Subsidy Layering Review

Lead Office: USDA-RD

Participating Offices: Treasury-IRS, USDA-RD, HUD-MF, HUD-PIH, HUD-CPD

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Issue Statement:

The Housing and Economic Recovery Act of 2008 (HERA) encouraged the Federal government to standardize its subsidy layering review processes, but consistency is still lacking. In many cases, Federal programs have a common denominator approach where some Federal programs overlap only when another Federal program mirrors all of their requirements. Absent this, subsidy layering review processes remain inconsistent. Inconsistency in review processes leads to slow and uncoordinated processing and decision making, and creates problems related to data collection and timing of the subsidy layering reviews, particularly as they may relate to the 'critical path' of the development project.

Background: Section 102 of the Department of Housing and Urban Development Reform Act of 1989 requires all projects receiving HUD subsidy combined with any form of other Governmental Assistance to undergo a Subsidy Layering Review. This review will certify that there is no overlap of government subsidies when combining housing assistance programs administered by FHA with other forms of Federal funds administered by Federal, State, or local agencies. Subsequently, this requirement was merged with the Section 911 reviews required by Housing Finance Agencies (HFAs) per LIHTC involvement to comply with the regulatory requirements of Section 42(m)(2) of the 1986 Internal Revenue Code.

The issue of subsidy layering is addressed differently by Treasury, HUD, and USDA. Subsidy layering is a statutory requirement to assure that Federal resources are neither duplicative nor wasteful when applied to affordable rental housing. These differences largely turn on the extent of subsidy layering analysis that the agencies require, ranging from USDA-RD requirements that rely on the subsidy layering review performed for LIHTC subsidy layering review purposes, to HUD-CPD's HOME program, which provides detailed guidance on how the analysis must be completed.

Developers often approach the subsidy funding process without a full picture of what resources will be used or obtained. This may result in a significant stretch of time between the start of the process and the final assembly of all funding sources. In addition, while there is a description of 'best practices' administered by Housing Finance Agencies, some funding review processes are more robust than others.

Other issues that may create challenges include timing issues (i.e., Does a review of resources require a commitment of all resources? Will professional reports such as an appraisal be used within their effective period?), data definitions (i.e. Will the appraised value or CNA findings be acceptable to all programs? How will reserve account deposits be determined, and how will operating costs be defined?), or how to resolve findings or issues (i.e., What happens when one program disagrees with another on underwriting data or terms being provided? What kind of notice will be required when a problem is found? Will joint actions against developers be used? How will issues be communicated to the developer community?).

Proposed Alignment:

Alignment summary: The Team proposes to pursue the following, with the ultimate goal of reducing redundant reporting and increase the timeliness of SLR and funding approvals:

- *Agree on a standard set of SLR facts:* Standard 'facts' include information about sources and uses of funds, appraised values, current and projected capital needs and market information;
- *Collect the SLR facts in a standard format:* The standard 'format' includes forms, applications or submissions to an automated database;
- Establish a process and timeline to immediately share the facts and findings between all Federal funders and the LIHTC allocating agencies: 'Sharing' refers to how and when the information can be used by Federal funders and participating LIHTC allocating agencies to conduct the subsidy layering review and other funding approval decisions.

Specific actions to effect alignment: To implement this recommendation, the Team has established a working group to review existing data and data collection currently performed by several programs within HUD and by Housing Finance Agencies in support of the LIHTC program. Based on that review, the working group will propose a standard set of SLR facts for acceptance by all Federal funders and LIHTC allocating agencies.

A second working group will review internal protocols to share and make recommendations using SLR information to further align the process of reviewing the information and approving the transactions. Since much of the information captured in the SLR involve issues being considered by other alignment teams, such as those reviewing Capital Needs Assessments, appraisals, and market studies, a strong effort will be made to ensure our recommendations fit with those being developed by other teams. A third working group will provide recommendations on the most effective way to communicate to the development and professional community the changes to current protocols and requirements.

To achieve full implementation, the Team expects to adopt a data collection and review protocol that resembles the following five steps:

1. Establish a point of contact for each State HFA and each Federal rental program.
2. Establish or adopt a SLR/Sources and Uses Form that is agreed upon by all stakeholders. This form should require the developer's signature certifying all sources applied for as of the date of application or that will be applied for are included and their uses do not overlap. The form should also include the developer/borrower agreeing to release all submitted data to any applicable funding source or government agency.
3. The developer/borrower submits the form as a part of the initial application for funding. Each source of financing listed would be emailed a copy of the SLR/Sources & Uses form as approved by the subject agency after their underwriting (the form is still an estimate at this point).
4. An updated/interim submission of the same SLR form should be submitted to all overseers of the sources of financing at construction close. This updated form would be emailed to each of

the sources of financing listed after underwriting review (the form is still an estimate at this point).

5. A final SLR should be submitted by developer/borrower to all sources of financing once substantial lease up occurs (or if tax credits, when 8609's are issued). This form would include the final uses and which sources of financing covered those final uses. Each financing source would be emailed a final copy of this form after review and certification by the reviewing agency.

This would satisfy the goal of public disclosure of sources and uses. It would also allow us to have verification from each of the sources of financing at the appropriate stages; application, construction close, and lease up. Currently, many agencies have a cost certification process in which the developer/borrower submits their paid construction invoices to the financing agency and they verify those costs as eligible uses of their funds. Each agency would have a register of project expenses (uses) and a corresponding register of sources.

<u>State-level Pilots:</u> To initiate this process, pilots will be implemented in several States to see if these SLR alignment actions can be implemented quickly at a State level. The goal of the pilots will be to have an MOU established between the State HFA, HUD, and USDA that states what entity will perform the subsidy layering review and identify how data will be shared between parties to assure that all further funding review and approval decisions are made using the same information. The implementation efforts of the pilots will be used as basis for the working groups to complete their tasks and establish a national format that can be used in other States.

<u>Resource Estimate for Implementation:</u> It is anticipated that the resources needed to implement this proposal as a pilot will be limited since many subsidy layering reviews are already being conducted by housing finance agencies, and the basic product of the alignment concept is an agreement or memorandum of understanding on how to proceed. However, for national implementation, depending on the level and extent of existing efforts, resources will be needed to review the current situation, resolve issues and differences, and establish an agreement to proceed.

For the pilot, the Team anticipates a series of meetings will be necessary to determine best how to implement these provisions in each State where an agreement is established. Representatives from the HFA, USDA and each program to be covered by that agreement in HUD will need to be represented during these meetings and legal assistance will be necessary to prepare the agreement. The Team anticipates decision making for the funding of approximately 200 USDA projects and 300 HUD projects with LIHTC resources will be affected by this proposal each year, after full implementation (about 50 during the pilot).

Additionally, there may be merit to eliminating or streamlining any subsidy layering requirements that cause any Federal program to be treated differently. One possibility is to mutually agree to a single point of contact for all SLR reviews, such as the State HFA. This may require development of a compensation schedule for any project's SLR which the HFA completes on behalf of one of the agencies but which doesn't receive direct Federal funding through that particular State agency.

<u>Estimated cost savings for owners, operators, developers, investors and/or lenders:</u> The Team anticipates the primary benefit will be faster subsidy layering reviews that result in quicker transactional decisions. This will reduce some of the developer's risk and lead to fewer instances where seed capital or dependent 3rd party

funding is lost because of delayed subsidy layering or underwriting reviews. The Team also expects there to be some reduction in the costs to submit approval documentation as the goal will be for the developer to submit their information to only one agency. The Team will be able to identify more realistic cost savings once the pilot proceeds and additional feedback from stakeholders has been received.

<u>Estimated cost savings for State, local, and Federal governments:</u> For example, HUD-PIH estimated staff time related to reviewing and approving a complete and error-free SLR application is 4 hours, with a policy-based limitation of 30 days total for review. For pilot States, staff time related to approvals equals approximately 980 hours on the 121 CF properties for which a SLR was performed in 2007. Staff time savings due to SLR alignment would be dependent upon the number of subsidy streams each property has; however, if SLR alignment had been implemented for the CF properties in 2007, approximately 496 staff hours could have been saved.

Additionally, the Team anticipates an additional benefit to government will be consistent reporting of facts by applicants leading to faster and better informed decision making. The Team also expects faster access to information and an opportunity to reduce the number of reviews associated with transactional approval. Ultimately, the instances of poorly informed decision making to be reduced saving the government unwise expenditures of limited housing resources. The Team will be able to identify more realistic cost savings once the pilot proceeds and additional feedback from stakeholders has been received.

<u>Schedule for Alignment Implementation:</u> The initial steps in implementation are the pilot, followed by the finalization and approval of the conceptual approach, after which full implementation will follow. It is anticipated that during March the Team will make contacts with target pilot States, establish working groups to implement the State pilots and receive final direction from DPC and RPWG to pursue pilot milestones. During late March and April, the Team will proceed with discussions on a State by State basis and seek to establish MOU’s once a decision is made to begin implementation. Once the pilots are under way and the resulting conceptual approach is approved, a full national roll out could be achieved within 12 months of a successful pilot.

Purpose

This document is part of an ongoing effort to better align Federal rental policy across the Administration and is sponsored by the Rental Policy Working Group. The Rental Policy Working Group is composed of the White House Domestic Policy Council (DPC), National Economic Council (NEC), Office of Management and Budget (OMB), and the U.S. Departments of Housing and Urban Development (HUD), Agriculture (USDA), and Treasury.

The specific areas of concern identified herein emerged from July 2010 stakeholders gathering at the White House on areas of Federal rental policy inconsistency across the administration. The revised conceptual proposals for alignment articulated within this report are preliminary in nature and have not been endorsed by any Federal agency or office.

With any questions, please contact the Rental Policy Working Group Agency Alignment Leads: Larry Anderson, Director of Multi-Family Housing Preservation and Direct Loans at USDA-Rural Development, Ben Metcalf, Senior Advisor at HUD's Office of Multifamily Housing Programs; or Michael Novey, Associate Tax Legislative Counsel in Treasury's Office of Tax Policy.