Affordable Housing Construction Program Guide:

CDBG-DR LIHTC Gap Financing

State of Nebraska CDBG-DR Program

JANUARY 2022 DRAFT

RECORD OF CHANGES

The following table summarizes amendments to the Affordable Housing Construction Program Guide: CDBG-DR LIHTC Gap Financing.

Date Change Approved	Change Number	Description of Change

TABLE OF CONTENTS

1 EXECUTIVE SUMMARY

The purpose of this Program Guide is to outline the process for administering the State of Nebraska's Department of Economic Development (DED) Affordable Housing Construction Program (AHCP), funded by the United States (US) Department of Housing and Urban Development's (HUD) Community Development Block Grant – Disaster Recovery (CDBG-DR).

The AHCP focuses on providing support related to affordable housing recovery and housing resilience, including the construction of affordable housing that reduces flood vulnerabilities in counties declared under associated allocation(s).

Based on its evaluation of unmet needs, as outlined in the State of Nebraska's Action Plan for Winter Storm Ulmer, DED has allocated funding to housing activities, including the Affordable Housing Construction Program, which includes three (3) distinct "sub-programs" for which CDBG-DR may be used to acquire, newly construct, or rehabilitate housing:

- ***CDBG-DR LIHTC Gap Financing***: Provides gap financing for the production of affordable multifamily housing simultaneously seeking an award of Low-Income Housing Tax Credits (LIHTCs) from the Nebraska Investment Finance Authority (NIFA);
- ***Small/Non-LIHTC Rental Production***: Provides financing, including gap or primary financing, for affordable multifamily rental housing not otherwise seeking LIHTC, particularly projects sponsored by nonprofits and/or public housing authorities and those serving special needs populations; and
- ***Homeownership Production***: Provides financing to support the production of affordable for-sale housing targeted primarily to low- and moderate-income (LMI) buyers by covering "appraisal gaps" (i.e., the difference between total development cost and market value) and "affordability gaps" (i.e., the difference between an eligible buyer's purchasing power and the market value of the house).

This Guide covers the ***CDBG-DR LIHTC Gap Financing*** element of the Affordable Housing Construction Program and is intended to outline the "rules of the road" for prospective Applicants, including underwriting criteria, transactional terms, and the applicability of various Federal cross-cutting requirements. Additional guides for the other two (2) Affordable Housing Construction Program Sub-Programs—the Small/Non-LIHTC Rental Production and Homeownership Production programs—will be published separately.

To promote the production of additional affordable housing in disaster-impacted communities, DED will use CDBG-DR funds to provide ***gap financing*** to projects also receiving LIHTC awards from NIFA. Pursuant to CDBG-DR requirements, at least 80% of the State's total CDBG-DR award must be invested in areas identified by HUD as the "most impacted and distressed" (MID).

To maximize opportunities for infrastructure investments in non-MID counties within this overall requirement, the Affordable Housing Construction Program is available exclusively in the MID counties. Structures within the 1% annual chance (100-year) floodplain will not be eligible.

In collaboration with NIFA, DED will administer this program, including provision of technical assistance to selected project owners. Selected project owners (e.g., development owners, Successful Applicants) will be responsible for housing development, overseeing project closeout, and retaining necessary standards and documents as described in section 9, ***Ongoing Project Requirements***.

The State of Nebraska enforces conduct of the CDBG-DR program to ensure that no person is excluded from participation in, denied the benefit of, or subjected to discrimination in any housing program or activity because of their age, race, color, creed, religion, familial status, national origin, sexual orientation, military status, sex, disability, or marital status.

1.1 ASSOCIATED ALLOCATION(S)

- Winter Storm Ulmer (DR-4420)
    - In early 2019, the State of Nebraska suffered record-breaking damage from severe winter weather, straight-line winds, and its worst flooding event in 50 years, leading to a Federal major disaster declaration (DR-4420) under the Stafford Act. Damage from DR-4420 was widespread, leading to disaster declarations in 84 of the State's 93 counties (and four tribal areas), with the worst damage located in the eastern part of the state.
    - HUD Most Impacted and Distressed (MID) is detailed in the Action Plan and includes Dodge, Douglas, and Sarpy counties.
    - Pursuant to the federal requirements for DR-4420, a minimum of 80% of this allocation must be invested in HUD-defined MID areas.
    - A minimum of 70% of total CDBG-DR program funds must be spent on Low-to-Moderate Income (LMI) populations.

This subsection may be updated should other allocations become available due to subsequent disaster events or supplemental allocations.

2 SCOPE

This Program Guide applies to all DED employees, providers, vendors, contractors, consultants, Subrecipients, partners, citizens, Applicants and Successful Applicants[1], external departments, and agencies doing business with DED, as well as beneficiaries and others associated with, working for, accessing, or attempting to access benefits under the CDBG-DR programs.

3 ACRONYMS

Acronyms used within this Program Guide are provided below. Controlling definitions are found in the ***CDBG-DR Program Definitions***.

Acronym	Meaning
AIA	American Insurance Association
AMI	Area Median Income
AUGF	Authority to Use Grant Funds
CDBG-DR	Community Development Block Grant – Disaster Recovery
CFR	Code of Federal Regulations
CPA	Certified Public Accountant
CPD	Office of Community Planning and Development
DBA	Davis-Bacon Act
DCR	Debt Coverage Ratio
DED	Nebraska's Department of Economic Development
DRGR	Disaster Recovery Grant Reporting

[1] Applicants refers to eligible entities such as for-profit and non-profit developers that are eligible to apply for assistance under the Affordable Housing Construction Program. Successful Applicants references those Applicants selected for award and contracted to perform project activities under a funding agreement with DED.

Acronym	Meaning
EO	Executive Order
GAO	Government Accountability Office, also formally known as the Comptroller General of the United State
HOME	HOME Investment Partnerships Programs
HUD	United States Department of Housing and Urban Development
ICC	International Code Council
LEED	Leadership in Energy and Environmental Design
LEP	Limited English Proficiency
LIHTC	Low Income Housing Tax Credit
LMI	Low- to Moderate-Income
MBE	Minority-Owned Business Enterprise
MID	Most Impacted and Distressed
NEPA	National Environmental Policy Act
NHTF	National Housing Trust Fund
NIFA	Nebraska Investment Finance Agency
NOI	Net Operating Income
PA	Public Assistance
PBV	Project-Based Voucher
QAP	Quality Allocation Plan
REO	Real Estate Owned
RROF	Request for Release of Funds
UA	Utility Allowance
UCC	Uniform Commercial Code
UFAS	Uniform Federal Accessibility Standards
UPCS	Uniform Physical Condition Standards

Acronym	Meaning
URA	Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970
US	United States
USC	United States Code
VAWA	Violence Against Women Act of 1994
WBE	Women-Owned Business Enterprise

4 CDBG-DR AHCP: LIHTC GAP FINANCING SUB-PROGRAM OVERVIEW

On December 3, 2019, HUD announced an allocation to Nebraska of $108,938,000 in CDBG-DR funding. Issuance of the associated Federal Register Notice followed on January 27, 2020 (85 FR 4681). These funds are intended to assist Nebraskans and their communities in recovering from the devastating effects of the severe weather conditions and subsequent flooding that occurred during the first half of 2019. The impacts of these disasters on Nebraska's infrastructure, housing, and economy were widespread, with damage particularly focused in the eastern part of the state.

In accordance with the Action Plan and consistent with the data HUD used in determining Nebraska's allocation amount and the findings of the Unmet Needs Assessment (UNA) (section 2 of the ***Action Plan***), DED is investing **up to $26,000,000** in affordable housing across the State of Nebraska. To distribute these funds, the Affordable Housing Construction Program (AHCP) makes available a portion of those funds for ***CDBG-DR LIHTC Gap Financing*** for the production of affordable multifamily housing simultaneously seeking an award of Low-Income Housing Tax Credits (LIHTCs) from the Nebraska Investment Finance Authority (NIFA).

In exchange for low-cost permanent financing, project owners must agree to income, rent, and other restrictions for an affordability period of at least 15 and up to 20 years (depending on project type). Projects are monitored for compliance during the affordability period to ensure that ongoing Federal requirements are satisfied and that projects continue to serve their intended LMI housing purpose. **The overarching goal of the program is to increase affordable housing supply in flood-impacted areas and increase community resiliency in the face of future natural disasters.**

4.1 SUMMARY OF REQUIREMENTS AND PRIORITIES

Table 1 summarizes the AHCP's priorities in the context of Federal and State requirements.

Table 1: Summary of CDBG-DR Requirements and Priorities

Entity	Requirement/Priority	Citation
HUD	Tie Back to the Disaster	85 FR 4681
	Eligible Activity[2]	24 CFR 570.482
	Meet a National Objective	24 CFR 570.483
	Prioritization of HUD-defined MID areas	85 FR 4681
	Prioritization of Vulnerable Populations	Section 4.4.1 of the State of Nebraska DR-4420 Disaster Recovery Action Plan
State	Local and Regional Coordination	Section 4.4.2 of the State of Nebraska DR-4420 Disaster Recovery Action Plan
	Ongoing Outreach	Section 2.4.2.3 of the State of Nebraska DR-4420 Disaster Recovery Action Plan
Affordable Housing Construction Program	• Invest in projects that are cost reasonable and consider proportion of impact to expected population. • Prioritize disaster survivor populations. • Prioritize mitigation and resilience measures (capped at 25% of total cost). • Support resource coordination with existing housing programs. • Support and address the needs of PHAs.	Section 5.2.1 of the State of Nebraska DR-4420 Disaster Recovery Action Plan

[2] HUD allows grantees to use up to 15% of the total grant award for planning activities. Planning expenditures can be counted towards the 80% expenditure requirement for spending in HUD-defined MID areas as long as there's a clear tie regarding how planning activities benefit those areas.

4.2 SUB-PROGRAM OBJECTIVES

Program funds through the AHCP will be exclusively directed to benefit the HUD-defined MID areas (Sarpy, Dodge, and Douglas counties). To promote the production of additional affordable housing in disaster-impacted communities, DED will use CDBG-DR funds to provide ***gap financing*** to projects also receiving LIHTC awards from NIFA through this sub-program.

To promote long-term resiliency and mitigate future flood vulnerabilities, structures within the 1% annual chance (100-year) floodplain will not be eligible.

Following the disaster and through the federally guided Nebraska Housing Recovery Support Functions (RSFs), HUD coordinated a Housing Impact Assessment report that identified four key recovery considerations for housing.[3] As summarized in ***Table 2*** below and described in section 5.1 of the ***Action Plan***,[4] DED developed housing program objectives based on these four housing issues, which HUD developed based on the needs as communicated by local long-term recovery groups and through outreach efforts.

Table 2: HUD Housing Impact Assessment and CDBG-DR Housing Program Objective Matrix

HUD-Identified Housing Issue	CDBG-DR Housing Program Objective
Increased need for affordable, accessible housing stock, particularly rental housing and subsidized rental housing for very- and extremely low-income renters.	DED will use CDBG-DR funds to leverage existing resources, including LIHTC, to increase the supply of affordable rental housing stock. Preference will be given to projects that target households earning less than 50% of AMI.
Improve housing resiliency.	DED will incorporate sustainability and resilience requirements within its CDBG-DR Affordable Housing Construction Program, including restricting building activity within the 100-year floodplain.

[3] Housing Recovery Support Function, "Nebraska Housing Impact Assessment, DR-4420," August 27, 2019.

[4] "State of Nebraska DR-4420 Disaster Recovery Action Plan." DED. Accessed December 2021. https://opportunity.nebraska.gov/wp-content/uploads/2021/04/StateofNebraskaDR-4420ActionPlan_04.26.2021.pdf.

HUD-Identified Housing Issue	CDBG-DR Housing Program Objective
Increase availability of workforce housing, particularly near rural employment hubs, to support agricultural workers and reduce commute times.	DED will partner with NIFA to develop workforce housing in the areas that experienced significant flooding through the joint application process, layering CDBG-DR with the LIHTC Program. CDBG-DR funds will be used as gap funding for LIHTC developments in impacted communities, incentivizing developers to target these communities.
Improve housing rehabilitation and construction capacity in impacted communities, i.e., smaller communities with limited capacity will need assistance in housing rehabilitation and new construction.	DED will provide and make available technical assistance to facilitate project development.

4.3 SUB-PROGRAM GOALS

The need to rebuild communities with an emphasis on resiliency became apparent after the 2019 disasters. In an effort to promote recovery and to prevent future catastrophic disaster-related damages, the overarching goal of the program is to **increase affordable housing supply in flood-impacted areas and increase community resiliency in the face of future natural disasters.**

As defined in ***Table 1***, the AHCP is structured to meet a series of Federal and state requirements. Program goals that will inform Applicant selection include:

- Benefit LMI persons;
- Implement projects in HUD-defined MID areas; and
- Support community resiliency.

DED will review applications to evaluate their eligibility under CDBG-DR, as described in section 5, ***Application and Award Process***. If eligible, CDBG-DR funds under this sub-program may be used to fund:

- Construction of rental housing;
- Rehabilitation of rental housing; and

- Land acquisition for eligible construction activities.

Analysis will be conducted to verify that projects are compliant with CDBG-DR requirements as described in section 6.2, ***Key Federal Requirements***. Following verification of eligibility and compliance, DED will select awardees and proceed with SRAs and funding agreements with Successful Applicants and Subrecipients.

4.4 ONGOING UNMET NEEDS ASSESSMENT

As contemplated in the ***Action Plan***[5] and discussed in the ***Citizen Participation Plan***,[6] Nebraska will actively work to identify housing projects that address resiliency and achieve an equitable, effective recovery. Especially as AHCP sits in a shared arena with other ongoing programs funded annually, DED will work with State partners to continually identify unmet needs that housing activities may be able to support, and similarly communicate emerging unmet needs that are ineligible for the AHCP to programs that may be able to address them.

5 APPLICATION AND AWARD PROCESS

DED will accept applications in concert with NIFA through a combined ("joint") application process that allows Applicants to simultaneously submit requests for CDBG-DR and LIHTC funds. DED does not anticipate that all available CDBG-DR funding will be placed via a single application round (with an application deadline in early 2022) and, as appropriate and until funding is exhausted, may continue to coordinate with NIFA on subsequent application cycles. Within each funding round, DED and NIFA will identify any round-specific application requirements, deadlines, or considerations. This may include, but is not limited to, updated underwriting criteria, funding limits, or priority project characteristics.

5.1 SUBMISSION OF MATERIALS

All Applicants for CDBG-DR must comply with the combined application criteria (which may vary from one (1) cycle to the next) published by DED and NIFA. In all cases, DED reserves the right

[5] "State of Nebraska DR-4420 Disaster Recovery Action Plan." DED. Accessed December 2021. https://opportunity.nebraska.gov/wp-content/uploads/2021/04/StateofNebraskaDR-4420ActionPlan_04.26.2021.pdf.
[6] "State of Nebraska DR-4420 Disaster Recovery Citizen Participation Plan." DED. Accessed December 2021. https://opportunity.nebraska.gov/wp-content/uploads/2021/10/CPP-rev08312021_clean-StateofNebraskaDR-4420.pdf.

to require the submission of additional information as needed to complete project underwriting prior to closing on the CDBG-DR loan.

5.2 INITIAL REVIEW AND PRELIMINARY AWARDS

When they receive a combined application for LIHTC and CDBG-DR funds, DED and NIFA staff will review and analyze the project and developer as presented in the application. Proposals will be scored using criteria in the QAP and/or specific application materials. Regardless of strict numerical ranking, the scoring does not vest in an Applicant or project any right to a reservation or commitment of CDBG-DR funds. DED will, in all instances, commit CDBG-DR funds consistent with sound and reasonable judgment, prudent business practices, and the exercise of its inherent discretion.

Projects seeking CDBG-DR funds prior to the receipt of all other funding sources, including Federal LIHTC reservations from NIFA, may be provided with non-binding Preliminary Awards. Preliminary Awards will be contingent upon the (1) continued availability of CDBG-DR funds from HUD; (2) the Successful Applicant's receipt of a LIHTC award; (3) DED's receipt of the HUD AUGF following completion of the Environmental Review process (as applicable); (4) receipt of firm commitments for all other construction and permanent financing (5) final underwriting; and (6) other items noted in the project-specific Preliminary Award.

5.3 CONTRACTING/COMMITMENT PROCESS

Affordable Rental Housing projects receiving a Preliminary Award will be assigned to a Project Manager responsible for shepherding projects to formal commitment and closing (i.e., execution of binding legal agreements obligating CDBG-DR funding). The Project Manager will be responsible for managing final underwriting of the project, ensuring any general or special conditions of the Preliminary Award are met, negotiating project-specific transaction terms, and coordinating with assigned DED legal counsel on any modifications to standard form legal documents.

Following commitment and closing, the Project Manager will also be the primary point of contact for the owner through the project, and thus responsible for processing draw requests, reviewing (or coordinating with DED contractors and/or NIFA to review) construction progress and compliance with labor standards, negotiating and seeking internal approvals on any proposed contract changes, and coordinating with assigned compliance and asset management staff on the handoff of the project as it approaches construction completion, the start of marketing, and being placed in service.

5.4 ONGOING COMPLIANCE AND ASSET MANAGEMENT

Once a project is placed in service, it will be assigned to DED compliance and asset management staff who will retain primary responsibility throughout the period of affordability and/or life of the CDBG-DR loan, whichever is longer.

The assigned asset manager will be responsible for overseeing periodic remote and on-site monitoring of the project for compliance (which may be completed by NIFA and/or DED contractors), reviewing financial performance including reviewing and approving withdrawals from reserves and ensuring any payments due have been properly collected, and otherwise managing the DED's relationship with the project and owner over time.

6 PROJECT FUNDING REQUIREMENTS

6.1 ELIGIBILITY CRITERIA

6.1.1 ELIGIBLE APPLICANTS

NOTE: This section anticipates submission and HUD approval of a Substantial Amendment to the Action Plan clarifying that developers may seek funding directly from DED rather than requiring CDBG-DR funding be routed through a Subrecipient. If HUD does not approve that change, this guide will be updated.

Developers of affordable rental housing—including nonprofit developers and PHAs—are eligible to apply for CDBG-DR funding to provide gap financing to projects receiving LIHTC awards. DED will ultimately enter into direct funding agreements with single-purpose, single-asset entities (i.e., limited partnerships or limited liability companies) established by the prospective owner of a proposed project. For-profit sponsors are also eligible to apply. In general, DED will provide priority to projects sponsored by nonprofits and PHAs.

6.1.2 PROJECT LOCATION

The Affordable Housing Construction Program, including the CDBG-DR LIHTC Gap Financing program covered by this Guide, is limited to projects located in the MID counties: Dodge, Douglas, and Sarpy. In addition, specific sites must **not** be located within the 100-year flood plain and must not have characteristics that pose environmental risks (see ***Environmental Review*** in section 4.2.1 below).

In keeping with DED's affirmative fair housing obligations and sound real estate investment principals, sites should provide reasonable access to retail (e.g., grocery, pharmacy, general retail, etc.), educational opportunities, medical services, recreational amenities, job centers, and public/governmental services. Sites should not be unduly impacted by incompatible nearby uses such as industrial facilities, hubs for commercial truck traffic, landfills, adult entertainment establishments, or similar land uses. Affordable housing construction and/or rehabilitation contracts will be subject to appropriate site and neighborhood standards.

6.1.3 PROJECT TYPES

DED will entertain proposals for new construction and acquisition/rehabilitation, including adaptive reuse and historic preservation projects, of multifamily developments. Projects may propose to serve seniors (i.e., age-restricted at 55 or 62+) or families (i.e., without age restriction). Additionally, DED will entertain projects that provide preferences for, or restrict units exclusively to, vulnerable populations, including but not limited to people who are disabled, victims of domestic violence, or homeless individuals. Any preferences/restrictions proposed must be clearly disclosed in the application for funding and may not violate Federal, State, or local nondiscrimination requirements.

6.2 KEY FEDERAL REQUIREMENTS

6.2.1 ENVIRONMENTAL REVIEW

Federally assisted projects are subject to a variety of environmental requirements. Developers should be familiar with these requirements and are strongly encouraged to discuss any questions they have with DED staff prior to entering into a purchase agreement or submitting an application.

Submitting an application for CDBG-DR funds triggers Environmental Review requirements. These requirements are described in further detail under the CDBG-DR ***National Environmental Policy Act Policies and Procedures***. Once an application for Federal funds is submitted, a project proposal is subject to the Environmental Review requirements and requires an environmental clearance and, as applicable, submission of a Request for Release of Funds (RROF) to and issuance of an AUGF by HUD.

DED is responsible for conducting the Environmental Review and completing all necessary public notifications, and submitting the RROF, as applicable, to HUD. However, the Successful Applicant is responsible for cooperating with DED in the Environmental Review process and providing information necessary for DED to fulfill its responsibilities under 24 CFR Part 58 and other applicable regulations.

Successful Applicants are prohibited from undertaking or committing or expending any funds (including non-Federal funds) to any physical or choice-limiting actions on the site prior to an environmental clearance as required by Part 58. Physical and choice-limiting actions include, but are not limited to, property acquisition, demolition, movement, rehabilitation, conversion, repair, or construction. This prohibition applies regardless of whether Federal or non-Federal funds are used and taking a choice limiting action prior to completion of the required environmental clearance process will result in the denial of any CDBG-DR funds from DED.

6.2.2 RELOCATION

All CDBG-DR projects are subject to requirements of the URA. Successful Applicants must further document that any purchase of property meets the requirements of URA, including provision of notices to the seller identifying the transaction as a voluntary sale not under the threat of eminent domain. Details regarding these requirements for the CDBG-DR program are provided for in the ***One-for-One Replacement Housing, Relocation, and Real Property Acquisition Policies and Procedures***.

Additionally, for properties occupied by commercial or residential tenants at the time of application, URA requires certain notices to tenants in place as of the application for Federal funds. Failure to provide such notices may result in substantial compliance costs or render a project ineligible. To ensure compliance with URA, Successful Applicants should consult DED staff ***prior to*** the submission of any application involving an occupied property to understand the requirements of URA.

6.2.3 LABOR STANDARDS

CDBG defines a project as “one (1) or more buildings on an undivided lot or on contiguous lots or parcels, which are commonly-owned and operated as one (1) rental, cooperative, or condominium project.” The use of CDBG-DR funding for construction or rehabilitation of a residential project with eight (8) or more residential units triggers federal labor standards including DBA and the Contract Work Hours and Safety Standards Act. Among other requirements, DBA requires the payment of prevailing wages, various worker protections, and weekly payroll and compliance reporting by contractors and subcontractors on federally assisted projects. Additional detail regarding these requirements is provided in the ***Davis-Bacon Act Policies and Procedures***.

In the case of CDBG-DR, however, labor standards are triggered, in part, by which project costs are paid with CDBG-DR funding. If CDBG-DR funding is used *exclusively* for otherwise eligible non-construction costs, then DBA is not triggered. This may include scenarios where the CDBG-DR investment can be dedicated solely to property acquisition, architectural/engineering fees, and/or legal and accounting services (see also ***Eligible Costs*** in section 6.2).

In practice, given the nature of the projects anticipated in this program, DED expects that most projects will trigger labor standards. Successful Applicants who believe they may be able to allocate CDBG-DR funding solely to acquisition and/or design costs should contact DED in advance to discuss whether the project can be structured in a manner that does not trigger labor standards.

In the event that other project sources, such as HOME funds or the award of PBVs, trigger labor standards, then the entire project will be subject to DBA even if CDBG-DR funding, on its own, did not trigger the requirements. In such cases, reporting to DED on labor standards requirements including DBA will be required.

6.2.4 MINORITY-OWNED BUSINESS ENTERPRISES (MBE) AND WOMEN-OWNED BUSINESS ENTERPRISES (WBE)

Developers must develop and maintain a MBE/WBE plan that demonstrates marketing and solicitation of MBE/WBE businesses and contractors for the construction of the project.

6.2.5 SECTION 3

Owners and developers of projects receiving $200,000 or more in aggregate HUD funding (including but not limited to CDBG-DR, CDBG, HOME, and NHTF) are subject to the requirements of Section 3 of the Housing and Community Development Act of 1968 as implemented in 24 CFR Part 75. The purpose of Section 3 is to provide, to the greatest extent feasible, economic opportunities, particularly employment, generated by HUD-assisted development activity to low- and very low-income persons. In practice, DED expects that all CDBG-DR projects will be subject to Section 3. The applicability of these requirements and how they will be implemented under all CDBG-DR programs for the State of Nebraska is provided for in the ***Section 3 Policies and Procedures***.

Projects subject to Section 3 are required to take steps to achieve HUD-specified benchmarks (and maintain records and provide reporting) on total labor hours worked including by eligible “Section 3 workers” (25% of total labor hours) and by “Targeted Section 3 workers” (5% of total labor hours). This includes developing and maintaining a Section 3 Plan that demonstrates a marketing plan to include Section 3 contractors and all tiers of subcontractors in the construction of the project

Note that the Section 3 regulations were comprehensively updated in 2020. HUD continues to provide guidance and training on the updated requirements. More information is also available on the HUD Exchange’s Section 3 page.

6.2.6 FAIR HOUSING AND EQUAL OPPORTUNITY

The following Federal nondiscrimination and equal opportunity guidelines apply to all CDBG-DR rental projects and affect both development and operation of assisted housing:

- The requirements of the Fair Housing Act (42 USC 3601-19) and implementing regulations at 24 CFR Part 100; EO11063, as amended by EO12259 (3 CFR § 1958 B1963 Comp., P. 652 and 3 CFR § 1980 Comp., P. 307) (Equal Opportunity in Housing) and implementing regulations at 24 CFR Part 107; and of the Civil Rights Act of 1964 (42 USC 2000d) (Nondiscrimination in Federally Assisted Programs) and implementing regulations issued at 24 CFR Part 1;

- The prohibition against discrimination on the basis of age under the Age Discrimination Act of 1975 (42 USC 6101-07) and implementing Regulations at 24 CFR Part 146,

- The requirements of Section 504 of the Rehabilitation Act of 1973 (29 USC 794) and implementing regulations at 24 CFR Part 8;

- The requirements of Executive Order 11246, as amended by Executive Orders 11375, 11478, 12086, and 12107 (3 CFR § 1964-65, Comp., p. 339) (Equal Employment Opportunity) and the implementing regulations issued at 41 CFR Chapter 60;

- The requirements of 24 CFR § 5.105(a)(2) requiring that HUD-assisted housing be made available without regard to actual or perceived sexual orientation, gender identity, or marital status and prohibiting Subrecipients, owners, developers, or their agents from inquiring about the sexual orientation or gender identity of a beneficiary (i.e., prospective tenant), or occupant of, HUD-assisted housing for the purpose of determining eligibility for the housing or otherwise making such housing available. This prohibition on inquiries regarding sexual orientation or gender identity does not prohibit any individual from voluntarily self-identifying sexual orientation or gender identity.

6.2.7 PROPERTY STANDARDS

In addition to any applicable State and/or local code requirements, projects must be developed to meet the following standards:

- Green Building – As further delineated in the ***Green Building Standards Guide***, new construction or substantial rehabilitation projects must meet one (1) of the following green building standards:
    - ENERGY STAR (Certified Homes or Multifamily High-Rise);
    - Indoor airPLUS;

- Enterprise Green Communities;
- ICC-700 National Green Building Standard; or
- LEED (New Construction, Homes, Existing Building Operation and Maintenance, and Neighborhood Development).

Projects involving less than substantial residential rehabilitation (i.e., less than 75% of replacement cost) must adhere to HUD CPD's Green Building Retrofit Checklist in its entirety and apply all measures within the checklist to the extent applicable to the Project's building type (i.e., single-family, multifamily, low-rise, mid-rise, etc.). For further details, see the ***Green Building Standards Guide***.

- HUD Broadband Rule: All buildings of five (5) or more residential units in new construction or substantial rehabilitation projects must include the installation of "broadband infrastructure" as defined by 24 CFR § 5.100. In practice, this requires the developer to provide the wiring for high-speed internet but does not require the project to provide the internet service itself.
- Accessibility: All projects must meet applicable Section 504/UFAS requirements. New construction projects with five (5) or more total units and substantial rehabilitation projects with 15 or more total units must provide 5% of the project's units (but not less than one [1]) for physically disabled occupants and another 2% of units (but not less than one [1]) designed to be accessible to those with visual or hearing impairments.

During the Affordability Period, DED will require that CDBG-DR projects comply with HUD's UPCS, the same standard applied by LIHTC.

6.3 UNDERWRITING AND SUBSIDY LAYERING

6.3.1 PROJECT UNDERWRITING

All project applications must include a professionally prepared market study consistent with the requirements of the QAP. Proposed rent levels must be supported by the Successful Applicant's market study and within rent limits as described in ***Income and Rent Restrictions*** (section 6.3) of this document. If the market study is more than one (1) year old as of closing on the CDBG-DR loan, DED reserves the right to require a Successful Applicant to submit an update or a new market study.

All CDBG-DR applications must include the three (3) most recent audited annual financial statements (if unavailable, then the three (3) most recent tax returns) of the developer(s), ownership entity, guarantors, and Project, if applicable, and will be subject to DED's evaluation of fiscal soundness.

Generally, project underwriting will also include the following:

- A vacancy factor of at least **5%** will be used for projects where all units are supported by a project-based rental assistance contract with a term equal to or in excess of the Affordability Period (e.g., project-based Section 8), and at least **7%** for all other projects, unless the market study indicates another, more conservative, vacancy factor is needed;

- DED staff will use a maximum **2%** inflation factor for all sources of income;

- All operating expenses will be underwritten with an inflation factor of at least **3%**;

- All projects must maintain a DCR of at least **1.15** for the Affordability Period or loan term, whichever is longer. Properties with excessive DCRs may have rent increases reduced or denied. An Expense Coverage Ratio will be analyzed for projects with no required debt payments. DED will generally expect underwritten cash flow to equal not less than **8%** of the sum of operating expenses, replacement reserve deposits, and hard debt service (as applicable);

- Proposals must include justification of operating costs that includes a comparison to similar projects in the local market. Developers with REO portfolios that include comparable projects should submit operating cost data for most recent trailing 12-month period;

- Unless otherwise approved by DED, the operating budget of new constructions must include a minimum deposit of **$300** per unit per year for family projects or **$250** per unit per year for senior projects to the Replacement Reserve. The Replacement Reserve must be funded and maintained for the full Affordability Period or loan term (whichever is longer) and reflected in the operating expenses for the full projection of expenses, as applicable. Replacement Reserve deposits must be inflated at **3%** annually. In the case of rehabilitation, the capital needs assessment obtained from a qualified third-party professional acceptable to DED will be used to establish the minimum annual Replacement Reserve deposits, which shall be inflated at **3%** annually;

- Projects must include a capitalized operating reserve equal to **eight (8)** months of underwritten operating expenses, amortizing debt service (if any), and required reserve deposits. If drawn, the operating reserve must be replenished prior to distributions of surplus cash flow. The operating reserve is intended to protect against unplanned operating deficits. If the DED's underwriting projections anticipate deficits within the applicable Affordability Period, an operating deficit reserve must be capitalized as well;

- To substantiate equity pricing, Successful Applicants must submit documentation indicating that a syndicator or investor has reviewed the proposal and indicated preliminary pricing along with their interest in the Project. Prior to closing, DED will review the amended/restated partnership/operating agreement, including detailed pricing and equity pay-in provisions; and

- Successful Applicants must provide the amounts and terms for all project funding sources. Amortizing permanent financing that will be senior to any CDBG-DR loan **may not mature** prior to the expiration of the CDBG-DR Affordability Period.

6.3.2 PERFORMANCE REQUIREMENTS

DED requires submission of a project proforma in the common format (i.e., Microsoft Excel) provided in the NIFA/DED 9% LIHTC Application. However, DED may require additional project finance detail prior to closing, including development period and lease-up/stabilization cash flow projections.

If not otherwise itemized, Successful Applicants must be able to separate the hard costs of any stand-alone accessory buildings, including leasing offices, community buildings, laundry facilities, free-standing garages or carports, or maintenance buildings.

6.3.3 COST LIMITATIONS

Consistent with DED's obligations under 2 CFR Part 200, all project costs must be reasonable and necessary whether directly paid with CDBG-DR funding or another source. As part of its underwriting review, DED will review all project costs, including hard and soft costs, to evaluate their reasonableness and may, at its option, require Successful Applicants to obtain additional quotes, bids, or third-party reviews of individual or total costs. Applications may be determined ineligible if costs are determined to be unreasonable. Additionally, CDBG-DR projects will be subject to the following specific cost limitations:

- The maximum allowable Developer Fee, from which any consultant fees and/or predevelopment loan interest must be paid, is 15% of project costs less the developer fee itself, except that in the case of acquisition of an existing building to be rehabilitated the maximum developer fee attributable to the acquisition cost shall be 5% of the net building acquisition cost (i.e., exclusive of the cost of land and any transactional fees associated with the purchase);

- The maximum allowable contractor fees, including General Requirements, Overhead, and Profit, shall not exceed 14% of the construction cost less the contractor fees;

- In combination, the maximum allowable Developer Fee, Contractor General Requirements, Overhead, and Profit, and Consultant fees is 24% of the adjusted eligible basis (i.e., the project's eligible basis less the fees delineated herein);

- In all cases other than purchases for nominal consideration, the acquisition cost of must be supported by an independent, third-party appraisal prepared by a State-licensed appraiser. Acquisition will be capped at the lesser of the of the actual acquisition purchase price or the current as-is market value;

- DED does not permit a contingency to be included within a property's construction estimate or construction contract, unless such contingency is required in writing by HUD, another governmental agency, or an independent third party; and

- Architectural design/supervision/engineering/survey fees may not exceed 7% of total hard construction costs (not including any contractor overhead, profit, general requirements, or construction contingency) for new and/or rehabilitation projects.

6.3.4 IDENTITY OF INTEREST

Successful Applicants must disclose any identity of interest relationship purchases or contracts with related companies during either the development or ongoing operation of the project. DED must approve identity of interest relationships and has sole discretion over this matter. Considerations will include the capacity and track record of the related party and whether pricing is equivalent to that which could be expected from an arms-length relationship.

6.3.5 OTHER PUBLIC FUNDING

Successful Applicants must disclose all other commitments for funding with the initial CDBG-DR application to DED at the time of application and/or upon receiving any additional commitments of funding following application to DED. Consistent with requirements pertaining to the "duplication of benefits," this includes any other assistance in connection with DR-4420 that has been or is expected to be received for the project.[7]

DED will conduct a subsidy layering review as part of the underwriting process for any project that includes other public subsidies. Using its underwriting criteria, DED will assess the project and may require changes to the transaction to ensure that cash flows to the owner/developer are not excessive. Changes may include a reduction in CDBG-DR, reductions in the rents being charged to tenants, requirements that excess cash is deposited to an operating reserve, or increases in annual payments on the CDBG-DR.

[7] See 76 FR 71060 as imposed via 83 FR 5844.

DED will consider adjusting its underwriting in consultation with other funders to the project. However, DED retains, at its sole discretion, the power to decide whether to accept alternative standards.

7 TRANSACTION STRUCTURE

7.1 CDBG-DR FUNDING LIMITS

The maximum CDBG-DR award per project is $2,000,000 and is not to exceed $150,000 per housing unit constructed inclusive of all hard and/or soft costs.

7.2 CDBG-DR AGREEMENT AND DECLARATION

In addition to any financing documents, owners of projects must sign a CDBG-DR Agreement with DED. The CDBG-DR Agreement will identify requirements for compliance with the CDBG-DR regulations and will remain in effect in the event of any prepayment of the CDBG-DR loan. In the event a Project is also receiving other funding, separate written agreements may be required for each funding source (e.g., HOME, NHTF, etc.).

Each CDBG-DR-funded project owner must record a Declaration of Restrictive Covenants in favor of DED enforcing CDBG-DR and DED guidelines, as applicable. The Declaration will be recorded separately and distinctly from the CDBG-DR deed of trust and will remain in place during the Affordability Period even if the CDBG-DR loan is prepaid prior to the expiration of the Affordability Period or loan maturity.

Among other requirements, the Declaration will include requirements pertaining to:

- Restrictions on the transfer or sale of the property without DED's prior permission;
- Restrictions on placing additional liens or further encumbrances on the property absent DED's prior permission;
- DED oversight of reserves and distributions of surplus cash; and
- Ongoing requirements for project compliance through the CDBG-DR Affordability Period, including:
    - The length of the period of affordability;
    - Income and rent restrictions on CDBG-DR-assisted units;
    - Property standards to be enforced;

- Marketing and leasing requirements; and
- Recordkeeping and reporting requirements.

Even when the CDBG-DR loan is subordinate to other debt, the CDBG-DR Declaration must be recorded senior to all liens and encumbrances associated with the project financing, including any loans senior to the CDBG-DR loan, and structured to survive any foreclosure by a senior lien, unless otherwise approved by DED.

7.3 LOAN STRUCTURE AND TERMS

DED will provide CDBG-DR funds in the form of a direct loan to the property owner (i.e., the limited partnership or limited liability company established for the purpose of owning the project). Funding commitments are not transferable without prior written DED approval.

The CDBG-DR award is intended as construction/permanent financing. Proceeds of the CDBG-DR award will only be released in conjunction with approved monthly construction draws and/or submission of invoices for approved soft costs and satisfaction of all requirements outlined below.

In general, the CDBG-DR loan will:

- Carry 3% simple interest and be deferred for the applicable Affordability Period (i.e., 15 or 20 years) with all outstanding principal and interest due at maturity;
- Be repayable in full upon any default or upon a sale, refinancing,[8] or transfer of the property not otherwise approved by DED; and
- Be secured with a Deed of Trust, promissory note, and appropriate UCC liens. The Deed of Trust will be recorded in the appropriate county and generally may be subordinate only to an amortizing permanent first mortgage and a temporary construction loan, all of which must be approved by DED, as applicable.

[8] In general, DED will only approve subordinations within the affordability period that result in a reduction of the interest rate and payment on any senior debt, refinance only the then outstanding balance of the senior loan(s), and do not result in an earlier maturity of the senior loan(s). Subordination to accommodate refinancing beyond the Affordability Period will also be limited to the outstanding debt with DED considering transactions where any increase in the principal balance of senior loans is for the sole purpose of investing in needed capital improvements.

When necessary for purposes of a determination that the CDBG-DR loan constitutes "bona fide debt" in the context of including costs financed by CDBG-DR in the project's eligible basis, DED will consider extending the term of the CDBG-DR loan for *up to* 40 years.

7.4 RESERVES AND SURPLUS CASH DISTRIBUTIONS

To preserve the ongoing viability of projects, DED will require the establishment and maintenance of various reserves. Reserves must remain in place so long as the Project's CDBG-DR loan is outstanding or for the duration of the Affordability Period, whichever is longer. Withdrawals from reserves will require written approval by DED, and in the event an owner makes unauthorized withdrawals DED reserves the right to require a deposit account control agreement imposing additional safeguards against unauthorized withdrawals.

Reserves will include (see ***Project Underwriting*** in section 4.3.1 for additional details regarding reserve accounts):

- An operating reserve intended to protect against unexpected operating deficits;
- A Replacement Reserve intended to fund future capital and rehabilitation needs. Initial reserve deposit requirements are noted in ***Project Underwriting*** (section 4.3.1), and DED may modify reserve requirements during the term of the loan based on periodic capital needs assessments. Projects involving rehabilitation will be required to capitalize the replacement reserve in a minimum amount of $1,000 per unit or such higher amount determined by the capital needs assessment;
- At DED's option, a preservation reserve account may be created and funded with a percentage of surplus cash available each year. The preservation reserve is intended to ensure the Project's satisfaction of the Affordability Period; and
- As may be required based on specific or unique project features, additional specialty reserves may be required, such as for tenant services, abnormal security costs, etc.

DED must also approve any distributions of surplus cash, which among other items, will require that all reserves be fully funded, the Project be in compliance with all Federal requirements, the Project not be in default, and that the Project retain sufficient liquidity following the distribution.

7.5 INSURANCE

During construction and for the duration of the Affordability Period or term of the CDBG-DR loan, whichever is longer, owners must maintain insurance coverage as specified by DED in the application materials for any given funding round and as further updated by DED from time to time. In addition to builder's risk policies during development, requirements will include but not be limited to maintenance of proper workers compensation, general liability, and hazard coverage in an amount equal to at least the replacement value for the Project.

7.6 GUARANTEES

Unless otherwise determined by DED, all underlying individuals, corporate entities, partnerships, or limited liability companies with an interest in the project's ownership entity (not including investor/syndicator partners or members of the ownership entity) will be required to provide the following guarantees:

- Completion Guarantee including provisions guaranteeing construction completion of the Project;
- Performance and Recovery Guarantee including provisions guaranteeing compliance with HUD CDBG-DR guidelines and indemnifying DED for any liability it incurs to HUD as a result of the project's failure to maintain compliance during the Affordability Period; and
- Replacement Reserve Guarantee to ensure annual deposits to a Replacement Reserve for the project in an amount consistent with the loan documents and/or covenant running with the land.

Guarantees shall be joint and several and must remain in effect throughout the Affordability Period. In addition to the guarantees listed above, unless otherwise approved by DED each project is required to obtain one (1) of the following options:

- Payment and performance bonds equal to 100% of the construction contract. During construction, and through any warranty period, the payment and performance bonds shall be assigned to DED; or
- An irrevocable standby letter of credit acceptable to DED for the benefit of DED in the minimum amount of the CDBG-DR award or 15% of the construction contract, whichever is greater. Any such letter of credit will be held by DED until project completion and stabilization.

7.7 TRANSFERS OF OWNERSHIP

During the Affordability Period or the life of the CDBG-DR loan, any transfer of title to the Project or any transfer of underlying partnership or member interests in the Owner will require the prior approval of DED with such approval to be in DED's sole discretion. However, DED's CDBG-DR transactional documents will incorporate exceptions for:

- Transfers of the LIHTC investor's interests among affiliates of the investor;
- The removal of a general partner or managing member for cause under the owner's partnership or operating agreement along with the associated insertion of an affiliate of the investor as the replacement general partner or managing member; and
- A transfer of title or the investor's interest to the original sponsor under any right of first refusal included in the owner's partnership/operating agreement.

8 DRAW PROCESS

8.1 DRAWING FUNDS

The CDBG-DR award is intended as construction and/or permanent financing. Proceeds of the CDBG-DR loan will only be released for reimbursement of eligible project costs, with supporting documentation for actual costs incurred.

8.1.1 CONDITIONS OF PERIODIC DRAWS

The obligation of DED to approve any draw request of Program funds is subject to the satisfaction of the following conditions at the time of making such request and such other conditions as outlined in the CDBG-DR Agreement.

- Draws will not be processed if the Owner is in default under the CDBG-DR loan or any other loan the Owner has received for the Project;
- The Project shall not have been materially damaged by fire or other casualty since the date of the award;
- DED shall have received evidence satisfactory to DED that all work and improvements requiring inspection by any governmental authority having jurisdiction have been inspected and approved by such authorities and by any other persons or entities having the right to inspect and approve construction; and
- Owner shall have submitted, at least 30 calendar days prior to the date a disbursement is desired, a completed disbursement request form including AIA G-702 (Contractor's Application for Payment) and G-703 (Continuation) forms and such other appropriate source documentation as may be required by DED and/or HUD including, without limitation, the following:

a. Current Contractor Tracking Form and lien waivers, which are to be dated no less than 10 business days prior to the date of the submission of the requested disbursement.

b. Evidence satisfactory to DED that the Project and the contemplated use thereof are permitted by and comply with all applicable uses or other restrictions and requirements in prior conveyances, zoning ordinances, or regulations that have been duly approved by the municipal or other governmental authorities having jurisdiction; that the required building permits and other permits have been obtained as required; and that no environmental impact statement is required or that such environmental impact statement has been properly filed and approved.

c. Appropriate certifications of compliance in all respects with labor standards and prevailing wage requirements applicable under Federal law.

d. Such other supporting evidence as may be requested by DED or its agents to substantiate all payments (proof of payment) which are to be made from the relevant disbursement and/or to substantiate all payments then made with respect to the Project, including but not limited to, canceled checks, invoices, and receipts.

e. DED shall have determined that all CDBG-DR requirements pertaining to the disbursement of funds have been met.

f. DED shall have received a current inspection report from a DED inspector (which may include a contracted third-party inspector) that verifies satisfactory completion of work to CDBG-DR standards.

g. DED shall have received a current/updated title endorsement, if required.

h. No determination shall have been made by DED that the undisbursed amount of the loan is less than the amount necessary to pay all costs and expenses of any kind that reasonably may be anticipated in connection with the completion of the Project.

8.1.2 CONDITIONS OF FINAL DRAW

In addition to the requirements set forth in ***Eligible Applicants*** (section 4.1.1), DED shall withhold payment on at least 10% of the CDBG-DR loan and require the following prior to the final disbursement of funds, the request for which shall not be submitted before completion of the Project, including all landscape requirements and offsite utilities and streets and correction of defects in workmanship and/or materials.

- A certificate of occupancy, if applicable; a certificate of substantial completion from the Project's architect; the builder's warranty from the general contractor; and a final approved construction report from DED's inspector for the Project and other requirements as outlined in the SRA;

- Evidence satisfactory to DED that the Project has been completed lien free and substantially in accordance with the plans and specifications;

- Review and final settlement of the cost certification performed by an independent CPA;

- Such other supporting evidence as may be requested by DED or its agent to substantiate all payments which are to be made from the final disbursement and/or to substantiate all payments then made with respect to the Project;

- Lease-up of all CDBG-DR assisted units, submission of tenant data necessary for DED to complete the Project in HUD's DRGR system, and DED's approval of income determinations for assisted tenants; and

- A determination by DED that all CDBG-DR requirements pertaining to the initial development of the Project have been met, including but not limited to, the monitoring of Davis-Bacon compliance, as applicable.

8.2 ELIGIBLE COSTS

Program funds awarded will only reimburse eligible costs incurred to develop the approved project. No program funds will be advanced to reimburse a project cost unless the Request for Disbursement Form with backup AIA certification, invoices, and receipts are submitted and approved. No funds will be disbursed until all environmental conditions are satisfied and all funding commitments/agreements are signed.

To simplify administration, DED is limiting the use of CDBG-DR funding to reimburse specifically for (1) acquisition of property (including vacant land or existing housing to be rehabilitated); (2) hard costs of construction (or rehabilitation); (3) architectural and engineering costs associated with the design of the Project; and (4) legal and accounting costs associated with the acquisition, financing, and construction of the Project (not including organizational or syndication related legal fees).

9 ONGOING PROJECT REQUIREMENTS

9.1 PERIOD OF AFFORDABILITY

HUD's requirements for CDBG-DR require an Affordability Period of 15 years for projects involving multifamily rehabilitation and 20 years for the new construction of multifamily rental housing. To promote administrative efficiency, HUD allows the Affordability Period, insomuch as possible, to be aligned to that of other funding sources. For projects under the CDBG-DR/LIHTC gap financing program, then, DED will enforce an Affordability Period of either 15 or 20 years from December 31 of the year in which the project is placed in service. For rehabilitation projects, this will align to the LIHTC compliance period, and for new construction projects, this will run for five (5) years beyond the end of the LIHTC compliance period.

During the Affordability Period, DED will monitor projects for ongoing compliance with the income and rent restrictions, as well as other ongoing requirements associated with CDBG-DR funding (e.g., affirmative marketing). In practice, because it has deliberately defined income restrictions and rent restrictions aligned to the requirements of LIHTC, DED anticipates that NIFA will complete most on-site monitoring as part of its ongoing oversight of a project for LIHTC purposes.[9] However, DED reserves the right in all cases to conduct remote or on-site monitoring to review compliance with the requirements of CDBG-DR, the program requirements established by DED, and project-specific transactional documents.

DED anticipates the publication of a CDBG-DR Rental Management Handbook, which will provide further guidance relating to ongoing compliance requirements, reporting procedures, and minimum operating expectations (e.g., insurance requirements, management of reserves, and the like). Project owners will be required, as part of the transactional documents associated with the CDBG-DR award, to comply with the Handbook and any future updates, revisions, or similar successor replacement publications thereto.

9.2 AFFIRMATIVE MARKETING, TENANT SELECTION, AND LEASING

As described within the ***Affirmatively Furthering Fair Housing Policies and Procedures***, the owner/developer must establish an affirmative marketing plan for all CDBG-DR funded projects. DED will generally accept a plan developed using HUD form 935.2a. Owners are expected to review their affirmative marketing efforts at least annually and update the affirmative marketing

[9] Additional detail on the coordination of monitoring between DED and NIFA will be provided at a later date.

plan not less than every five (5) years. Additionally, the owner/developer must ensure that LEP persons have the same access to information and services as all other Successful Applicants. Therefore, all marketing materials must follow the State's HUD approved Language Assistance Plan.

While CDBG's regulations do not include specific tenant protections, DED will require owners to develop a written tenant selection plan consistent with and apply the lease provisions of the HOME requirements at 24 CFR § 92.253 (*except* for cross-reference to 24 CFR § 92.359€ implementing VAWA provisions[10]). Among other requirements, the tenant selection plan must, insofar as is practical, provide for the selection of tenants from a project's waiting list in chronological order of their applications and provide written notification to any rejected Applicant of the reason for their rejection.

Leases between the tenant and owner shall be for one (1) year, unless by mutual agreement between the tenant and the owner. Owners are required to provide 30-days' written notice prior to terminating or refusing to renew the lease. Owners are prohibited from including unfair provisions in their leases and the following terms from 24 CFR § 92.253(b) are prohibited from CDBG-DR project leases:

- Agreement to be sued;
- Treatment of personal property;
- Excusing owner from responsibility;
- Waiver of notice;
- Waiver of legal proceedings;
- Waiver of a jury trial;
- Waiver of right to appeal court decision;

[10] DED notes that provisions of the VAWA are not applied to the CDBG Program, generally owning to the regular CDBG Program's lack of an affordability period. While CDBG-DR does introduce an Affordability Period, it does not explicitly apply VAWA requirements. DED strongly supports the Applicant and tenant protections imposed on most other HUD programs by VAWA. However, the VAWA statute applies substantially equivalent provisions to the LIHTC program, so rather than separately impose the same substantive requirements through DED policy, DED is electing to defer to NIFA's oversight of LIHTC projects related to VAWA issues.

- Tenant chargeable with cost of legal actions regardless of outcome; and
- Mandatory participation in supportive services (note, transitional housing projects funded with Program funds may be permitted to require service participation under limited circumstances; contact DED staff for more detail).

In general, the DED anticipates providing a standard form lease addendum for use by owners of CDBG-DR assisted housing that will provide required tenant protections and eliminate any prohibited provisions from uses otherwise used by owners.

9.3 INCOME AND RENT RESTRICTIONS

Under CDBG-DR, no fewer than 51% of the units in a project must be income/rent restricted. This does not vary based on percentage of project costs funded with CDBG-DR (in contrast to HOME's cost allocation approach or LIHTC's applicable percentage approach).

Per the Action Plan, all CDBG-DR rental units will be income and rent restricted at or below 80% AMI. However, to align to LIHTC, DED will impose the same income restrictions as NIFA based on the specific application under the QAP (i.e., including any deeper income targeting) and the set-aside election made for LIHTC purposes. In the absence of an income averaging election under LIHTC then, all CDBG-DR units are expected to be income and rent restricted at or below 60% AMI. To align to the requirements of LIHTC and most other federal rental programs, DED requires the use of the income definition at 24 CFR § 5.609 (commonly known as the Part 5 or Section 8 definition of income).

DED's definition of affordable rents in the Action Plan is the same as under LIHTC, allowing a rent not to exceed 30% of the income of a household at the applicable income limit (based on an imputed household size of 1.5 persons per bedroom or, in the case of a 0-bedroom/efficient unit a one-person household).

At the project level then, the CDBG-DR agreement and declaration will impose rent limits aligned to the actual income targets for all units otherwise benefiting from LIHTC.

9.3.1 UTILITY ALLOWANCES

The CDBG-DR rent limits are gross rent limits. The actual rent collected from a tenant must be adjusted, considering an allowance for tenant paid utilities, (i.e., the UA). For administrative efficiency, DED will allow owners to propose UAs using any methodology allowable under the LIHTC program. Underwritten UAs must be updated and approved by DED (or, as applicable and delegated to DED, by NIFA) prior to beginning leasing if the UA determination is more than one-year-old at that point. Additionally, once a project has been placed in service, UAs must be updated on an annual basis subject to the same approval.

Given the requirement that CDBG-DR projects be constructed to specific Green Building standards, DED encourages owners to consider establishing their utility allowance using an engineering model. This is likely to result in more accurate (and lower) UAs which may marginally increase rental revenues, thereby increasing NOI and supportable mortgage debt, reducing the need for gap financing.

9.4 REPORTING AND RECORDKEEPING

To allow effective oversight of awarded projects and document compliance with applicable CDBG-DR requirements, all projects must submit periodic reports to DED. Detailed reporting and monitoring requirements are described in the ***Recordkeeping and Data Management Policies and Procedures***, the ***Monitoring and Compliance Plan***, and the ***Anti-Fraud, Waste, and Abuse Policies and Procedures***.

Additionally, the CDBG-DR Agreement and Declaration provide DED, NIFA, HUD, the GAO, and all other pertinent Federal or State agencies or their designated representatives the right to inspect records and property.

While this section outlines standard reporting requirements, DED reserves the right to require additional reporting or to alter the reporting format or frequency based on future changes to CDBG-DR requirements or DED policy. Additionally, DED reserves the right to require additional or more frequent reporting for projects with compliance deficiencies.

- Project owners are required to report monthly during the development phase and lease-up phase. Monthly reports will be due on the fifth business day of the following month;
  - During the construction phase, owners must provide reports detailing construction progress and barriers to progress, copies of invoices being paid, and evidence of appropriate lien waivers. As applicable to a given project, owners must also report on compliance related to labor standards, Section 3, MBE/WBE outreach, and similar requirements.
  - During the initial phase of lease-up, reports detailing the number of additional leases, total project leases, marketing activity, and income and expenses may be required. Once the owner has leased 100% of units, leasing and marketing reporting will be required annually.
- Annual Reports shall be required for all CDBG-DR projects, and shall include an Annual Occupancy Report, utility allowance documentation, and examples of marketing materials;
- All projects will be required to submit an audit prepared by an independent CPA within 180 days of the end of its fiscal year. For small projects where the cost of a project-specific

audit is deemed to be burdensome by DED, a statement of financial condition may be accepted with prior approval by DED; and

- DED may periodically require owners to obtain a capital needs assessment prepared by an independent third-party architect, engineer, or other qualified firm approved by DED. Such capital needs assessments shall be used for the purposes of determining the adequacy of the Replacement Reserve, considering its existing balance, planned deposits, and anticipated future capital replacement costs for the Project. If the capital needs assessment indicates the Replacement Reserve is not sufficient to address anticipated capital costs during the Affordability Period and the term of the CDBG-DR loan, the owner must, at DED's option, either make an additional deposit or increase its annual deposits sufficient to meet any underfunding. If an additional deposit is required, the owner (or the Guarantors) must replenish the Replacement Reserve Account within six (6) months.

9.5 MONITORING

Throughout the period of performance, DED will conduct regular desktop and on-site monitoring as described in the ***Monitoring and Compliance Plan***. The purpose of on-site monitoring visits will include, at minimum, reviews of project records and inspection of the premises, including common areas and residential units. Following project closeout, DED will monitor the project for ongoing compliance with CDBG-DR requirements including, but not limited to, income and rent restrictions or the longer of the Affordability Period or so long as the CDBG-DR loan is outstanding. As noted earlier, in practice DED also expects NIFA may conduct most on-site monitoring acting on behalf of DED. However, DED reserves the right to conduct site visits at a frequency based on changes to CDBG-DR regulations, DED policy, or based on evidence of compliance deficiencies in a prior monitoring visit.