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## FEDERAL HOUSING FINANCE AGENCY

### ADVISORY BULLETIN

AB 2013-08

### Guidance on On-Site Monitoring of Projects under the Affordable Housing Competitive Application Program

#### **Introduction**

This advisory bulletin (AB) provides guidance to the Federal Home Loan Banks (FHLBanks) on incorporating site visits into their project monitoring policies and procedures for certain projects awarded funds under the competitive application program of the Affordable Housing Program (AHP). This AB does not mandate site visits for AHP projects. Rather, it describes the existing monitoring requirements of the AHP regulation and provides guidance to the FHLBanks on how they may meet those requirements by identifying risks and conditions that may warrant a visit to the project site.

#### **Guidance**

Under the AHP regulation, the FHLBanks are responsible for monitoring AHP projects and are required to adopt written policies for their initial and long-term monitoring. The FHLBanks' monitoring policies must be included in their AHP Implementation Plans. See 12 C.F.R. § 1291.7(a). The AHP regulation identifies non-exclusive risk factors for the FHLBanks to consider in developing their monitoring policies. Periodically, the FHLBanks should reevaluate the effectiveness of their monitoring policies to determine whether changes in those risks and other conditions may warrant amending their existing initial and long-term monitoring policies.

Any such reevaluation should include an assessment of facts and circumstances that would result in the need or preference to complement off-site monitoring with project site visits. For 2014, we expect that each FHLBank's management will conduct such a reevaluation in consultation with its board of directors and Advisory Council early in the year and document the conclusions and associated discussions. As warranted, an FHLBank should revise its monitoring policies and procedures and implement any changes no later than June 30, 2014.

Off-site monitoring generally provides sufficient information for an FHLBank to evaluate whether projects comply with their AHP application commitments and the AHP regulation. However, when there are issues that cannot be resolved or confirmed off-site, an FHLBank should consider visiting the project when the visit could aid the FHLBank in addressing these issues.

An FHLBank should design its monitoring policies and procedures to provide the FHLBank with the essential, objective information it needs to adequately monitor its AHP projects and promptly identify projects that may be at risk of noncompliance. Those policies and procedures should allow the FHLBank to take timely action to address any noncompliance or to maximize the effectiveness of the FHLBank's AHP subsidy recovery efforts. Factors cited in the regulation, which may influence whether to conduct site visits, include: the amount of AHP subsidy in the project; the type, size, or location of the project; project sponsor experience; and any monitoring of the project by other government entities. Additional factors for consideration could include the costs and potential benefits of conducting a site visit, and a project's risk of AHP noncompliance.

### ***Initial Monitoring:***

The AHP regulation requires each FHLBank to adopt a written policy for the initial monitoring of owner-occupied and rental projects under the competitive application program. See 12 C.F.R. § 1291.7(a)(1)(i). Under the regulation, an FHLBank's monitoring policy must require AHP project sponsors or owners to provide the information necessary for the FHLBank to determine whether: the project is progressing satisfactorily towards completion and occupancy by eligible households; the AHP subsidies are used for eligible purposes according to the commitments in the AHP application; the project's household incomes and rents comply with the income targeting and rent commitments made in the AHP application; the project's actual costs were reasonable in accordance with the FHLBank's project cost guidelines and the AHP subsidies were necessary for the completion of the project as currently structured; each AHP-assisted unit of an owner-occupied project and rental project is subject to an AHP retention agreement; and any services and activities committed in the AHP application have been provided.

An FHLBank's monitoring policy must also include requirements for: (i) FHLBank review of back-up project documentation on household incomes and rents maintained by the project sponsor or owner; and (ii) maintenance and FHLBank review of other project documentation in the FHLBank's discretion. An FHLBank may not select projects for initial monitoring using a sampling plan, but may use a reasonable risk-based sampling plan to review the back-up project documentation. See 12 C.F.R. § 1291.7(a)(1)(ii), (iii).

Generally, the FHLBank may verify these requirements off-site through the review of: certificates of occupancy; project owner certifications of household incomes and rents; and certifications or, as appropriate, executed contracts, for the provision of any services and activities committed to at the project. However, if the documentation is not provided to the FHLBank in a complete or satisfactory manner and the information cannot be obtained off-site, a site visit may be warranted.

An FHLBank's initial monitoring policy may identify characteristics and conditions where a site visit might provide a more accurate or complete assessment of the project's potential for noncompliance than might be identified through off-site monitoring. For example, with some projects the risk of noncompliance could be greater during the construction and initial lease-up phase of the project. A visual inspection could provide valuable information on whether the project is making satisfactory progress. Or, in the absence of adequate documentation, a site visit might be useful to verify that services committed in the AHP application are being provided.

***Long-Term Monitoring:***

Rental projects must comply with certain requirements specified in the AHP regulation over a required 15-year retention period. The AHP regulation provides for three methods of long-term monitoring of completed rental projects under the competitive application program, depending on the characteristics of the rental project. For completed AHP rental projects where an FHLBank does not rely on monitoring by a federal, state, or local government entity, the FHLBank is required to adopt a written monitoring policy for monitoring such projects commencing in the second year after completion through the 15-year AHP retention period. This monitoring determines whether household incomes and rents comply with the income targeting and rent commitments, respectively, made in the approved AHP application. The policy must include requirements for: (i) FHLBank review of annual certifications by projects owners that household incomes and rents are in compliance with the commitments made in the approved AHP application; (ii) FHLBank review of back-up project documentation on household incomes and rents maintained by the project owner; and (iii) maintenance and FHLBank review of other project documentation in the FHLBank's discretion. See 12 C.F.R. § 1291.7(a)(4)(i), (ii).

The FHLBanks' monitoring policies must take into account risk factors such as the amount of AHP subsidy in the project, type of project, size of project, location of project, sponsor experience, and any monitoring of the project provided by a federal, state, or local government entity. An FHLBank may use a reasonable, risk-based plan to select the rental projects to be monitored and to review the annual project owner certifications, back-up, and any other project documentation. See 12 C.F.R. § 1291.7(a)(4)(iii).

For completed AHP rental projects that have been allocated federal Low-Income Housing Tax Credits (LIHTC or tax credits), an FHLBank may rely on the monitoring of the state-designated housing credit allocation agency of the income-targeting and rent requirements applicable under the LIHTC Program, and the FHLBank need not obtain and review reports from such agency or otherwise monitor the projects' long-term AHP compliance. See 12 C.F.R. § 1291.7(a)(2).<sup>1</sup>

For completed AHP rental projects that received funds other than tax credits from federal, state, or local government entities, an FHLBank may rely on the monitoring by these entities of the

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<sup>1</sup> FHFA's experience with the LIHTC Program has been that Internal Revenue Service penalties to investors appear to be an effective deterrent to a project's noncompliance with the household income targeting and rent requirements. It is also important to note that under the LIHTC, allocating agencies conduct regular site visits to monitor compliance with habitability standards. See 26 U.S.C. § 42(m)(1)(B)(iii).

income targeting and rent requirements applicable under their programs, provided that the FHLBank can show that: (i) the compliance profiles regarding income targeting, rent, and retention period requirements of the AHP and the other program are substantively equivalent; (ii) the entity has demonstrated and continues to demonstrate its ability to monitor the project; (iii) the entity agrees to provide reports to the FHLBank on the project's incomes and rents for the full 15-year AHP retention period; and (iv) the FHLBank reviews the reports from the monitoring entity to confirm that they comply with the FHLBank's monitoring policies. See 12 C.F.R. § 1291.7(a)(3).

For the vast majority of AHP projects, an FHLBank can successfully conduct long-term monitoring off-site by reviewing the household income targeting and rent documentation submitted by the project sponsors or owners, or by relying on monitoring by federal, state, or local government entities where permitted in the AHP regulation. In some circumstances, site visits may be warranted if information provided to the FHLBank is inadequate to establish compliance, or an FHLBank finds indications of a project's possible noncompliance with the income targeting and rent commitments, and the issues cannot be resolved off-site. For example, an FHLBank may consider visiting a project to follow up with the project sponsor or owner if either party has not responded to FHLBank requests for information in a timely or satisfactory manner.

Regardless of whether an FHLBank monitors an AHP project or relies upon the monitoring of a government entity, the FHLBank could be ultimately responsible for recovering the amount of any AHP funds not used in compliance with the project's AHP application commitments or the AHP regulation. See 12 C.F.R. § 1291.8(a). If an FHLBank is presented with credible information from a reliable source that the third-party monitoring is insufficient or has ceased, or if the FHLBank has sufficient reason to believe that household incomes and rents for a project do not comply with the income targeting and rent commitments made in the approved application, then the FHLBank should conduct its own monitoring of the project and that might include site visits, as warranted. It may be prudent for an FHLBank's written monitoring policies to include provisions for the frequency and scope of project site visits to address such situations.

***Additional Examples of Factors for Possible Inclusion in Monitoring Policies:***

In addition to those factors discussed above that might warrant a project site visit, below are some non-exclusive examples an FHLBank should consider for inclusion in its monitoring policies:

- The project is a problem project or has been placed on the FHLBank's watch list;
- The FHLBank has become aware of possible problems in the project from such sources as funders, monitoring entities, or interested parties, or through unfavorable attention in the media indicating possible AHP noncompliance;
- The project is solely or primarily funded with AHP subsidy, the amount of AHP subsidy in the project is substantial, or the project has a large number of AHP units;

- Changed circumstances or new information call into question the operational capacity of the project sponsor or owner, or the continued operational feasibility of the project; and
- The FHLBank suspects that the owner, sponsor, managing agent, or other party may have misrepresented factual information or falsified income verifications or altered tenant files.

FHFA examiners will review an FHLBanks' monitoring policies, procedures, and practices to determine whether they identify risks and conditions that may warrant a visit to the project site.

**Effective Date:** December 13, 2013

Advisory Bulletins communicate guidance to FHFA supervision staff and the regulated entities on specific supervisory matters pertaining to the Federal Home Loan Banks, Fannie Mae, and Freddie Mac. Contact Kari Walter, Senior Associate Director, Office of Supervision Policy, at [karen.walter@fhfa.gov](mailto:karen.walter@fhfa.gov) or (202) 649-3405, Kyle Roberts, Associate Director, Office of Supervision Policy at [kyle.roberts@fhfa.gov](mailto:kyle.roberts@fhfa.gov) or (202) 649-3005, or Sylvia Martinez, Principal Adviser/Manager, Division of Federal Home Loan Bank Regulation (DBR), at [sylvia.martinez@fhfa.gov](mailto:sylvia.martinez@fhfa.gov) or 202-649-3301 with comments or questions pertaining to this bulletin. FHLBanks seeking additional guidance on on-site monitoring of projects under the competitive application program of the Affordable Housing Program may submit their questions to DBR at [dbr.hci@fhfa.gov](mailto:dbr.hci@fhfa.gov).