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MassHousing's Procedures for **Monitoring and Reporting Developer's Contributions** **and Guaranteed Annual Payments**

As part of the underwriting process, developers would sometimes contractually commit additional contributions to the funds flow of a development so that the financial feasibility of a project could be enhanced. These contributions allowed for a larger mortgage and syndication raise, while maintaining a debt service coverage ratio of 110 percent. Developer's contributions may take any of the following forms:

- (1) HODAG/ARP's
- (2) Direct Cash Investments
- (3) "Cliff" Type Investments
- (4) Commercial Lease Income Guarantees

(1) HODAG/ARP's

Cities and towns in the Commonwealth of Massachusetts made loans to developers by utilizing H.U.D. funds under the Housing Development Action Grant (HODAG) program. The loans are administered by the cities and towns, are interest bearing, and are due on the sale or refinancing of the project. Most developers utilized these loans to pay for part of the cost of construction. A few developers choose to have all or part of the proceeds of these loans used for the purchase of long-term investment programs/annuities (ARP's) to enhance the funds flow of the development. Because of these actions, the development could support a larger mortgage or cover the expenses of additional project costs.

Essentially, there were two types of long-term investment programs/annuities that were utilized. One preserved the principal, while generating a stream of interest income. The second provided for a larger stream of payments that incorporated both a reduction in principal and an interest income component. Under the second alternative, the principal balance is extinguished over the life of the long-term investment/annuity.

If the long-term investment/annuity is under the control of the developer, the HODAG/ARP's section of the F.C.-7 form must be completed to compare the contractual requirement versus the actual contribution to the funds flow of the development. The actual payment should be shown on line #15. B of the F.C.-1. Of concern to the Agency will be whether the remaining long-term investments/annuities are able to generate the expected contributions to the funds flow of the development. Should the Agency decide that the remaining principal has been impaired, to the extent that the owner can not fulfill the contractual requirements of the underwriting, the owner will be required to make additional contributions to adequately fund the investment/annuity programs.

If the long-term investment program/annuity is under the control of the city or town, the amount received annually by the development (which is technically a loan like SHARP) should be shown as a component of Line #14.C of the F.C.-1 form, as part of RDAL/Other Subsidy.

(2) Direct Cash Investments

Direct cash investments may take several different forms. In certain more formal arrangements, the owner is under an obligation to the Agency to make annual cash contributions to the development, up to a specified amount, to assure the financial feasibility of the project. The annual contribution was stipulated in the pro forma financial projection for the development that was part of the original underwriting. To assure that the contribution would be made, the owner had to furnish to the Agency an unconditional, irrevocable, letter-of-credit (Developer's Contribution Letter-of-Credit) which obligates the issuer to pay the Agency such sum as the Agency may from time to time demand in writing. Likewise, the Development Fund Agreement may have required the owner to make cash advances to the project to fund operating deficits (i.e. Operating Deficit Guarantees) up to a stipulated amount.

Other arrangements may be somewhat less formal. For example, owners may make voluntary cash contributions to the funds flow of a project or may impute a cash contribution when they defer the receipt of a portion of the development fee earned, until the time of the sale or refinancing of the development. Owners may also be considered to have made voluntary cash contributions when they permit their Operating Letter-of-Credit to be reduced to make debt service or escrow payments.

(3) "Cliff" Type Investments

Because of the expiration of SHARP subsidy after the 15th year ("Cliff"), developers were at times required to fund the shortfalls necessary to preserve the financial feasibility of the project for the years between 16 and 20. To provide enough subsidy to cover these years, developers purchased zero coupon bonds that had a value at maturity equivalent to the shortfall to be funded. If the organization issuing the zero-coupon bond were to become insolvent, the Agency would expect the owner to fund any deficiencies in the terminal value of the investment.

(4) Commercial Lease Income Guarantees

For projects that have commercial space, developers typically guaranteed, as part of the underwriting, that any shortfalls in anticipated Gross Potential Commercial Lease Income, resulting from market conditions, would be absorbed through a Commercial Lease Income Guarantee. The guarantees typically committed the developer to fund a fixed level of commercial lease income or to absorb any operating deficits. Owners should anticipate that the Agency will seek full funding of these guarantees through additional payments to the funds flow of the development.

Since in all four types of developer's contributions and guaranteed annual payments the owner is obligated to contribute a defined sum to the funds flow of the project, Form F.C.-7 has been designed to monitor contractually required versus actual contributions/payments. The form is divided into two parts. Part I measures the difference between contractually required and actual contributions. Part II summarizes the actual contributions and their respective treatment on the Statement of Funds Flow Available for Equity (F.C.-1) and the Statement of Operations & Reconciliation to Form F.C.-1 (F.C.-2A & F.C.-2B). Nevertheless, the aggregate amount shown as the Developer's Contribution on Line #19 of the Form F. C.-1 may not exceed the amount the owner was contractually required to contribute during the calendar years.

The Agency will enforce the contractual requirements agreed to as part of the underwriting of the projects to preserve their financial feasibility. A hypothetical illustration has been added to assist in understanding how this form is to be completed.

This form must be completed by all developments with Commercial Lease Guarantees, as well as any other project for which this form may be applicable.

The Auditor for each development must review the calculations and provide appropriate assurances as part of the Report on Supplemental Information.