 The Developer must identify the general contractor profit and overhead (expressed as a percentage of construction hard costs), general conditions/requirements, general contractor liability insurance premium and general contractor payment and performance bond/letter of credit cost to be included in the general contract, subject to HOST approval.

3.2.3.2 General contractor profit and overhead combined shall not exceed the following CHFA limits (expressed as a percentage of construction hard costs):

number of units	w/ identity of interest[1]	w/o identity of interest
75+ units	6%	8%
31-74 units	8%	10%
30 units or less	10%	12%

3.2.3.3 General contractor general conditions/requirements shall not exceed 8% for the proposed construction period.

3.2.4 General Partner Asset Management Fee

3.2.4.1 The Developer asset management fee should range from $5,000 to $7,000 per year based on the size and complexity of the project. Asset management fees are allowed for tax credit projects only.

3.2.5 Ground Leases

3.2.5.1 HOST will not accept must-pay ground lease payments that exceed the restricted market value of the site based on the appraisals required above.

3.2.6 Residual Receipts

3.2.6.1 Sharing of residual receipts among public agency lenders should be proportional to each lenders' investment in the project, unless other limitations apply, but in no event should the share to HOST be less than 25%. If residual receipts are not shared with other public lenders, HOST share should be no less than 50% and no greater than 75%.

3.2.7 Developer/General Partner Loans

[1] Identity of interest between Applicant, Owner, builder, and/or subcontractors. An identity of interest will be assumed if any of the following factors are present: common financial interest; any family members; individual and corporation where 50 percent or more of outstanding stock is owned by that individual; members of the same controlled group of corporations; a partnership and each of its partners; a corporation and each of its shareholders.

3.2.7.1 Repayment of Developer/general partner loans approved by HOST to fund the development, operation or maintenance of the project will be permitted out of cash flow.

3.2.7.2 Interest on Developer/general partner loans, including operating deficit loans, will not exceed the applicable federal rate (AFR) and will be underwritten on a case-by-case basis.

3.2.8 Developer Equity Requirements

3.2.8.1 On affordable projects, where 100% of the units are restricted to 80% of median income or less, no Developer equity investment shall be required.

3.3 Project Income and Operating Expenses

3.3.1 Market Rents

3.3.1.1 Market rents in mixed-income projects must be no higher than market rate as demonstrated by a third-party professional market study completed within six months of application.

3.3.2 Affordable Rents

3.3.2.1 All affordable rents must be consistent with HUD rents for very low-income, low-income or moderate-income households, as applicable.

3.3.3 Operating Expenses

3.3.4.1 Operating Expenses shall be defined to include, but not be limited to, all reasonable operating expenses of the property, including real estate taxes, insurance premiums, utilities, building maintenance, painting and repairs, management fees, payroll, administrative expenses, marketing expenses, legal expenses, interest expenses, replacement reserves, audit expenses, and security on supportive housing projects (excluding any Developer Fees payable).

3.3.4.2 Minimum Operating Expenses per unit per annum (PUPA) must be at least equal to $4,400, excluding replacement reserves, and $6,100 for project-based Section 8 projects or a lower amount based on three years of audited financials. For senior-only projects, a lower PUPA may be accepted if documentation of actual expenses from an existing senior-only deal is made available. A lower PUPA may be accepted for projects that are exempt from real estate taxes with evidence of the exemption and estimated of per unit taxes is provided.

3.3.4.3 Proposed Operating Expenses should be justified based on actual operating expenses at the Developer's comparable projects, or other comparable projects, as evidenced by audits. Comparable projects should be within a similar geographic area, have similar tenant populations and be of comparable size.

3.3.4.4 Operating Expenses for specialized housing types (e.g. SH, special needs) require review of empirical evidence on expenses and vacancies at comparable developments.

3.3.4.5 Other income (non-commercial) is limited to parking and laundry. Charges must not exceed fees charged for these services in market-rate properties.

3.3.4 Vacancy Allowance

3.3.4.1 For 100% affordable projects, a minimum vacancy allowance of 7% should be used on all rental income, 10% for any retail/commercial income, and 5% for projects receiving project-based Section 8 subsidy for 100% of the units.

3.3.4.2 Vacancy rates for special needs and Supportive Housing projects should be justified based on experience of comparable developments.

3.3.5 Replacement Reserves

3.3.5.1 Minimum replacement reserve deposits should equal an amount required by a senior permanent lender, or at least $300 per unit per year for family projects and $250 per unit per year for senior projects, whichever is greater. For acquisition/rehabilitation projects, the replacement reserve deposit should equal at least the annualized amount indicated by a PNA or PCA performed by a qualified firm acceptable to HOST based on the extent of the rehabilitation.

3.3.5.2 Capitalized replacement reserves may substitute for annual per unit requirements depending on the amount to be capitalized, which may include existing reserves for project-based Section 8 projects.

3.3.5.3 Interest earned on replacement reserve accounts shall remain in the account, to be used for qualified expenses.

3.3.5.4 Reserve accounts must remain with the property and may not be captured by limited or general partners upon exit.

3.3.6 Operating Reserves

3.3.7.1 A capitalized Operating Reserve is required in an amount equal to at least four months of estimated operating expenses and must-pay debt service under stabilized occupancy. An increased Operating Reserve may be required based on lease-up projections contained in the market study. Project-based Section 8 projects may substitute the reserves purchased from the seller and transferred by HUD if they equal or exceed the minimum operating reserves.

3.3.7.2 Annual deposits to the Operating Reserve account shall be made in an amount equal to 3% of the annual operating budget until a balance equal to a minimum six months of operating costs is achieved, unless a higher amount is required by the project investor or lender or is warranted based on the risk of the project and Developer in the judgment of HOST staff.

3.3.7.3 Interest earned on the Operating Reserve shall remain in the account, to be used for qualified expenses.

3.3.7.4 Reserve accounts must remain with the property and may not be captured by limited or general partners upon exit.

3.3.7 Service Amenities

3.3.1.7 Services may include those items identified in HUD Title 24. Social services should be appropriate to the target population (family, able-bodied senior, frail senior, special needs, homeless).

3.4 Cash Flow

3.4.1 Debt Coverage Ratio Minimums and Maximums

3.4.1.1 For any one of the first three years, the minimum debt coverage ratio for all amortized debt is 1.15:1.0 and the maximum debt coverage ratio is 1.30:1.0.

3.4.2 Escalation Factors

3.4.2.1 Projects must demonstrate a debt coverage ratio of at least 1.15 to 1.0 for the term of the permanent debt, with rent and income escalated at 2.0% per year and Operating Expenses escalated at 3.0% per year. On preservation projects the escalation factors must be justified by the prior 3-5 years of income and expense growth.

3.4.2.2 Replacement reserve deposits should be adjusted every five years based on an escalation rate of 2% per year, or the average of the last 3 years annual inflation rates, whichever is greater.

3.5 Financing Assumptions and Assessment for All Debt and Equity

3.5.1 HOST Assessment of Financing

3.5.1.1 HOST must assess for reasonableness all financing and financing terms for the project, including any construction loan, permanent loan, tax-exempt bond, tax credit equity investment and intercreditor agreement.

3.5.2 Construction Loan

3.5.2.1 Acceptable lender third-party costs to be included in the development budget include legal costs, appraisal fees, construction cost review, loan extension fees, and inspections during construction.

3.5.4 Tax-Exempt Bonds

3.5.4.1 For private placement bonds, underwriter costs and credit enhancement costs should not be incurred.

3.6 Long-Term Guarantors

3.6.1 HOST will underwrite long-term guarantors that are not part of the Developer entity based on the submission requirements and criteria in Section 1.1.

3.6.2 The Developer will submit the terms of any and all financial guarantees provided by guarantors that are not part of the permanent Developer entity, which shall be subject to HOST approval.

3.7 General Partner Contribution

3.7.1 Any General Partner contribution shown as a source of financing must be approved by HOST.

4. Competitive Requirements for Debt and Equity

Developers shall conduct a competitive solicitation for construction and permanent mortgage debt and, if applicable, for LIHTC equity investment. This may require sending the solicitation to three to five lenders and investors currently active in the Denver market. In all cases, the preferred partner's letter of intent should be denoted and included with the original application, but the letter of intent must be submitted before HOST begins underwriting. The solicitation should include the following, as applicable:

4.1 Construction Loan Terms

- Loan amount
- Interest rate index and spread
- Loan fees
- Loan term, extension options and fees
- Conditions to fund
- Loan to value ratio
- Loan valuation method
- Legal fees (and caps), appraisal costs, and inspection fees
- Collateral

4.2 Permanent Loan Terms

- Loan amount
- Interest rate and spread
- Loan term
- Amortization
- Conditions of permanent loan conversion (occupancy rate, debt coverage ratio, months of stabilized operation, achievement of pro forma rents, other)
- Debt coverage ratio
- Collateral

4.3 Tax-Exempt Bond Debt Terms (in addition to the items in Section 6.2)

- Credit enhancement (letter of credit, other)
- Issuance costs
- Other annually recurring loan fees (e.g., insurance, trustee, issuer)
- Floating rates, caps and collars

4.4 LIHTC Equity Investment Terms

- Tax credit pricing (cents on the dollar)
- Pay-in schedule, benchmarks and requirements
- Developer Fee pay-in schedule
- Investor asset management fee
- Cash flow distributions
- Replacement reserve requirements
- Operating Reserve requirements
- Operating deficit guarantee: limits and length
- Construction completion guarantee: dollar/percentage limits and length
- Tax credit recapture guarantee: dollar/percentage
- Credit adjuster terms
- Option price and conditions
- Right of first refusal conditions
- Pledge that project operating and replacement reserve account balances will remain with the project upon investor exit.

5. Supportive Housing

5.1 Supportive Housing (SH) is defined as decent, safe, affordable, community-based housing for people who are experiencing homelessness and have disabilities or special needs that provides tenants with the rights of tenancy and links to intensive supportive services.

5.3 Minimum Operating Expenses for SH Projects are $7,000 per unit if security costs are included in Operating Expense plus $7,200 per unit below the line for supportive services.