FHLBank San Francisco

Proposed Amendments to Affordable Housing Program Regulation: Issues and Solutions

On March 14, 2018, the Federal Housing Finance Agency (FHFA) published proposed amendments to the Affordable Housing Program (AHP) regulation that would offer some benefits to the AHP, but would also pose many challenges to program participants. We hope that this summary, which outlines the Federal Home Loan Bank of San Francisco's main concerns, will be a useful resource for program stakeholders in preparing their own comments on the Notice of Proposed Rulemaking (NPR).

The primary challenge of the proposed amendments is the introduction of new outcome requirements that would require awarded AHP dollars to meet FHFA-prescribed priority categories. The Bank has outlined the outcome requirements and proposed a solution below.

On pages 3-5, we have identified other changes to current practices proposed in the NPR that would make the AHP harder to use and reduce program participation by members and sponsors, as well as recommended solutions that would make the AHP more effective.

Outcome Requirements for Statutory and Regulatory Priorities

For the past 28 years, the AHP has used a clear scoring system for its competitive program. Project applications are scored and ranked in descending order. Awards are then given to the highest-scoring projects until the funds are exhausted. The proposed outcome requirements framework would mandate that awarded AHP dollars meet multiple outcomes. This would create a complex awarding structure, resulting in unintended consequences that would reduce program flexibility, narrow the pool of sponsors/developers and members that participate, and lessen the transparency of the AHP.

Awarding AHP

Current Scoring System:
straightforward, transparent

7 FHFA categories
+ 2 FHLBank categories
= **100 points**

Proposed Outcome Requirements:
complex, less transparent

- 10% of funds used for home purchase
- At least 55% awarded to two statutory priorities
- At least 55% awarded to two of three regulatory priorities, with a 10% minimum in each of those priorities
- At least 55% of rental units reserved for households earning 50% or less of area median income

Reduced Flexibility

While the priorities in the outcome requirements structure appear to offer greater flexibility, the practical implications of these new requirements would make the program *less flexible* to meet local needs.

Example: *An FHLBank's AHP annual contribution is $30 million. The FHLBank chooses to allocate 30% ($9 million) to its home purchase set aside program and $21 million to the general AHP competitive fund. To meet the regulatory priorities, 55% of the total funding, or $16.5 million ($30 million x 55%), must meet two of the three regulatory priorities. This means that 79% of the general AHP fund ($16.5 million/$21 million) would have to meet these priorities.*

Because FHLBanks will want to avoid the consequences of not meeting the required outcomes, the FHFA priorities will drive scoring and overshadow the local needs of each FHLBank district. Regardless of the amount allocated to the FHFA-mandated priorities, the consequence of the outcome requirements structure is that it creates a prescriptive, one-size-fits-all, program that does not allow flexibility to respond to and leverage local opportunities and meet local needs.[1]

Reduced Program Transparency

The new outcome requirements structure may force FHLBanks to diverge from the long-standing process of selecting projects in descending application score order. In some instances, FHLBanks would have to select lower-scoring projects to fulfill the outcome requirements. This would make the process for selecting awarded projects more complex and less transparent for participants. Focusing on FHFA-prescribed priorities would also reduce the ability of FHLBanks to address the unique housing needs of their districts.

Recommended Solution

The current AHP application scoring structure, while it has worked successfully for 28 years, still lends itself to greater improvement. The FHFA can still establish program priorities as required by the statute to the current scoring-based system under the existing regulation. The final AHP regulation should eliminate the FHFA-prescribed outcome requirements, retain the clear scoring structure currently in place, and incorporate additional flexibility by:

- Providing the FHLBanks with scoring discretion beyond what is available in the current regulation, and
- Allowing the FHLBanks to create targeted funds.

A scoring-based system that allows the FHLBanks additional flexibility is superior to an outcome requirements-based structure and will allow the FHLBanks to sufficiently respond to local needs, expand participation, and maintain program transparency.

Other Areas of Concern

The following discussion highlights other proposed changes to current practices that would make the AHP harder to use and may reduce program participation by members and sponsors. Also included are recommendations regarding Need for Subsidy and Supportive Services that would maximize the effectiveness of the AHP.

[1] This example is based on the Bank's understanding of the FHFA interpretation of the regulation in the FHFA's March 27, 2018. webinar.

Thresholds for Targeted Populations

The proposed amendments change the threshold amount needed for projects to qualify as serving targeted populations, such as the homeless, special needs, or other targeted groups. The threshold would increase the portion of units reserved for targeted populations from 20% to 50%. This new threshold is not compatible with other funders of AHP projects and does not recognize the benefit of a mixed-occupancy development, which allows developers to cross-subsidize units in a project. Ultimately, since rental subsidies are difficult to secure, raising the minimum number of units required to serve targeted populations could have a negative effect on a project's feasibility and may discourage some sponsor/developers from applying for AHP funding.

Recommended Solution: Retain the current 20% threshold for targeted populations.

Ability to Make Project Modifications

Under the proposed amendments, AHP project modifications will be delayed, and AHP sponsors unduly burdened, because of a new "cure first" requirement. This change requires the sponsors of awarded AHP projects that are not able to completely fulfill the commitments made in their AHP applications to attempt to "cure" the issue before requesting a modification to the project. Sometimes the cause is something beyond a sponsor's control, such as market conditions or changes in a third-party servicer provider. In these cases, having a cure requirement increases funding risk to the sponsor, may increase the cost of the project, and may delay the disbursement of funds. Delays caused by this new requirement will also affect members that have committed construction or permanent financing or are providing equity to the project.

Recommended Solution: Retain the FHLBanks' current practice of verifying that any modified project, had it applied for AHP funding with the modifications in place, would still have scored high enough in the funding round to receive the AHP award.

Sponsor Capacity and Qualifications

The proposed amendments require FHLBanks to evaluate the ability of the sponsor and all members of the development team (i.e., sponsor affiliates and team members, including general contractors) to perform the responsibilities committed to in the application. This will add a documentation burden for sponsors. In addition, the entire development team may not be in place at the time of the AHP application, making it impossible to assess total capacity.

Recommended Solution: Retain the FHLBanks' current practice of reviewing the qualifications and experience of the project sponsor only.

Long-Term Monitoring of Low-Income Housing Tax Credit (LIHTC) Project by Members

The proposed amendments would require members to amend current agreements with LIHTC sponsors and revise future AHP agreements to include a provision that requires the sponsor to report to the FHLBank LIHTC projects that are noncompliant with income targeting or rent requirements during the 15-year retention period. The current AHP regulation does not require long-term monitoring of LIHTC projects. This adds a new requirement and burden on sponsors to actively monitor LIHTC projects for 15 years and introduces risk to the member if noncompliance is not discovered and reported promptly.

Recommended Solution: Eliminate this new requirement.

Need for Subsidy and Supportive Services

The AHP would benefit greatly from amendments that simplify the program, optimize its impact, and maximize the reliance on other funders, as outlined below.

When evaluating **need for subsidy**, it is important to understand how the AHP fits into the national system for the production and financing of affordable housing. By definition, the AHP subsidy provides gap financing for affordable housing projects and, as stated in the NPR's preamble (page 11344), it has the "…capacity to leverage additional public and private resources for affordable housing…" The AHP subsidy, though crucial to the development of affordable housing, represents only a small percentage of a project's overall financing.

Although the NPR states only that the project's cash flow and cost be "reasonable," the FHLBanks are concerned that the language of the NPR's preamble prescribing various standards for evaluation of the project's cash flow to determine need for subsidy and accordingly, the project's eligibility for subsidy, could severely limit the FHLBanks' ability to: 1) effectively coordinate with major funders, and 2) arrive at sensible, fair, and pragmatic judgments in cases where a project may appear to have sufficient funds to proceed with development and operation of the project without the use of AHP subsidy.

Proposed Solution: Re-adoption of the existing definition of need for subsidy—the gap between a project's development sources and uses—would be in the best interests of the program.

The FHLBanks understand that the FHFA's historical interpretation of the statutory authority has been that **supportive services** are not an eligible use of AHP subsidy and therefore should not be a development expense. The FHLBanks have advocated strongly for a broader regulatory interpretation of the statutory permissible uses for AHP funds and to allow acceptance of supportive services expenses as a standard expense necessary to operate most, if not all, affordable rental housing projects, to be viewed in the same vein as other costs, such as property management, security, and payroll. The NPR explicitly links the Special Needs and Promotion of Empowerment regulatory criteria with supportive services, further emphasizing that services are not optional. In our view, this is a compelling reason supporting the acceptance of supportive services as an ordinary operating expense. Many major funders require that supportive services expenses appear on the operating pro-forma. Requiring the FHLBanks to separate supportive services expenses from the project's pro forma to analyze the need for subsidy leads to misrepresentation and confusion and adds an unnecessary burden to sponsors.

Recommended Solution: Allow projects to include supportive services expenses in a project's operating pro forma.

Share your concerns with the FHFA. The comment period for the proposed amendments closes on Monday, May 14, 2018. Comments can be submitted online at FHFA.gov or by mail to Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590-AA83, Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street, SW, Washington, DC 20219.