Arizona Department of Housing

HOME-ARP Underwriting Guidelines

Date Issued: May 31, 2022

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EQUAL HOUSING OPPORTUNITY

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Introduction

This document describes the guidelines used by the Arizona Department of Housing (ADOH) in the underwriting of HOME-ARP:

1. Non-congregate shelter;
2. Non-congregate shelter conversion to rental or transitional housing; and
3. Rental housing.

It also includes the market assessment requirements for HOME-ARP rental housing projects. A HOME-ARP project is a site or sites together with any building or buildings under common ownership, management and financing and assisted as a single undertaking. The project includes all activities associated with the site(s) and building(s).

Underwriting is the process of identifying, evaluating and mitigating project risks. The goal of underwriting is to ensure both project feasibility (the project will be completed) and project viability (the project will remain viable throughout the minimum compliance period or restricted use period). The ADOH recognizes that there are inherent risks in every project. Underwriting may result in the imposition of requirements to balance inherent and identified risks with the goal of producing and sustaining safe, decent and affordable housing.

Full underwriting will occur:

1. Prior to making a commitment of HOME-ARP funds to a project; and
2. At the time of final draw when final sources and uses can be verified.

Technical reviews may also be conducted at initial closing or construction/rehabilitation start or at any time there is a material change. Material changes may also require an updated market assessment and/or project application.

The ADOH may choose to review the underwriting of other lenders, including financial institutions, subrecipients, federal, state or local government agencies, and underwriting contractors. When doing so, the ADOH will document, based on these underwriting guidelines, the determination that the project meets program requirements, is compliant with the ADOH written underwriting and subsidy layering standards, is a reasonable investment, and is likely to remain financially viable throughout the compliance or use period. The ADOH may discuss the project with other funding sources and mutually disclose known information. For administrative ease, the ADOH may align underwriting standards with other public funders, particularly if those standards are more restrictive or conservative.

Exceptions and Interpretation

The ADOH has developed these underwriting guidelines to comply with requirements of awarding federal assistance and to provide clarity to applicants on expectations. However, the ADOH cannot identify every possible special circumstance that may warrant an exception to these guidelines. Likewise, the ADOH cannot identify every possible work-around that might be creatively identified by an applicant. Consequently, the ADOH reserves the right to waive specific underwriting criteria for specific projects when, in its judgment, the purposes of the federal assistance can be better achieved without taking on undue risk. When waiving any given requirement, the ADOH may impose additional special conditions or business terms that are not otherwise typically applied to projects.

The ADOH reserves the right to reject any element of a transaction that, despite not being specifically prohibited, was not anticipated by these guidelines, specifically those that otherwise create unacceptable risks, excessive returns to the owner/developer, or undermine the public purposes of the federal assistance.

Underwriting Framework

The ADOH underwriting framework includes complying with program rules and regulations and reasonable business practices, including but not limited to evaluation of:

1. Regulatory requirements applicable to the project, including occupancy by and affordability to the target population, compliance with NCS restricted use and rental housing minimum compliance periods, property standards, and cross-cutting federal requirements.
2. For rental housing projects and NCS conversions to rental housing, market risk, including whether sufficient demand exists for the project, the anticipated lease-up period, how the project compares to the competition, and whether general economic conditions support ongoing viability.
3. Owner/developer risk, including whether the owner/developer, including any subsidiaries or special-purpose entities has the capacity to develop and operate the project based on a history of experience or team members with experience.
4. Project risk, including sources and uses, ongoing operating assumptions, and the development schedule. This includes confirming that all sources of project financing are available and committed to the project.
5. Subsidy layering analysis to determine the actual amount of program funds required for project feasibility and viability.

Non-congregate Shelter (NCS)

Before committing HOME-ARP funds to a non-congregate shelter (NCS) project, the ADOH will evaluate the project to determine the amount of HOME-ARP capital subsidy, including any capitalized replacement reserve, necessary to provide shelter for qualifying populations throughout the minimum HOME-ARP restricted use period.

Regulatory Requirements

The ADOH will evaluate the project to ensure it meets all regulatory requirements, including but not limited to the following minimum requirements.

1. The project evidences sufficient operating revenue to cover operating expenses throughout the restricted use period for the project type.
2. If the project will be converted to HOME-ARP rental housing (including transitional housing):
    a. The conversion will occur after the minimum NCS restricted use period; and
    b. The project design is appropriate to conversion for use as affordable rental housing, which may include single room occupancy units.
3. The waiting list procedures document how applicants for occupancy will be selected in chronological order to the extent practicable.
4. The project does not charge occupancy fees.
5. Commitment and expenditure deadlines. The timeline evidences:
    a. If acquisition only, the project will be operated as HOME-ARP NCS within six (6) months of execution of the ADOH-owner/recipient agreement;
    b. If construction or rehabilitation (including HOME-ARP funding of a capitalized replacement reserve):
        i. Construction or rehabilitation will begin within twelve (12) months of execution of the ADOH-owner/recipient agreement; and
        ii. The project will be completed within four (4) years of execution of the ADOH-owner/subrecipient agreement.
6. If the project includes acquisition and/or rehabilitation, the applicant submits a capital needs assessment that demonstrates the project will meet habitability and property standards throughout the restricted use period.

Market Assessment and Project Need

A market assessment is not required for HOME-ARP NCS; however, the applicant must document how it determined need for the number of proposed HOME-ARP units and beds.

Owner/Developer and Development Team Assessment

The developer includes the owner, the developer, and any underlying corporate entities and individuals that will own the HOME-ARP project. The ADOH will consider specific skills and experience with development, including but not limited to shelter management, asset management, public financing, and service provision, including:

1. Recent, ongoing, and successful experience with development of similarly sized and regulated shelter or facilities;
2. The presence of adequate staff with specific skills and experience appropriate to their roles in the project; and
3. The financial capacity of the owner/developer to meet its financial obligations and risks of the project.

To evaluate the owner/developer and development team, the ADOH requires that applicants submit:

1. The name(s) and role(s) of staff and consultants principally responsible for project management during the construction phase (the development team) and operating phase (the operating team), a list of similar projects completed by the project team, or if the project team has not completed similar projects, a list of projects completed by individual team members. The project(s) list must include:
   a. Name and location of similar projects;
   b. Type(s) of project funding used;
   c. Number of units, rooms and beds; and
   d. On-site and off-site services provided.

The ADOH may require and review a list of real estate owned or underway (including partnership/ membership interests). This review may include project performance and financial factors such as net occupancy, cash flow, outstanding loan balances, net equity of individual projects, and the overall portfolio.

Technical/Professional Capacity

The ADOH will review the collective capacity of the development team including, but not limited to, the general contractor, architect, engineer, market analyst, shelter manager, accountant, attorney, and any other specialized professionals or consultants, *and* the individual experience of team members.

As a whole, the development team must have the skills and expertise necessary to successfully complete and operate the shelter. The ADOH will examine whether the team members have worked together successfully in the past. The ADOH will also consider prior experience with the team. In no case may any member of the development team be a suspended, debarred, or otherwise excluded party.

New entities, new development team members, and new staff will be considered higher risk than those with successful past experience working together.

Financial Capacity

Developers and owners must demonstrate financial capacity to support the proposed project during construction. The ADOH will *not fund* a project where cash needs exceed the developer's net or liquid assets. The ADOH will identify financial capacity risks by requiring the applicant submit:

1. The applicant's most recent audit;
2. Current fiscal year-to-date income and expense statement;
3. Current balance sheet showing all assets and liabilities, including contingent liabilities (e.g., construction loans or operating deficit guarantees);
4. Income and expense statements and balance sheets for the two previous fiscal years, unless an audit is submitted; and
5. A list of any litigation, pending judgments, bankruptcies with the past seven years that apply to the applicant, any principals or officers, or any affiliated entities. Any litigation and pending judgments must be described.

The ADOH will review the submitted documentation to determine:

1. If the financial management system complies with Generally Accepted Accounting Principles;
2. If there are any material weaknesses in the entity's financial management system or internal controls;
3. If the developer or owner is a nonprofit organization, it's audit evidences that it meets the financial accountability standards of 2 CFR 200.302 regarding financial management and 2 CFR 200.303 regarding internal controls; and

4. That sufficient financial resources are available to cover any shortfalls during the construction period. This will include an analysis of the owner's or developer's net worth, portfolio risk, litigation, pending judgments and bankruptcies, pre-development funding, and liquidity.

Disqualification

ADOH may disqualify an application based on substantive evidence connecting a development team member to any of the following:

- Making a misrepresentation or providing materially false information in an application;
- Has been involved in any project awarded LIHTCs where there has been a material change (including in general partners or managing members) that ADOH did not approve in writing beforehand;
- Allowing a shelter or affordable rental housing property to enter into foreclosure;
- Being removed from a shelter or rental housing ownership entity by an equity investor or ADOH;
- Not being in good standing with any affordable rental housing program administrator or the State of Arizona;
- Has been a debtor in a bankruptcy within the past five (5) years;
- Has been a party in a civil, administrative or criminal matter which resulted in an adverse fair housing settlement, an adverse civil rights settlement, or an adverse federal or state government proceeding and settlement against that party or a pattern of adverse civil proceeding and judgments against that party as evidenced by three (3) or more adverse judgments within the previous five (5) years;
- Has been found to be directly or indirectly responsible for any other project within the past five (5) years in which there is or was uncorrected noncompliance with state or federal rules, regulations or standards;
- Has outstanding compliance issues with HUD or ADOH;
- Has ADOH fees that are due and remain unpaid at the time of application;
- Has a loan payment that is due and remains unpaid without a pending deferral request at the time of application; and
- Being debarred, suspended, or otherwise excluded from any federal contract.

Project Assessment

To identify project risks, the ADOH will evaluate sources and uses, ongoing operating assumptions, and profit and returns to the owner/developer. To ensure adequate information is available to assess project risk, the ADOH will require applicants submit:

1. Firm commitment letters for all permanent financing sources (loans, grants) that include:
    a. Amount
    b. Term and amortization (not less than the minimum HOME-ARP restricted use period);
    c. Fixed interest rate;
    d. Fees charged;
    e. Reserve requirements;
    f. Anticipated lien position; and
    g. Acceptance of the HOME-ARP covenants, conditions and restrictions for non-congregate shelter.
2. If the applicant is a partnership or limited liability corporation, a copy of the partnership agreement or operating agreement, which must indicate the cash contributions by the partner(s) or member(s);
3. If equity is committed by the developer or owner(s), evidence of available equity funds;
4. Acquisition documents, such as the purchase agreement, option or closing statement, and appraisal or other documentation of value. An appraisal must be performed by a state-licensed appraiser. Closing costs must be documented;
5. Construction and other cost estimates (e.g., professional services, soft costs, capitalized reserves) based on the scope of work;
6. Agreements governing capitalized reserves for replacement;
7. A capital needs assessment for all acquisition and/or rehabilitation projects;
8. An operating proforma (project income and expense statement) encompassing not less than the minimum HOME-ARP restricted use period and including:
    a. Projected operating revenue and assistance;
    b. Projected non-residential revenue, if any;
    c. Vacancy rates that do not exceed 10%; and

d. Operating expenses, including but not limited to development-paid utilities, shelter operating fees, reserves, and debt service. Note that supportive services are separately accounted for in HOME-ARP projects.

Sources and Uses

The ADOH will review the sources and uses statement, development budget, timeline and supporting documentation. The ADOH may adjust any factor during the underwriting analysis to adjust for known conditions not accounted for in the development budget. Sources and uses underwriting will ensure:

1. Proposed uses of program funds are eligible;
2. All funds are firmly committed to the project or are contingent only upon receipt of HOME-ARP funds;
3. Total funding sources are adequate and timely in their availability to cover development costs at all phases of the project;
4. All senior debt bears a fixed interest rate, has a term equal to or longer than the required minimum restricted use or compliance period, and allows for the recording of covenants, conditions, and restrictions imposing federal requirements senior to all other financing documents;
5. Development costs, including those paid with other sources, are reasonable, necessary and customary both on a line item and total project basis;
6. The cost of land and/or buildings acquired or to be acquired does not exceed the as-is market value of the property based on the submitted appraisal, plus documented closing costs;
7. The HOME-ARP capitalized replacement reserve funds only those major systems replacements necessary during the restricted use period as evidenced in the Capital Needs Assessment;
8. The contingency does not exceed 10% of project hard costs, unless the project is an acquisition or rehabilitation project and documentation identifying risk factors is included with the application;
9. Any conditions of other funders on drawing funds will not have a negative impact on project feasibility and/or viability;
10. Permanent funding repayment terms are incorporated into long-term operating projections;
11. All funding sources' requirements are incorporated into the project structure;

12. No other funding sources have requirements that conflict with ADOH HOME-ARP requirements;
13. Capitalized reserves cannot be withdrawn as fees or distributions;
14. The budget is adequate to meet property standards and occupancy by HOME-ARP qualifying populations throughout the restricted use period;
15. The costs associated with cross-cutting regulations (environmental review, URA, Davis-Bacon) compliance are included in the budget; and
16. The total amount of program funds requested is reasonable and necessary considering all funding available to the project (subsidy layering review).

The ADOH will not make a firm commitment of funds to any project that does not evidence all financing sources are in place to complete and operate the project for the entire restricted use period. When all financing sources are not in place to complete and operate the project, the ADOH may make a conditional commitment of funds to a project. When a funding source is contingent upon receipt of HOME-ARP funds from the ADOH, contingencies may not include automatic self-expiring clauses or highly conditioned language.

Operating

The ADOH will review the operating proforma to ensure the following. The ADOH may adjust any factor during the underwriting analysis to adjust for known conditions not accounted for in the operating budget.

1. Individual line item and collective revenue (including non-residential revenue) and operating costs are reasonable, necessary and customary when compared to other similar projects.
2. Revenue will be sufficient to cover expenses throughout the restricted use period.
    a. The operating budget must demonstrate the project operates at least at break-even in each year during the restricted use period, unless there is:
        i. A capitalized operating reserve maintained outside the control of the project owner or shelter operator and sufficient to fully fund all operating deficits; or
        ii. Evidence of commitment of secured sources for operating; or
        iii. An appropriate and acceptable plan for securing additional sources of funds for any operating gap during the restricted use period.
    b. The HOME-ARP application will automatically increase operating costs 3% annually and operating expenses 2% annually.

3. Identities of interest are disclosed;
4. Replacement reserve payments are adequate to realistically cover the cost of replacing covered items and are not less than the amount determined necessary in the capital needs assessment.
5. Other funding debt service and reserve requirements are included.

Profit and Returns to Developers and Development Team Members

The ADOH will evaluate development sources and uses and the operating budget and supporting documentation to ensure:

1. The developer fee does not exceed 15% of total development costs for projects that have 61 or more beds and 20% of total development costs for projects that have 60 or fewer beds. Developer fees include those actually paid or otherwise recognized as income of the developer and other costs paid to third-parties, such as construction oversight and consultant's fees.
2. Contractor fees, including profit, overhead and general requirements do not exceed 15% of net construction costs. Net construction costs are the amount of the construction cost less contractor fees and building permits.
3. Architectural fees do not exceed $7,000 per unit for projects with 61 or more beds, $8,000 per unit for projects with 31-60 beds, and $9,000 per unit for projects with 1 to 30 beds.

Subsidy Layering and Gap Analysis

Subsidy layering analysis is conducted to ensure only the amount of program funding necessary to provide safe shelter for the minimum HOME-ARP restricted use period is provided to the project. The subsidy layering analysis will combine all underwriting factors with an examination of any other funding sources to ensure only the amount of HOME-ARP funds necessary for project feasibility and viability are provided to the project.

If the subsidy layering analysis reveals that the gap between available sources and the uses of funds exceeds the amount requested, the ADOH may deny assistance to the project or reduce the amount of HOME-ARP funding provided to the project.

Final Underwriting

When final underwriting takes place at project completion and the project costs are lower than originally underwritten, the ADOH may reduce the HOME-ARP funding provided to the project.

Non-congregate Shelter Conversion

Projects intended for conversion will be underwritten as NCS at the time of project application and later as rental housing prior to the ADOH providing final approval for conversion. Conversion underwriting will require the owner submit a complete rental housing application to the ADOH not less than six months prior to the planned conversion. The complete rental housing application will be underwritten using the rental housing underwriting criteria in this document and will additionally ensure:

1. Sufficient funding is firmly committed to meet the costs of converting the project to rental housing without additional HOME-ARP investment;
2. Sufficient funding is firmly committed to bring the project into compliance with the required rental housing property standards;
3. The project evidences positive cash flow throughout the remaining restricted use period without additional HOME-ARP investment;
4. The existing replacement and operating reserves not funded by HOME-ARP are sufficient to cover any replacement costs or operating deficits for the remaining restricted use period without additional HOME-ARP investment.

Rental Housing

Before committing HOME-ARP funds to a rental housing project, the ADOH will evaluate the project to determine the amount of HOME-ARP capital subsidy and operating cost assistance necessary to provide quality affordable housing for qualifying populations that will be financially viable throughout the minimum 15-year HOME-ARP compliance period. Project underwriting will include the entire project, not just the HOME-ARP units. Low-income Housing Tax Credit (LIHTC) projects will be underwritten following the LIHTC underwriting requirements.

The ADOH underwriting includes an in-depth review of underlying project assumptions, development sources and uses, and projected operating income and expenses.

The following underwriting criteria apply to rental projects funded in whole or in part with HOME-ARP. Unless otherwise agreed to in the funding agreement, annual principal and interest payments will be required. The interest rate will be determined using a 15-year amortization period and combined 1.05 debt service coverage ratio for all primary and secondary debt, including deferred developer fees. The debt service coverage ratio will be based on stabilized operating or year 2. Payments of principal and interest may be deferred or forgiven.

Regulatory Requirements

The ADOH will evaluate the project to ensure it meets all regulatory requirements, including but not limited to the following minimum requirements.

1. The <u>minimum per unit HOME-ARP subsidy</u> is not less than $1,000 per unit.
2. <u>HOME-ARP Units.</u> The HOME-ARP Program permits the funding of one or more units in a project, including mixed-income and mixed-use properties. However, HOME-ARP funds may only be used to pay eligible costs for HOME-ARP-assisted units. When fewer than 100% of a project's units are designated as HOME-ARP assisted, only the costs allocable to the HOME-ARP-assisted units may be paid. This requirement dictates the minimum required number of units that must be designated as HOME-ARP assisted. Of HOME-ARP Units:
    a. Not less than 70% (rounded up to the nearest whole number) must be set-aside for tenancy by HOME-ARP Qualifying Populations. These units are referred to as HOME-ARP QP Units.
    b. Up to 30% must be set-aside for tenancy by households with income less than 80% of the area median income adjusted for household size and geographic area. These units are referred to as HOME-ARP LI Units.

3. Commitment and expenditure deadlines. HOME-ARP funds are considered committed to a project at the time the ADOH and project owner execute a legally binding written agreement. The timeline must evidence:
    a. Acquisition, if applicable, will occur within six (6) months;
    b. Construction or rehabilitation will begin within twelve (12) months;
    c. The project will lease-up within six (6) months of development phase completion; and
    d. The project will be completed within four (4) years.
4. Projects must meet the property standards defined in the ADOH written property standards for NHTF funds, and all local codes, zoning and ordinances.
5. Acquisition and/or rehabilitation projects must submit a capital needs assessment.
6. For HOME-ARP Qualifying Units (HOME-ARP QP Units), unit rents, including utilities, must not exceed 30% of the adjusted household income of the qualifying population tenant up to the Low-HOME-ARP or fair market rent for the bedroom size as published by HUD. For underwriting purposes, unless the market assessment or project application documents occupancy assumptions or evidences commitment of project-based rental assistance, the ADOH will calculate the anticipated year 1 HOME-ARP QP rent as 30% of income of a household whose income is 30% of the AMI, adjusted for anticipated occupancy by bedroom size. Stabilized operating (years 2 through 15) for HOME-ARP QP rent will assume the Low-HOME-ARP rent.
    a. 1 person per each single room occupancy or 0-bedroom unit;
    b. 2 people per 1-bedroom unit;
    c. 3 people per 2-bedroom unit;
    d. 4 people per 3-bedroom unit.
7. For HOME-ARP Low-income Units (HOME-ARP LI Units), unit rents, including utilities, must not exceed the High HOME rent for the bedroom size as annually published by HUD.
8. Unit occupancy. Within six (6) months of construction completion, HOME-ARP assisted units must be initially occupied by tenants who are qualifying populations, or low-income households as specified in the funding agreement.
9. Minimum compliance period. The minimum compliance period for HOME-ARP rental housing projects is fifteen (15) years.
10. The waiting list and tenant selection criteria provide for selection from the waiting list in chronological order to the extent practicable.

11. The affirmative marketing plan complies with HUD and ADOH requirements.

Market Assessment

All applications for ADOH HOME-ARP rental housing funds must demonstrate demand for the proposed housing. The contents of the required market assessment will vary based on the number of units in the proposed project and whether or not all units in the project will be HOME-ARP assisted.

All market assessments, regardless of project size or type must:

1. Be not more than six months old at the time of application or reapplication;
2. Utilize current US Census, Claritas, ESRI, primary data, or document the reliability of other data if used; and
3. Assess and document the demand for the type and number of all housing units being developed, not just those designated as HOME-ARP assisted.

The ADOH will evaluate the market assessment to identify market risks including whether the market assessment evidences:

1. Proposed rent levels that are within regulatory limits *and* are reasonable for the market area and/or proposed population taking into account any known rent concessions offered by competing properties;
2. Achievable occupancy rates, based on a comparison of comparable properties in the primary market area and data regarding the number of low-income and sheltered and unsheltered individuals and/or families in the project market area;
3. A reasonable capture rate that does not exceed the following. A higher capture rate may be accepted for projects that include project-based subsidies, or when service providers indicate an adequate pipeline of eligible households that will be consistently referred to the project:
    a. Ten percent (10%) for the project as a whole and twenty-five (25%) for any specific bedroom size.
    b. Fifty percent (50%) of the most recent point-in-time count of unsheltered persons and persons sheltered in emergency or transitional housing for the project area.
4. Absorption rates that are reasonable based on the expected lease-up period and a comparable comparison period. The absorption rate must evidence that occupancy will be achieved at the proposed rents within not more than six (6) months of completion; and

5. The project is unlikely to have a negative impact on other comparable projects in the PMA.

Projects with 31 or more Total Units

If the applicant proposes to or has already applied for an allocation of Low-Income Housing Tax Credits (LIHTC) or another source of federal funding, including a guarantee or insurance program, the applicant must provide the market study that will be or has been submitted to ADOH or the federal agency.

If the project will not include LIHTC or another federal funding source, the applicant must submit a market study that contains the content, data, analysis, and conclusions described in the National Council of Housing Market Analysts (NCHMA) model standards available at www.housingonline.com. The market study need not be conducted by an NCHMA member and must be conducted by a market analyst unaffiliated with the project owner/developer. Contents must include:

1. Purpose of the report and scope of work conducted.
2. Project description.
3. Unit mix by bedroom size and targeted income level.
4. Maximum and minimum income for each unit type.
5. Project-based subsidies that will be offered and the number and type of units that will be subsidized.
6. Population and unit targeting, including qualifying populations and low-income households.
7. Location and site characteristics, including any adverse site conditions.
8. Definition of the primary market area (PMA), how it was determined, and a map of the PMA.
9. Definition of a secondary market area or the region in which the PMA is located.
10. Economic factors and demographic characteristics of the PMA in relation to the secondary market area or region.
11. Detailed income increments for lower income households, including 30% AMI, 50% AMI, and 80% AMI.
12. Population and household estimates, including people experiencing homelessness, at risk of homelessness, fleeing or attempting to flee domestic violence, dating violence, sexual assault, stalking, or human trafficking, and any other special populations to whom the project may be targeted.

13. Competitive environment in the PMA, and if appropriate the secondary market area or region.
14. Other affordable housing communities in the PMA, including income and special populations targeting, rent structure, vacancy rates, amenities, and any offered concessions.
15. Affordability analysis, demand analysis, capture rates, absorption period and absorption rate.
16. For rehabilitation projects, current rents, current and historical vacancy rates, wait lists, and if the project includes HOME-ARP low-income units, an analysis of the number of existing units occupied by residents expected to be income-eligible upon project completion.
17. Analysis and conclusions that summarize important points from each section of the market study.

Project with 30 or Fewer Total Units or All Units are HOME-ARP Qualifying Population and Low-income Units

Projects with thirty (30) or fewer units and those in which all units are HOME-ARP Qualifying Population and Low-income units may elect to submit a market assessment as required for projects with thirty-one (31) or more units or may submit an abbreviated market assessment that includes:

1. Purpose of the report and scope of work conducted.
2. Project description.
3. Unit mix by bedroom size and targeted income level.
4. Qualifying population assumptions and maximum and minimum income for each unit type.
5. Project-based subsidies that will be offered and the number and type of units that will be subsidized.
6. Location and site characteristics, including any adverse conditions.
7. Definition of the primary market area (PMA) and description of how it was determined, or PMA based on the service area of the providers assisting the population.
8. Waiting lists for the project or waiting list for projects with similar income or special populations targeting in the PMA. Absent this data, the applicant must submit detailed PMA income increments for lower income households, including 30% AMI, 50% AMI, and 80% AMI, and point-in-time count data.

9. For rehabilitation projects, current rents, current and historical vacancy rates, wait lists, and if the project includes HOME-ARP low-income units, an analysis of the number of existing units occupied by residents expected to be income-eligible upon project completion.
10. Analysis and conclusions that summarize important points from each section of the market study.

Owner/Developer and Development Team Assessment

The developer includes the owner, the developer, and any underlying corporate entities and individuals that will own the HOME-ARP assisted property. The ADOH will consider specific skills and experience with development, including but not limited to property management, asset management, public financing, and service provision, including:

1. Recent, ongoing, and successful experience with development of similarly sized and regulated housing;
2. The presence of adequate staff with specific skills and experience appropriate to their roles in the project; and
3. The financial capacity of the owner/developer to meet its financial obligations and risks of the project.

To evaluate the owner/developer and development team, the ADOH requires that applicants submit:

1. The name(s) and role(s) of staff and consultants principally responsible for project management during the construction phase (the development team) and operating phase (the property management team), a list of similar projects completed by the project team, or if the project team has not completed similar projects, a list of projects completed by individual team members. The project(s) list must include:
    a. Name and location of similar projects;
    b. Type(s) of project funding used;
    c. Number of units and affordable units; and
    d. On-site and/or off-site services provided for people experiencing homelessness.

The ADOH may require and review a list of real estate owned or underway (including partnership/ membership interests). This review may include project performance, and financial factors such as net occupancy, actual DCR, cash flow, outstanding loan balances, net equity of individual projects, and the overall portfolio.

Identity of Interest Relationships and Costs

Applicants must disclose all identity of interest relationships/contracts and/or costs involved in a transaction during the development period and following completion of the project. An identity of interest is any relationship based on family ties or financial interests between or among two or more entities involved in a project-related transaction that could reasonably give rise to a presumption that the entities may not operate at arms-length.

Technical/Professional Capacity

The ADOH will review the collective capacity of the development team including, but not limited to, the general contractor, architect, engineer, market analyst, management company or property manager, accountant, attorney, and any other specialized professionals or consultants, *and* the individual experience of team members.

As a whole, the development team must have the skills and expertise necessary to successfully complete and operate the development. The ADOH will examine whether the team members have worked together successfully in the past. The ADOH will also consider prior experience with the development team. In no case may any member of the development team be a suspended, debarred, or otherwise excluded party.

New entities, new development team members, and new staff will be considered higher risk than those with successful past experience working together.

Financial Capacity

Developers must demonstrate financial capacity to support the proposed project during construction, lease-up, and ongoing operations. The ADOH will *not fund* a project where cash needs exceed the developer's net or liquid assets. The ADOH will identify financial capacity risks by requiring the applicant submit:

1. The applicant's most recent audit;
2. Current fiscal year-to-date income and expense statement;
3. Current balance sheet showing all assets and liabilities, including contingent liabilities (e.g., construction loans or operating deficit guarantees);
4. Income and expense statements and balance sheets for the two previous fiscal years, unless an audit is submitted; and
5. A list of any litigation, pending judgments, bankruptcies with the past seven years that apply to the applicant, any principals or officers, or any affiliated entities. Any litigation and pending judgments must be described.

The ADOH will review the submitted documentation to determine:

1. If the financial management system complies with Generally Accepted Accounting Principles;
2. If there are any material weaknesses in the entity's financial management system or internal controls;
3. If the developer is a nonprofit organization, it's audit evidences that it meets the financial accountability standards of 2 CFR 200.302 regarding financial management and 2 CFR 200.303 regarding internal controls; and
4. That sufficient financial resources are available to cover any shortfalls during both the construction and operating periods, except for any shortfall that is planned for funding with HOME-ARP operating cost assistance. This will include an analysis of the developer's net worth, portfolio risk, litigation, pending judgments and bankruptcies, pre-development funding and liquidity.

Disqualification

ADOH may disqualify an application based on substantive evidence connecting a development team member to any of the following:

- Making a misrepresentation or providing materially false information in an application;
- Has been involved in any project awarded LIHTCs where there has been a material change (including in general partners or managing members) that ADOH did not approve in writing beforehand;
- Allowing a shelter or affordable rental housing property to enter into foreclosure;
- Being removed from a shelter or rental housing ownership entity by an equity investor or ADOH;
- Not being in good standing with any affordable rental housing program administrator or the State of Arizona;
- Has been a debtor in a bankruptcy within the past five (5) years;
- Has been a party in a civil, administrative or criminal matter which resulted in an adverse fair housing settlement, an adverse civil rights settlement, or an adverse federal or state government proceeding and settlement against that party or a pattern of adverse civil proceeding and judgments against that party as evidenced by three (3) or more adverse judgments within the previous five (5) years;

- Has been found to be directly or indirectly responsible for any other project within the past five (5) years in which there is or was uncorrected noncompliance with state or federal rules, regulations or standards;
- Has outstanding compliance issues with HUD or ADOH;
- Has ADOH fees that are due and remain unpaid at the time of application;
- Has a loan payment that is due and remains unpaid without a pending deferral request at the time of application; and
- Being debarred, suspended, or otherwise excluded from any federal contract.

Project Assessment

To identify project risks, the ADOH will evaluate sources and uses, ongoing operating assumptions, the development schedule, and profit and returns to the developer. To ensure adequate information is available to assess project risk, the ADOH will require applicants submit:

1. Firm commitment letters for all permanent financing sources (loans, grants) that include:
    a. Amount
    b. Term and amortization (not less than the minimum HOME-ARP restricted use period);
    c. Fixed interest rate;
    d. Fees charged;
    e. Reserve requirements;
    f. Anticipated lien position; and
    g. Acceptance of the HOME-ARP covenants, conditions and restrictions for rental housing.
2. If the applicant is a partnership or limited liability corporation, a copy of the partnership agreement or operating agreement, which must indicate the cash contributions by the partner(s) or member(s);
3. If equity is committed by the developer or owner(s), evidence of available equity funds;
4. Acquisition documents, such as the purchase or lease agreement, option or closing statement, and appraisal or other documentation of value. An appraisal must be performed by a state-licensed appraiser. Closing costs must be documented;

5. Construction and other cost estimates (e.g., professional services, soft costs, capitalized reserves) based on the scope of work;
6. Agreements governing capitalized reserves;
7. A third-party appraisal to substantiate the value of the property after rehabilitation or construction, if applicable;
8. A capital needs assessment for all acquisition and/or rehabilitation projects;
9. An operating proforma (project income and expense statement) encompassing not less than the minimum 15-year HOME-ARP compliance period and including:
    a. Projected residential revenue (rents);
    b. Projected non-residential revenue;
    c. Vacancy rates that do not exceed 10%; and
    d. Operating expenses, including but not limited to development-paid utilities, management fees, reserves, and debt service. Supportive services are accounted for separately in HOME-ARP projects.

Sources and Uses

The ADOH will review the sources and uses statement, development budget, timeline and supporting documentation. The ADOH may adjust any factor during the underwriting analysis to adjust for known conditions not accounted for in the development budget. Sources and uses underwriting will ensure:

1. Proposed uses of program funds are eligible;
2. All funds are firmly committed to the project or are contingent only upon the receipt of program funds and environmental clearance;
3. Total funding sources are adequate and timely in their availability to cover development costs at all phases of the project;
4. All senior mortgage debt bears a fixed interest rate, has a term equal to or longer than the required minimum compliance period, and allows for the recording of covenants, conditions and restrictions imposing federal requirements senior to all other financing documents;
5. Development costs, including those paid with other sources, are reasonable, necessary and customary both on a line item and total project basis;
6. The cost of land and/or buildings acquired does not exceed the as-is market value of the property based on the submitted appraisal, plus documented closing costs;

7. If HOME-ARP funds are requested for a capitalized operating reserve for HOME-ARP qualifying population units:
    a. A minimum of $300 per non-HOME-ARP qualifying population unit must be deposited into a lease-up reserve. Deposits to the lease-up reserve may be released when the property reaches ninety-three percent (93%) occupancy;
    b. Not less than $250 per unit for new construction projects and $350 per unit for acquisition and/or rehabilitation projects must be funded to a replacement reserve specifically for non-HOME-ARP qualifying population units; and
    c. The project operating reserve must equal at least four (4) months of operating expenses and debt service for the non-HOME-ARP qualifying population units.
8. If HOME-ARP funds are NOT requested for a capitalized operating reserve for HOME-ARP qualifying population units:
    a. A minimum of $300 per unit must be deposited into a lease-up reserve. Deposits to the lease-up reserve may be released when the property reaches ninety-three percent (93%) occupancy;
    b. Not less than $250 per unit for new construction projects and $350 per unit for acquisition and/or rehabilitation projects must be funded to a replacement reserve; and
    c. The project operating reserve must equal at least four (4) months of operating expenses and debt service for the entire project.
9. The contingency does not exceed 10% of project hard costs, unless the project is an acquisition or rehabilitation project and documentation identifying risk factors is included with the application;
10. The timing of program funds and the items for which program funds will be used coincides with the project schedule;
11. Any conditions of other funders on drawing funds will not have a negative impact on project feasibility and/or viability;
12. Permanent funding repayment terms are incorporated into long-term operating projections;
13. All funding sources' requirements are incorporated into the project structure;
14. No other funding sources have requirements that conflict with ADOH funds requirements;
15. Capitalized reserves cannot be withdrawn as fees or distributions;

16. The budget is adequate to meet and maintain property standards throughout the minimum compliance period;
17. The costs associated with cross-cutting regulation (environmental review, URA, Davis-Bacon) compliance are included in the budget; and
18. The total amount of program funds requested is reasonable and necessary considering all funding available to the project (subsidy layering review).

The ADOH will not make a firm commitment of funds to any project that does not evidence all financing sources are in place to complete and operate the project. For LIHTC projects, this includes a confirmed reservation from the ADOH and a good faith offer of equity investment from an investor. When all financing sources are not in place to complete and operate the project, the ADOH may make a conditional commitment of funds to a project. When a funding source is contingent upon receipt of HOME-ARP funds from the ADOH, contingencies may not include automatic self-expiring clauses or highly conditioned language.

Operating

The ADOH will review the operating proforma to ensure the following. The ADOH may adjust any factor during the underwriting analysis to adjust for known conditions not accounted for in the operating proforma.

1. Individual line item and collective revenue (including non-residential revenue) and operating costs are reasonable, necessary and customary when compared to other similar projects.
2. Revenue will be sufficient to cover expenses, debt service, and mandatory replacement reserve requirements while generating reasonable cash flow throughout the minimum compliance period.
3. New construction projects must evidence a minimum operating expense of $4,700 per unit per year ($4,880 if the project includes WIFI service), not including real estate taxes and reserve payments.
4. The operating proforma must demonstrate the project operates at least at break-even (debt coverage ratio of 1.0 or higher) in each year during the minimum compliance period, unless there is a capitalized operating reserve maintained outside the control of the project owner or property manager and sufficient to fully fund all operating deficits.
5. Vacancy rates and collection losses reflect local market conditions for comparable projects and do not exceed 10%. The ADOH may adjust vacancy rates and collection losses for any project based on the actual vacancy rates of comparable projects in the market area, the presence of project-based subsidy, or occupancy by special populations.

6. The HOME-ARP application will automatically increase operating costs 3% annually and operating expenses 2% annually.
7. Identities of interest are disclosed;
8. Other funding debt service and reserve requirements are included;
9. Any net operating income generated during the compliance period is not attributable to HOME-ARP operating cost assistance.

Profit and Returns to Developers and Development Team Members

The ADOH will evaluate development sources and uses and the operating proforma and supporting documentation to ensure:

1. The developer fee does not exceed 15% of total development costs for projects that have 61 or more beds and 20% of total development costs for projects that have 60 or fewer beds. Developer fees include those actually paid or otherwise recognized as income of the developer and other costs paid to third-parties, such as construction oversight and consultant's fees.
2. Contractor fees, including profit, overhead and general requirements do not exceed 15% of net construction costs. Net construction costs are the amount of the construction cost less contractor fees and building permits.
3. Architectural fees do not exceed $7,000 per unit for projects with 61 or more units, $8,000 per unit for projects with 31-60 units, and $9,000 per unit for projects with 1 to 30 units.

When another funding source imposes a lower developer, contractor or architectural fee, the allowed fee will be the fee imposed by the other funding source.

Deferred Developer Fees

When a project includes a deferred developer fee as a financing source, the ADOH will generally require that projections of surplus cash, after any cash-flow contingent payment due the ADOH, be sufficient to repay the deferred fee within 15 years. Unless otherwise provided for in the "waterfall" provisions of an LIHTC project partnership or operating agreement, all surplus cash distributions will first be credited to the deferred developer fee.

Subsidy Layering and Gap Analysis

Subsidy layering analysis is conducted to ensure only the amount of program funding necessary to provide safe, decent and affordable housing for the required minimum compliance period is provided to the project. The subsidy layering analysis will combine factors evaluated under market, developer, and project risk with an examination of other funding sources to ensure only the amount of HOME-ARP funds necessary for project feasibility and viability are provided to the project.

If the subsidy layering analysis reveals that the gap between available sources and the uses of funds exceeds the amount requested, the ADOH may deny assistance to the project or:

1. Reduce the amount of HOME-ARP funding; and/or
2. Increase the number of HOME-ARP units.

Final Underwriting

When final underwriting takes place at project completion and the project costs are lower than originally underwritten, the ADOH may reduce the HOME-ARP assistance provided to the project.

Additional Underwriting

All projects, including HOME-ARP NCS and HOME-ARP Rental Housing are subject to additional underwriting when any material change occurs. A material change includes:

1. Any additional funding source is committed to the project, regardless of whether the funding source was identified in the application as tentative;
2. Change in the number of beds or units;
3. Addition or deletion of any funding source necessary for the completion of the development;
4. Change in any development funding source amount;
5. Substitution of one or more members of the development or operating team;
6. Changes in the development budget; and
7. Changes in the operating budget that increase costs or decrease revenues by more than $100/month or $1,200/unit per year.