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Small Sites Program
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SMALL SITES PROGRAM UNDERWRITING GUIDELINES

The Small Sites Program (SSP) Underwriting Guidelines were approved by the San Francisco Citywide Affordable Housing Loan Committee on July 18, 2014 and revised by staff due to market conditions on June 1, 2015 and apply to all applications for Small Sites Program financing received. SSP applications will be reviewed in the order received and thoroughly underwritten according to these standards in order to determine the project and project team's eligibility for SSP funds.

I. SITE ELIGIBLITY/SELECTION

A. Building Type

1. 5-25 residential or mixed-use buildings are prioritized; buildings with fewer than 5 residential units will be considered on a case-by-case basis.
2. All residential units must meet the San Francisco Planning Department's definition of "dwelling unit" and fully conform with Planning Code requirements applicable to the site, including zoning, General Code compliance, and any relevant neighborhood plan controls.

B. Site Selection Criteria

Applications will be reviewed in the order received; however, in the instance where two applications are received within 30 days of each other and there are not sufficient SSP funds available to finance both projects, applications will be prioritized according to scoring criteria contained in the SSP Notice of Funding Availability (NOFA) according to the following priority characteristics:

1. Building is at immediate risk for Ellis Act eviction or in the process of an Ellis Act eviction
2. Building is located in a neighborhood with a high level of Ellis Act evictions
3. Existing residents include vulnerable populations: families with minor children, elderly, disabled and catastrophically-ill persons
4. Buildings housing residents with the lowest incomes (assuming other program criteria are met)
5. Buildings which require the lowest amount of subsidy per unit

II. GENERAL CITY FINANCING TERMS

A. Maximum City Subsidy

Maximum City subsidy including acquisition and rehab/permanent financing is $300,000 per unit.

B. Term

1. Loan Term: 30 years ("Loan Term")

2. Restriction Term:
   a) Declaration of Restrictions Term: For the life of the project, surviving expiration of the Loan Term and/or loan repayment
   b) Declaration of Restrictions must be recorded in first position
   c) All appraisals submitted with SSP applications must show both the fair market value and the value with regard to restrictions. It is expected that once restrictions are in place, all future appraisals and refinances will be based on the restricted value.

C. Loan Interest Rate

3% annual simple interest. Loan repayments shall be applied first to interest and second to principle. However, if, in any given year, an SSP building generates insufficient cash flow to repay all interest due, unpaid interest due for that year shall be forgiven.

D. Repayment

1. Full Loan Repayment: Loan to be repaid in full at conclusion of the Loan Term or upon any transfer of title that results in loss of affordability.
   a) Cash-out refinances are prohibited, except for the purpose of improving and rehabilitating the building, subject to MOHCD approval.
   b) MOHCD may extend the term of its loan at a refinance for the purpose of preserving affordability.
   c) Financing subordinate to the City's loans or lines of credit secured against the property are prohibited.

2. Residual Receipts:
   a) If replacement reserve balance is less than 1.5 times the original capitalized replacement reserve required in Section IV(B)(3), below: 1/3 of residual receipts may be retained by the project sponsor/owner and the remaining 2/3 must be deposited into the project's replacement reserve account.
   b) If replacement reserve balance exceeds 1.5 times the original capitalized replacement reserve required in Section IV(B)(3), below: 1/3 of residual receipts may be retained by the project sponsor/owner and the remaining 2/3 must be distributed to MOHCD for debt repayment.

E. Income and Rent Restrictions

1. At Acquisition:
   a) As an indication of general tenant approval of the proposed building purchase and the tenants' willingness to participate, a minimum of 75% of existing tenants must income certify for the building to be eligible for inclusion in the SSP. Up to 25% may be over income (above 120% AMI) or refuse to certify without rendering the property ineligible. Regardless of whether a unit's occupant(s) complete the income certification process or are over income at acquisition, all units must be restricted for the life of the project (see Section II(C)(2)(b) below).
   b) Average household income of a minimum of 75% of tenants must not exceed 80% of AMI at the time of acquisition. Project sponsors may include proposed rent levels for existing vacant units in this calculation.
   c) Existing tenant leases will be upheld at the then-current monthly rent level plus a 2% rent increase if the tenant's rent has not been increased within one year prior to acquisition unless such rent increase causes the household's rent to rise above 50% of its gross income, in which case Section II(E)(2)(e) applies. If the lease is within its initial one-year term or the tenant has experienced a rent increase within one year prior to acquisition, no rent increases will be applied until the expiration of such initial lease term or the one year anniversary for the most recent rent increase. The project sponsor must execute new leases with tenants and institute rent increases in conformance with Section II(E)(2)(c) below.
   d) If an existing tenant's household income is greater than or equal to 80% of state AMI, therefore rendering the unit ineligible for property tax exemption, and the rent paid by such household is

not adequate to cover the portion of property taxes assessed on the building that are attributable to that unit, then the pro rata share of the property tax assessment may be passed through to the tenant in the form of increased rent. Such rent increase may be phased in over time, but in no event may the property tax rent increase cause any household's rent to exceed 45% of its gross household income.

e) MOHCD policy for all units is that tenant households be housed in units with a bedroom count that matches household size. Following project rehabilitation, if SSP tenants are over-housed (i.e., residing in a unit with a bedroom count that exceeds the household size), the household's existing living arrangement will be allowed until such time that another appropriately sized unit in the building becomes available, at which time the tenant will be required to move into the appropriately-sized unit. Rent for that unit may decrease to reflect the smaller unit size, as appropriate. Building owners may request a hardship waiver from MOHCD if such a transfer is unduly burdensome to the tenant.

2. <u>Ongoing Affordability</u>:
   a) SSP buildings must achieve an average of 80% AMI <u>rents</u>, over time.
   b) At each vacancy, SSP building owners are required to ensure that the building works toward achieving its 80% AMI average rent by placing a new tenant in the vacant unit at the appropriate rate to bring the average closer to 80% (i.e. if a building's rents at acquisition average at 50% AMI, the next vacancy must be filled with a tenant at a higher rent level to bring up the average for the building). Vacant units may be rented up to a maximum of 120% AMI in order to achieve the required 80% AMI rent average.
   c) Rents must increase annually by the greater of 2% or the change in annual operating expenses, up to a maximum of 3.5%. If, in any given year, a Borrower requires a rent increase greater than 3.5% in order to maintain financial feasibility, Borrower may petition MOHCD for such an increase, which approval shall be subject to the Director's sole discretion and in compliance with MOHCD's loan documents.
   d) If a tenant's household income increases during tenancy to greater than or equal to 80% of AMI, therefore rendering the unit ineligible for property tax exemption, and the rent paid by such household is not adequate to cover the portion of property taxes assessed on the building that are attributable to that unit, then the pro rata share of the property tax assessment may be passed through to the tenant in the form of increased rent. Such rent increase may be phased in over time.
   e) If the owner's application of a rent increase in the manner described in this section results in any individual household's rent rising above 50% of that household's gross annual income (i.e., "severe rent burdening"), the owner may freeze the rent of the severely rent-burdened household for the year, provided that:
      1. The owner must demonstrate to the satisfaction of MOHCD that the property maintains short- and long-term financial sustainability in the form of positive cash flow, adequately funded reserves, and other indicators as MOHCD may reasonably request; and,
      2. At each annual income recertification, the ability of all households to pay required rent increases will be reassessed, as will the owner's requirement to demonstrate short- and long-term financial sustainability if the owner requests a continued rent freeze for any severely rent-burdened household.

f) Rents may increase no more than once per year, according to the inflation factor described above, regardless of whether the tenant is on a month-to-month lease.

g) If rents are increased above the 80% AMI average, all cash flow received as a result of such over payment will be due to MOHCD as loan repayments.

III. FIRST LOAN TERMS

A. Preferred Lenders

All SSP applicants must leverage City debt with a first mortgage. A list of preferred lenders who are familiar with the Small Sites Program is on MOHCD's website; however, applicants are free to select a lender who is not on the preferred lender list if the applicant is able to find better terms elsewhere. Applicants are subject to the underwriting requirements of the senior lender for approval of the first mortgage.

B. Suggested First Loan Terms

Understanding the need for a range of loan terms that are dependent on underwriting standards by outside lenders, MOHCD has established the following suggested loan terms for the SSP. While it is MOHCD's strong preference for SSP applicants to obtain loans with the combination of all terms listed, certain terms may be omitted or refined based on the senior lender's underwriting requirements and based upon whether the project includes commercial space. MOHCD's loan approval is subject to its review of all underlying third-party financing terms and determination that such terms are not in conflict with the terms of MOHCD's loan agreement and ancillary documents.

1. Acquisition loans that automatically convert to permanent with a 15-year minimum term
2. 30-year amortization schedule
3. 1.10 to 1.15 Debt Service Coverage Ratio
4. Nonrecourse to the borrower
5. Low interest rates
6. No more than 1.5% lender loan fees

IV. RESIDENTIAL DEVELOPMENT PROFORMA ASSUMPTIONS

A. Debt Service Coverage Ratio (DSCR)

1. Minimum: 1.10:1

2. Maximum: 1.20:1

3. Calculation Method: DSCR should be calculated after accounting for reserve deposits. DSCR should be calculated by dividing Net Operating Income (NOI), defined as revenue minus expenses minus replacement reserve deposits, by first mortgage payments (NOI/first mortgage payments) . The goal in all cases is to maximize the amount of leveraged debt.

B. Reserves

1. Capitalized Operating Reserves: 25% of budgeted 1st full year operating expenses (including hard debt service) in an interest-bearing account.

2. Operating Reserve Deposits: None unless balance drops below 25% of prior year's operating expenses (including hard debt service). Any such required payments would be made from cash flow that remains after all other required payments are made (e.g. hard debt service, other reserve payments, etc.).

3. Capitalized Replacement Reserves: The higher of $2,000 per unit or the amount necessary to pay replacement costs for the next 10 years, as specified in an approved CNA and taking into account any renovation achieved through the Small Sites Program that cannot be supported by replacement reserve deposits due to inadequate operating income. Replacement reserves must be deposited into an interest-bearing account.

4. Replacement Reserve Deposits: The higher of the amount needed according to an approved 20-year CNA or the amounts listed in the table below as permitted by available cash flow. May be updated every seven (7) years based on a revised CNA acceptable to the City. In addition to the deposits listed below, all property taxes that were included in the project's development budget and later refunded by the City's tax collector and 50% of the balance of unused construction contingency must be deposited into the project's replacement reserve account.

No. of Units	Replacement Reserve Deposits PUPY
<10	400
11-25	350

C. Fees

1. Developer Fee: A flat developer fee will be calculated as the sum of $75,000 for acquisition and $10,000 per unit for rehabilitation, if rehabilitation is applicable, up to a maximum of 5% of total development cost. If the project contains less than 5 residential units, the developer fee will be calculated as the sum of $15,000 per unit for acquisition and $5,000 per unit for rehabilitation, if rehabilitation is applicable, up to a maximum of 5% of total development cost. If the project's development budget is unable to support the level of developer fee indicated, the project sponsor may request that the remaining fee be deferred over a maximum 10-year period, payable after all other required expenses are paid but before the residual receipts split.

2. Asset Management Fee: Asset management fee to be calculated at $65 per unit per month with annual growth rate of 3.5%.

3. Property Management Fee: Maximum property management fee to be calculated at $65 per unit per month or the amount published by the U.S. Department of Housing and Urban Development Management Fee Schedule, as adjusted for specific project characteristics, whichever is greater. The property management fee shall increase at an annual growth rate of 3.5%.

D. Contingencies

1. Construction Contingency

- 15% of construction contract
- Purpose: Contingency for unforeseen conditions, minor errors and omissions. 50% of any contingency funds remaining after borrower's receipt of a certificate of completion from the San Francisco Building Department may be retained by the sponsor as an incentive fee. The remaining 50% must be deposited into borrower's replacement reserve account for the building, as described in Section IV(B)(4), above.

2. Soft Cost Contingency: 15% of soft costs, excluding developer and administrative fees, construction loan interest, and reserves for projects costing $5 million or more. Unspent funds allocated to soft costs shall return to MOHCD as excess proceeds.

V. RESIDENTIAL OPERATING PROFORMA ASSUMPTIONS

A. Vacancy Allowance:
- 5% of annual rent income

B. Increases in Gross Income
- 2.5% annually

C. Increases in Operating Expenses
- 3.5% annually

VI. OTHER UNDERWRITING GUIDELINES

A. Architect and Engineering Fees: If the scope of rehab requires architectural drawings (as opposed, e.g., to hiring a design/build contractor), then MOHCD's "Guidelines for Architect and Engineering Basic Services", attached hereto, shall apply. All architectural contracts should be full-service and include all design-related consultants, except for those excluded in MOHCD's Guidelines and specifically design/build consultants. They should also use standard AIA forms (or approved equivalent). Owner addenda are encouraged, including requiring the architect to design to a specified construction budget. Contracts should be signed as early in the process as possible, but no later than the completion of schematic design. Additional services will be allowed if there are significant changes in the A/E scope. Fees for Architecture/Engineering services should follow the schedule set forth in the Guidelines for Architect and Engineering Basic Services (Exhibit A).

B. General Contractor Fees/Price

1. Selection of contractor by RFP: When the developer selects a contractor through a negotiated bid process, the RFP should require competitive cost proposals that specify Overhead and Profit (OHP) percentages and General Conditions (GC) costs as separate line-items. Values for specific trade work, subcontractor work, and all other costs under the purview of the general contractor should be listed separately and exclude OHP and GC mark-ups. The fee is a criterion, but not the sole criterion for selection. Selection process and selection results must be approved by the City with respect to LBE participation, wage requirements and proposed contract price.

2. Overhead and Profit: These costs may not exceed 15% of the Contract Price.

3. General Conditions: These costs must be documented and reasonable given the conditions at the site.

4. Subcontractor Pricing: General contractors shall submit for the City's review a schedule of values that lists: 1) all proposed subcontractor pricing, without any general contractor markup; 2) clearly identified general contractor fees, as separate line-items, including overhead, profit, and general conditions; and 3) a final contract price. The City reserves the right to review all bids.

C. **Project Management Capacity**: Developer's project manager must have experience with at least one comparable, successfully completed project or be assisted by a consultant or other staff person with greater experience and adequate time to commit. When using a consultant, the consultant's resume should demonstrate that the consultant has successfully completed managing all aspects of at least two (2) comparable development projects in the recent past.

D. **Construction Management:** Developer must identify specific staff or consultant(s) who will provide construction management functions on behalf of the owner, including: permit applications and expediting, cost analysis, completion evaluations, change order evaluations, scope analysis and schedule analysis.

E. **Excess Proceeds:** Following issuance by the San Francisco Department of Building inspection of a Notice of Completion or similar document signifying full completion of the MOHCD-approved rehabilitation program, all MOHCD proceeds remaining after payment of all approved rehabilitation expenses shall return to MOHCD.

VII. EXCEPTIONS

MOHCD reserves the right to waive any portion of MOHCD's Small Sites Program Underwriting Guidelines, or to make exceptions on a case-by-case basis, for the purpose of preserving at-risk buildings as permanently affordable housing. Such waivers and/or exceptions shall be granted through the written approval of the Director of MOHCD, in his/her sole discretion, in consultation with the senior lender. Waivers and exceptions will not apply to the senior debt unless approved by the senior lender.