Attachment C: Standard Underwriting Assumptions for Preserving Affordable Housing – Rehabilitation Loans for Non-Profit Developers of Affordable Housing

Affordable Multi-family Rental

- Rental Income

Minimum Affordability: At least 51% of the proposed property's units must be restricted to households below 60% of area median income.

Affordable Rents: The scheduled rent for each unit must not exceed the HUD maximum rents established annually . Refer to the HOME Unit Fact Sheet for current Phoenix HOME rent limits and the Annual Area Median Income Table for income thresholds in determining rents.

Mixed Use: For underwriting analysis in mixed use properties, the income from the residential portion of a project shall not be used to support any negative cash flow of a commercial portion. Conversely, the commercial income shall not support the residential portion.

- Vacancy & Collection Losses:

Vacancy and collection loss allowances shall reflect current market conditions and should be at least 10% for all properties except SROs, which shall be at least 12% (allowances are subject to change according to market conditions). If higher economic vacancy rates are indicated by the market study, the Department may utilize the higher rate.

- Operating Expenses:

Project budgets must utilize operating expenses equal to operating expenses published annually by the Arizona Department of Housing in its Qualified Allocation Plan (QAP) or such other amount as may be indicated by comparative data approved by the City. This minimum threshold does not include property taxes, replacement reserves, landlord-paid tenant utilities for gas or electric service in master-metered buildings, or the costs of any service amenities provided. Such items must be specifically identified in the budget and estimated as additional expenses. Budgeted expenses should include sufficient detail to enable the Department to evaluate the appropriateness of line items, including proposed staff positions and payroll costs.

Applicants who propose operating expenses less than those published annually in the QAP must provide a detailed explanation of proposed operating expenses and the basis upon which each item was estimated (e.g., other similar projects operated by the applicant, market study, appraisal, third party management company estimate, etc.) At the Department's discretion, and to the extent that the permanent lender(s) and/or equity investor is in place and present evidence to the Department that they have agreed to lesser operating expenses, the operating expenses required by this subsection may be reduced by up to 10%.

- Replacement Reserves:

All rehabilitation projects must obtain a capital needs assessment and reserve study prepared by a qualified, licensed third party property inspector. Replacement reserves must demonstrate sustainability of the property for a minimum of 26 years.

Special Needs Projects

- Income and Operating Expenses

  Given the economic instability of the populations served by Special Needs Housing projects, and therefore, the reduction or unavailability of rental income, the Department requires an Operating Budget that fully itemizes expenses and income to operate the property and to provide support services as required of all Special Needs Housing applications.

- Replacement Reserves:

  All rehabilitation projects must obtain a capital needs assessment and reserve study prepared by a qualified, licensed third party property inspector. Replacement reserves must demonstrate sustainability of the property for a minimum of 26 years.
  Operating Reserves:

  An operating reserve equal to six months of operating expense, replacement reserve, and mandatory debt service payments shall be capitalized in the development cost budget. This reserve must remain with the project until such time as the demonstrated DSCR for a continuous 24 month period is at least 1.35. Thereafter, upon the owner’s request and Department approval, the reserve may be distributed as surplus cash (and will potentially be subject to sharing with the Department if the project utilizes a surplus cash flow loan.) For projects deemed high risk, the City may impose restricted access to reserves on an “annual only basis” after receipt and review by the City’s loan servicing administrator of the project’s required Annual Cash Flow Analysis Report.

  Applicable to All Applicants

- Budget Trending Assumptions:

  Out-year calculations shall utilize a 2.5% increase in gross income and a 3.5% increase in operating expenses (including taxes and replacement reserves). Applicants may use more conservative trending assumptions (i.e., a wider spread between income and expense trending rates) if these are warranted for a particular project.

- Debt Service Coverage Ratios:

  - All debt service with required fixed periodic payments (“Hard Debt”) (other than City Cash Flow loans), regardless of lien position, must be included in the calculation of DSCR.
  - To assure that the Department loan is the minimum amount required to make the Project feasible, projected DSCR may not exceed 1.15 unless approved by the Department due to unique circumstances (such as small project size, unreliable rental subsidies, etc.) If projected DSCR will exceed this limit, the City’s loan will be reduced accordingly.