

# HOME-ARP NCS Due Diligence Guidelines

HUD Notice CPD-21-10 establishes the requirements for funding of a Non-Congregate Shelter (NCS).

HOME-ARP NCS projects must meet program requirements for the restricted use period of 10-15 years, depending on the type of project. Section VI.E.6 establishes the due diligence requirements for funding an NCS project. HUD has labeled the requirements as “due diligence” rather than underwriting since NCS projects do not have operating revenue but rely on grants and other public sources to cover operating costs and consequently financial viability cannot be determined by typical operating proforma. Nevertheless, BHP must determine that NCS acquisition and/or development is financially feasible, including whether the HOME-ARP NCS project has secured or has a high likelihood of securing operating funding (operating costs cannot be paid with HOME-ARP.)

Pursuant to the Notice and 24 CFR Part 92, an NCS developer/owner must submit, and BHP must review:

- Evidence of appropriate skills and experience related to the development of shelters or similar facilities.
- Evidence of prior experience with operating shelters.
- An acquisition or development budget, timeline, and sources and uses statement for the acquisition and/or development of the project be submitted for review; and
- A proposed operating budget, including secured sources for operating costs and any operating gap that will require additional assistance. If there is a gap in the operating budget, the owner must submit a plan for securing additional private, local, state, or Federal funding sufficient for successful operation of the project. The plan must be acceptable to and approved by BHP.

BHP reserves the right to deviate from these guidelines when it is deemed appropriate to warrant taking on higher risk to carry out affordable housing projects that will achieve Program goals or to decline assistance to projects with unacceptable overall risk levels.

BHP reserves the right to request clarification or supplemental information from the applicant to make the threshold determination and may make adjustments to the proposed project to align with these requirements but will determine a project that cannot meet these threshold requirements to be ineligible for HOME-ARP funding.

# 1 Threshold Review of Regulatory Requirements

Prior to conducting the underwriting analysis, BHP will evaluate the project to ensure it meets all regulatory requirements, including but not limited to the following minimum requirements.

- The developer/owner has prior experience related to the development and operation of shelters or similar homeless facilities.
- The HOME-ARP funds will be expended, and the project is expected to be completed in compliance with the following program deadlines:
  - Construction or rehabilitation is expected to begin within twelve (12) months of commitment.
  - The project must be completed within four (4) years of commitment (BHP policy is for three-year contracts);
  - If Acquisition-only, the project will begin operation within six (6) months of acquisition; if development, the project will begin operation within six (6) months of development phase project completion; and
  - Notwithstanding all other deadlines, all HOME-ARP project funds must be expended prior to 9/30/2030.
- Projects will meet the applicable property standards defined in CPD Notice 21-10, VI.E.7, including all applicable local codes, zoning and ordinances, and the Lead Safe Housing Rule at 24 CFR Part 35. The NCS units will meet the following:
  - Will provide each individual or family with an acceptable, individual room to sleep which includes adequate space and security for themselves and their belongings.
  - Will have a natural or mechanical means of ventilation.
  - Will have in-unit sanitary facilities that are in proper operating condition and are adequate for personal cleanliness and the disposal of human waste;
  - Will provide for necessary heating/cooling.
  - Will have adequate natural or artificial illumination to permit normal indoor activities and support health and safety, and will have sufficient electrical sources to permit the safe use of electrical appliances; and
  - Will provide one working smoke detector and one working carbon monoxide detector in each unit, plus a second means of exiting the building.
- NCS units will only be occupied by individuals or families that meet the criteria for one or more of the Qualifying Populations during the restricted use period as defined in CPD Notice 21-10, Section IV.A, and must be open to all 4 QPs.

- The NCS will be used as a HOME-ARP NCS or as emergency shelter under ESG for the restricted use period of 15 years if new construction or 10 years if rehabilitation or acquisition.

## 2 Non-Congregate Shelter Projects – Due Diligence

If the project appears to comply with program requirements based on the Threshold Review, and Due Diligence Review will be conducted by BHP staff as described below and documented by the attached signed and dated checklist (plus the Cost Allocation and Subsidy Layering tabs that are part of the Development and Operating Budget Excel Workbook submitted by applicants.

### 2.1 Market Assessment

Given the restriction on occupancy to the 4 Qualifying Populations, general market studies are not required. Instead, applicants must demonstrate adequate need for the proposed units.

Needs assessments should focus on the segments of the population that meet the QP definition, and the availability of shelter and other housing facilities to serve QPs and that gaps that exist to serve the populations. Assessments for projects serving the Qualifying Populations should rely on primary data and secondary from service providers whose existing client base will form the primary pool of potential tenants.

### 2.2 Owner/Developer and Development Team Assessment

The development team can include the owner, the developer (if different), architect, contractor, service provider(s) and any other corporate entities and individuals that will be actively involved in the development of the NCS property. BHP will consider specific skills and experience with development, including but not limited to property management, asset management, public financing, and service provision, including:

1. Past experience with development and management of shelters and other housing serving the homeless.
2. The presence of adequate staff with specific skills and experience appropriate to their roles in the project; and
3. The financial capacity of the owner/developer to meet its financial obligations and risks of the project.

#### 2.2.1 Experience and Capacity

Owners/Developers should have relevant experience with operating shelters and providing services to the homeless population. Active involvement in the CoC is required. Experienced with successful HMIS data collection and reporting is also required.

The development team must have the skills and expertise necessary to successfully complete and operate the development. BHP will examine whether the team members have worked together successfully in the past. BHP will also consider prior experience with the development team. In no case may any member of the development team be a suspended, debarred, or otherwise excluded party.

BHP will review the collective experience and capacity of the development team including, but not limited to, the general contractor, architect, engineer, market analyst, management company or property manager, accountant, attorney, and any other specialized professionals or consultants, *and* the individual experience of team members.

Service providers (whether the owner/developer or a team member) should have relevant experience in providing assessments, referrals, and case management services specifically targeted to people who are homeless.

To evaluate the owner/developer and development team, BHP will review resumes and references of the owner/developer and development team, past experience with BHP projects and funding, and other relevant experience.

## 2.2.2 Financial Capacity

HOME-ARP provides funds on a cost-reimbursement basis. Owner/Developers must demonstrate financial capacity to support the proposed project during construction, lease-up, and ongoing operations. BHP will not fund a project where cash needs exceed the developer's net or liquid assets.

BHP will identify financial capacity risks by reviewing available documents, including:

- The applicant's most recent audit, if available, or income and expense statements and balance sheets for the two previous fiscal years.
- Current fiscal year-to-date income and expense statement;
- Current balance sheet showing all assets and liabilities, including contingent liabilities (e.g., construction loans or operating deficit guarantees);
- Any litigation, pending judgments, bankruptcies with the past seven years that apply to the applicant, any principals or officers, or any affiliated entities.

BHP will review the submitted documentation to determine:

- If the financial management system complies with Generally Accepted Accounting Principles.

- If there are any material weaknesses in the entity's financial management system or internal controls.
- If the developer is a nonprofit organization, it meets the financial accountability standards of 2 CFR 200.302-.303 regarding financial management and internal controls; and
- That sufficient financial resources are available to cover any shortfalls during both the construction and operating periods, except for any shortfall that is planned for funding with HOME-ARP operating cost assistance.

### **2.2.3 Disqualification**

BHP may disqualify an application or require replacement of a development team member based on substantive evidence of any of the following:

- Making a misrepresentation or providing materially false information in an application;
- Having been found to be directly or indirectly responsible for any other project within the past five (5) years in which there is or was uncorrected noncompliance with state or federal rules, regulations or standards; or
- Being debarred, suspended, or otherwise excluded from any federal contract.

## **2.3 Project Assessment**

To identify project risks, BHP will evaluate the development budget (hereafter referred to as the Sources and Uses), commitment of other funds, the development schedule, projected operating budget and ongoing operating assumptions, and projected profit and returns to the developer.

### **2.3.1 Sources and Uses**

BHP will review the sources and uses of the development budget, the development timeline and supporting documentation. Sources and uses will be reviewed to ensure the following:

Sources:

- Total funding sources are adequate and timely in their availability to cover development costs at all phases of the project.
- All funds are firmly committed to the project or are contingent only upon the receipt of program funds and environmental clearance.
- No other funding sources have requirements that conflict with BHP funding source requirements, and any conditions of other funding sources will not have a negative impact on project feasibility and/or viability; and

- The total amount of program funds requested is reasonable and necessary considering all funding available to the project (subsidy layering review).

Uses:

- Development costs, including those paid with other sources, are reasonable, necessary, and customary, both on a line item and total project basis.
- Acquisition costs, if applicable, do not exceed the as-is market value of the property based on the submitted appraisal, plus documented closing costs.
- The construction costs and construction contingency are reasonable and necessary to meet the physical standards established in Notice Section VI.E.7;
- Reasonable and necessary soft costs are identified in 24 CFR 92.206(d), except affirmative marketing to prospective tenants is not eligible.
- The costs associated with cross-cutting regulation (environmental review, URA, Davis-Bacon) compliance are reflected in the budget, to the extent they apply; and
- Developer fees or costs are reasonable.
- Replacement reserves are eligible only for rehabilitation projects. Costs to capitalize a replacement reserve to pay the reasonable and necessary costs of replacing major systems and their components whose useful life will end during the restricted use period. Major systems include structural support, roofing, cladding, and weatherproofing, plumbing, electrical and HVAC. The costs of replacing major systems must be determined through a Capital Needs Assessment. The costs of a replacement reserve must be included in the project budget in the written agreement and are subject to the return provisions of Section VI.E.10 at the end of the Restricted Use Period.

Ineligible costs that cannot be funded with HOME-ARP but must be supported in other ways within the applicant's operating budget include:

- An initial operating deficit reserve and/or a capitalized operating reserve are not eligible to be funded with HOME-ARP funds.
- NCS operations and supportive services but other funding sources must be identified in the Lead Applicant's operating budget to be reasonably expected to support NCS operations and supportive services funding during the Restricted Use Period.
- Costs to convert NCS units following the minimum use period but within the Restricted Use Period, if indicated, must be supported by other funding sources and identified in the proposal and budget.

### **2.3.2 Project Schedule**

Project schedules should be consistent with the program deadlines listed above under threshold requirements.

In addition, the following will be considered in the assessment of whether project readiness is sufficient to support the proposed schedule:

- All other Sources are firmly committed or reasonably expected to be firmly committed.
- Site control is sufficient to ensure timely availability of the property for development.
- Plans and specifications are sufficiently developed to produce reliable cost estimates, to support obtaining building permits to meet project start.
- Development team members, including the contractor, have been identified or the process for solicitation has been identified in the schedule; and
- Marketing and management have been identified to initiate marketing, tenant selection and rent-up in a timely manner.

### **2.3.3 Operating Budget**

A long-term operating proforma is not required, but an estimated operating budget must be included. Sources of funding must be identified and reasonably expected (if not committed) for the operation of the NCS and supportive services. Sources should be reasonably expected for the Restricted Use Period.

BHP will review the operating budget for the following:

- Sources of funds that are sufficient for operations have been identified; committed funds are expected but not required.
- Operating costs are reasonable to operate the project and maintain property standards throughout the Restricted Use Period.

If the project is proposed to be converted after the Minimum Use Period but before the expiration of the Restricted Use Period, the conversion must meet the requirements of Section VI.E.11.

The HOME-ARP Program permits the funding of one or more units in a project, including mixed-income and mixed-use properties, but HOME-ARP funds may only be used to pay eligible costs for HOME-ARP-assisted units.

Only the actual HOME-ARP-eligible development costs of assisted units may be charged to the HOME-ARP funding. Cost allocation is required in a mixed-use or mixed-income property to

determine which units at a minimum must be considered assisted. Unlike HOME and HTF, there is no maximum subsidy limit for HOME-ARP rental projects.

Note: Whether HOME-ARP units are fixed or floating can affect the cost allocation.

If the project will have less than 100% of the units as assisted, or if the property involves non-residential uses, cost allocation will be conducted as part of project underwriting to determine or verify the amount of funding and the number of assisted units before a HOME/HOME-ARP/HTF commitment can be finalized. Even if all units and space can be considered assisted, the cost allocation step is necessary to compare HOME/HOME-ARP HTF assistance to the minimum (\$1,000) and the HOME/HTF maximum subsidy limits.

## 2.4 Cost Allocation

Cost allocation is required when a project is not 100% devoted to the target housing. In most NCS projects, this may occur if there is service or other non-shelter space that needs to be excluded, and/or when there are costs that are ineligible to be reimbursed with HOME-ARP.

HOME-ARP does not have Maximum Subsidy limit, but eligible costs of the NCS unit and supporting facilities must be determined as a ceiling for the HOME-ARP investment.

The Cost Allocation is in Tab 4 of the Excel workbook provided to applicants. This Tab will be completed by BHP staff.

## 2.5 Subsidy Layering and Terms of Investment

Subsidy layering analysis is conducted to ensure that the amount of HOME-ARP funding, in consideration of all other public funding, is necessary to provide safe, decent and affordable housing for the required minimum compliance period.

Subsidy layering applies the same as rental housing, but it is assumed that the terms of investment will be non-amortizing deferred loans for the Restricted Use Period.

If the subsidy layering analysis reveals that available sources exceed the uses, BHP may reduce the amount of HOME-ARP funding, and/or may increase the number of HOME-ARP units.

BHP will not make a firm commitment of funds to any project that does not evidence all financing sources are in place to complete and operate the project. When all financing sources are not in place to complete and operate the project, BHP may make a conditional commitment of funds to a project.

The Subsidy Layering Certification is in Tab 5 of the Excel workbook provided to applicants. This Tab will be completed by BHP staff.

**HOME-ARP Non-Congregate SHELTER PROJECT**  
**DUE DILIGENCE REVIEW**

**(INSERT PROJECT NAME/ADDRESS)**

<b>Preliminary Review</b>	<input type="checkbox"/>
<b>Final Due Diligence Review</b>	<input type="checkbox"/>
<b>Completed by:</b>	<b>Date:</b>
<b>Market assessment</b>	<b>Notes</b>
Data was provided and supports adequate demand	<input type="checkbox"/>
<b>Developer experience &amp; financial capacity assessment</b>	<b>Notes</b>
Owner/Developer: <ul style="list-style-type: none"> <li><input type="radio"/> Has experience and capacity to oversee development</li> <li><input type="radio"/> Has financial liquidity &amp; resources to complete the project</li> <li><input type="radio"/> Has adequate financial management systems in place</li> <li><input type="radio"/> Has expertise to operate shelter</li> </ul>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>
<b>Project assessment</b>	<b>Notes</b>
Readiness: applicant has following in place & is able to begin construction within 12 mos.: <ul style="list-style-type: none"> <li><input type="radio"/> Ownership or site control</li> <li><input type="radio"/> Local approvals (zoning, building)</li> <li><input type="radio"/> If pre-1978 rehab, LBP risk assessment conducted</li> <li><input type="radio"/> Plans and specifications completed</li> <li><input type="radio"/> Construction bidding/contract</li> <li><input type="radio"/> Firm funding commitments</li> </ul>	<input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>

Environmental review: 1 of the following:	<input type="checkbox"/>	
o Environmental review to be done	<input type="checkbox"/>	
o Project assessment information received / environmental review in process	<input type="checkbox"/>	
o Environmental review completed / release of funds received	<input type="checkbox"/>	
<b>Sources</b>	<input type="checkbox"/>	
o Sources adequate to cover uses	<input type="checkbox"/>	
o Written commitments provided for all other development financing	<input type="checkbox"/>	
<b>Uses</b>	<input type="checkbox"/>	
o Costs are fully budgeted and complete	<input type="checkbox"/>	
o All costs are reasonable & necessary	<input type="checkbox"/>	
o Contingencies are reasonable	<input type="checkbox"/>	
<b>Acquisition cost is reasonable</b>	<input type="checkbox"/>	
<b>Construction scope &amp; costs sufficient to comply with:</b>	<input type="checkbox"/>	
o Program property standards	<input type="checkbox"/>	
o If 5+ new or 15+ substantial rehab units, Section 504 accessible units	<input type="checkbox"/>	
o If 12+ HOME-ARP units, Davis-Bacon	<input type="checkbox"/>	
o If pre-1978 structure, LBP costs	<input type="checkbox"/>	
o If rehab, useful life (if repl reserve, CNA)	<input type="checkbox"/>	
<b>Construction/rehabilitation costs are supported and reasonable</b>	<input type="checkbox"/>	
<b>Soft costs</b>	<input type="checkbox"/>	
o Soft costs are complete & reasonable	<input type="checkbox"/>	
o Marketing expenses are adequate	<input type="checkbox"/>	
o Developer fees (and related party fees) are appropriate and not excessive	<input type="checkbox"/>	
<b>NCS units – All HOME assisted units will serve QPs</b>	<input type="checkbox"/>	
<b>Operating sources &amp; expenses</b>	<input type="checkbox"/>	
o Sources are reasonable & sufficient to cover operations	<input type="checkbox"/>	
o Operating expenses are reasonable	<input type="checkbox"/>	

Restricted Use Period viability – Owner and sources likely to sustain project for Restricted Use Period	<input type="checkbox"/>	
○ Conversion during RUP is proposed and funded	<input type="checkbox"/>	
<b>Cost Allocation</b>		<b>Notes</b>
Cost allocation (calculations attached)		
○ HOME-ARP funds are for eligible costs and within limits	<input type="checkbox"/>	
<b>Subsidy Layering</b>		<b>Notes</b>
Subsidy layering – either:		
○ Other public sources reviewed and comply with subsidy layering guidelines (Attachment 2)	<input type="checkbox"/>	
○ No other public subsidies are required	<input type="checkbox"/>	