



## REGULATORY INTERPRETATION 1999-RI-03

**Date:** January 26, 1999

**Subject:** Demonstrating the Need for Affordable Housing Program Subsidy for Owner-Occupied Projects With Sponsor-Provided Permanent Financing

**Background:**

This provides guidance on how Federal Home Loan Banks (FHLBanks), their members, and Affordable Housing Program (AHP) project sponsors can demonstrate need for AHP subsidy in owner-occupied AHP projects involving primarily sweat equity, in-kind donations, volunteer professional labor and services, and sponsor-provided low-interest permanent financing. To date, these generally are projects sponsored by Habitat for Humanity, Inc. affiliates (Habitat) throughout the country. This guidance applies to Habitat projects as well as other sponsors whose projects demonstrate similar characteristics.

The issue that has arisen is how to analyze the non-cash contributions and the value of the permanent financing in the sources and uses framework required by the AHP regulation. Section 960.5(b) of the revised AHP regulation sets forth the eligibility requirements for projects receiving AHP subsidies under the competitive application program. *See* 12 C.F.R. § 960.5(b). A threshold requirement is that the FHLBank evaluate AHP applications for project feasibility and need for subsidy. *See* 12 C.F.R. § 960.5(b)(2). Among other things, section 960.5(b)(2)(iii) specifically provides that the requested AHP subsidy must be necessary for the financial feasibility of the project. If more AHP subsidy is granted than is needed to make the project feasible, the project is oversubsidized for purposes of the AHP. The result is that the subsidy ultimately may not be passed through to the project's intended beneficiaries. Thus, the AHP applicants are required to provide an analysis of all projected sources and uses of funds for the project, and demonstrate that the AHP subsidy is needed to make the project feasible. At the time disbursement of the AHP funds is requested, the approved project must continue to meet the requirements of section 960.5. *See* 12 C.F.R. § 960.8(c)(2). Thus, the FHLBank must also evaluate the project's continued need for subsidy at the time of disbursement.

In reviewing how the need for AHP subsidy in these projects was analyzed in the past, it became apparent that the various non-cash contributions and the value of the financial commitment made by the purchaser of the unit (for example a 20 year mortgage) were not being consistently represented in AHP applications. For example, in some applications, the promissory note between the sponsor and the buyer was considered as a source of funds at face value. This tends to overstate the sources, as the promissory notes are generally at little or no interest cost to the buyer. In other cases, the promissory note was excluded from the analysis altogether, which tends to understate the sources of funds.

### ***Guidance:***

A sponsor should demonstrate need for AHP subsidy by performing a cash sources and uses analysis. The analysis should calculate the gap between the cash costs<sup>1</sup> to complete the project and the sum of (1) any cash sources other than the sponsor, and (2) any cash contribution by the sponsor<sup>2</sup>. The gap resulting from the above calculation represents the maximum amount of AHP subsidy the sponsor may receive for the project. Applications for an owner-occupied AHP project of the type described above should be analyzed for sources and uses as outlined in the attached example (see Attachment #1).

Habitat projects generally do not include fees for the services that they provide (*i.e.*, developer's fee). If Habitat does charge a fee, the fee should be in accordance with the FHLBanks' guidelines for AHP projects in general. This fee recognizes the administrative value brought to the project by a sponsor.

By focusing the analysis on cash sources and uses, the sponsor can streamline the analysis, as non-cash contributions are exactly offset by the amount of non-cash expense they cover, and therefore cancel out of the comprehensive sources and uses analysis. For example, a contribution of materials (in-kind) is a source that reduces the need for cash payments by exactly its value.

If you have any question regarding this guidance, please contact Richard Tucker at (202) 408-2848 or Janet Fronckowiak at (202) 408-2575.

This is a Finance Board regulatory interpretation within the meaning of the Procedures for Requests and Applications adopted by the Board of Directors of the Finance Board pursuant to Resolution Number 98-51, dated October 28, 1998. The regulatory guidance set forth herein may be relied upon subject to modification or rescission by action of the Board of Directors of the Finance Board.

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<sup>1</sup> The cash cost is the actual total cash outlay needed to pay for materials, labor, land acquisition, or other costs of completing the project. This does not include donations of land, or in-kind donations of labor, materials, or services.

<sup>2</sup> The sponsor's cash contribution must include the present value of any payments the sponsor is to receive from the buyer. The present value of payments the sponsor is to receive from the buyer includes any cash downpayment from the buyer, plus the present value of any purchase note the sponsor holds on the unit. If such a note carries a market interest rate commensurate with the credit quality of the borrower (market rate), the present value of the note equals the face value of the note. If the note carries an interest rate below the market rate, the present value of the note can be determined using the market rate to discount the cash flows.

AFFORDABLE HOUSING PROGRAM NEEDS ANALYSIS SUMMARY

**Step 1**

Calculate the Present Value of the Buyer's Financial Commitment. For example, if the buyer of the unit is expected to repay the sponsor a \$25,000 promissory note in monthly installments over 20 years at zero percent interest, you should value that commitment as follows:

<b>Present value buyer's payments to sponsor</b>	
1. Mortgage Term in Years >>>>>>>>>	20
2. Actual Monthly Mortgage P&I Payment >>>	\$104.17
3. Assuming an Annual Market Rate of >>>>	9.00%
Present Value of Buyer's Contribution >>>>>>>	\$11,578

The appropriate discount rate used in this calculation should be determined by each Federal Home Loan Bank (a reasonable market rate plus an adjustment to reflect the credit quality of the borrower). The Federal Home Loan Banks should determine the applicable interest rate, and include it in the AHP application instructions.

One possibility would be to use the Fannie Mae or Freddie Mac commitment rate, adjusted to reflect the credit quality of the borrower (i.e., if the borrower is subprime, a subprime rate would be used to discount the cash flows). The value of the buyer's contribution is considered a source of cash and must be included in the sponsor's contribution.

**Step 2**

Calculate the maximum potential funding gap by outlining all cash sources (excluding Affordable Housing Program funds) and comparing those to cash uses.

<b>CASH SOURCES</b>		<b>CASH USES</b>	
Other Cash Sources	13,000	Developer's Fee	3,000
Sponsor's Cash Contribution*	11,578	Costs requiring cash payments	26,578
<b>Total sources excluding AHP</b>	<b>\$ 24,578</b>	<b>Total cash cost of unit</b>	<b>\$ 29,578</b>

Uses should include all costs requiring cash payments. In sum, they should equal the total cash cost of the unit/project. The gap potentially qualifying for Affordable Housing Program subsidy in the above example is \$5,000.

\*The sponsor's cash contribution must include the present value of any payments the buyer is required to make to the sponsor, in connection with the purchase of the unit.