



## Loan Review Process and Underwriting Guidelines<sup>1</sup>

This document summarizes the Loan Review Process and Underwriting Guidelines for the San Luis Obispo County Housing Trust Fund (the “HTF”). Its purpose is to convey our current standards, process and practices to prospective borrowers and investors. It is neither comprehensive nor exhaustive and will evolve over time. In addition, there are more specific guidelines for our state LHTF and matching funds.<sup>2</sup>

The Loan Review Process describes the general steps that the HTF takes when working and communicating with prospective borrowers, reviewing applications and approving loans. The Underwriting Guidelines describe how we review and evaluate loan applications and the standards upon which we base our lending recommendations and decisions.

The process and guidelines described in this document are driven by the mission and values of the HTF. Our mission is to increase the supply of affordable housing for extremely low, very low, low and moderate income<sup>3</sup> residents of San Luis Obispo County, including households with special needs. This mission is served by providing financing for the development, preservation, improvement and acquisition of housing that will remain affordable for the longest possible time. In addition, forty percent (40%) of the HTF’s resources are committed to benefiting households with special needs<sup>4</sup>.

Our core values are Leadership, Partnership & Stewardship. We strive to be a leader in the affordable housing field in our community and state. We partner with others to create and preserve affordable housing within our community. We also act as a prudent steward of the resources that we receive and manage.

The HTF was created to provide an additional source of financing for affordable housing projects. We fill a niche between bank loans and government housing programs. It has always been our policy to cooperate with banks and other private lenders rather than compete with them. If a project can qualify for a bank loan, we believe that it should obtain bank financing. If the bank can only provide a portion of the needed financing, we should partner with the bank to make the full amount available.

While the HTF does not directly compete with banks, we are not a lender of last resort nor do we require rejection letters as part of our application package. When it appears that an applicant may qualify for bank financing, we will request that they approach a bank for financing. Rather than delay the project while the bank processes the loan, we can process it concurrently to help expedite the project.

### 1. Loan Review Process

Applications for financing from the HTF typically go through a four-step process that begins with an initial inquiry, which may be made by telephone, email or in person. If the proposed project meets basic eligibility and targeting criteria and sufficient funds are available or will be available, the HTF extends an invitation for a complete application. The next step in the process is for staff to review and underwrite the application package. This is followed by a review and consideration of the request by our loan committee, which is called the Commission.

<sup>1</sup> The latest version of these Guidelines are online at [www.sloctf.org/files/guidelines.pdf](http://www.sloctf.org/files/guidelines.pdf).

<sup>2</sup> The LHTF Program Guidelines are online at [www.sloctf.org/files/guidelines-lhtf.pdf](http://www.sloctf.org/files/guidelines-lhtf.pdf).

<sup>3</sup> Our various income limits are online at [www.sloctf.org/files/income-limits.pdf](http://www.sloctf.org/files/income-limits.pdf). They are generally updated annually.

<sup>4</sup> Our definition of “Households with Special Needs” is posted online at [www.sloctf.org/files/special-needs.pdf](http://www.sloctf.org/files/special-needs.pdf).

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The final step in the process is consideration by the HTF's Board of Directors. This process can take as little as one month or may take many months to complete.

### **1.1. Initial Inquiry**

Potential applicants are encouraged to call or write to the HTF's staff to describe their projects and discuss their financing needs. A meeting with staff may be arranged for a more extensive review. Staff may discuss prospective applications with the Commission and/or the Board for policy guidance and/or to discuss priorities for the use of available funds.

### **1.2. Staff Review**

When applications are submitted to the HTF, staff reviews, analyzes and underwrites the applications. Preliminary title reports, environmental reports, appraisals or indicators of value, and other third party reports may be ordered. Follow-up information and/or documentation is frequently requested from the applicant. After underwriting and determining that projects meet the HTF's requirements, staff prepares and submits written reports to the Commission. The staff reports describe the applicants and their projects, analyzes various risks and recommends loan terms and conditions.

### **1.3. Commission Review**

Staff makes formal presentations on applications to the Commission for their review and consideration. The Commission evaluates the applications and makes recommendations to the Board of Directors concerning action on the applications. The Commission includes representatives from local jurisdictions, the banking industry, and social service providers so applications are reviewed from multiple perspectives.

### **1.4. Board Approval**

Staff prepares formal reports for the Board of Directors that outline the Commission's considerations and recommendations on each application. Staff makes a presentation on the applications and Commission recommendations to the Board. The Board considers and makes the final decision regarding each application. The Board may concur with the recommendations of the Commission or may deny applications or approve them with different terms or conditions.

## **2. Underwriting Guidelines**

Underwriting is the process of evaluating whether 1) the request meets our eligibility and targeting requirements, 2) the project is viable, and 3) the loan should be recommended for approval. While the underwriting of single family home loans can be fairly simple and straightforward, the underwriting of affordable housing projects is more involved. These Guidelines include a chart that summarizes many of the standards that we will use in underwriting applications. This chart is followed by short discussions of these and other underwriting considerations.

The fiscal soundness and integrity of the HTF are dependent on the successful repayment of all of the loans that we make. Consequently, we tend to focus on the following three areas when underwriting a loan application:

- Whether the project will be completed successfully
- Whether our loan will be repaid on schedule
- Whether we have adequate loan collateral in case something goes wrong

To the greatest extent possible, the HTF relies on documents that are produced for other lenders or other purposes when underwriting a requested loan. Such documents may include, but not be limited to, application forms, budg-

ets and financial analyses, appraisals, environmental assessments, engineering reports, plans and specifications, market studies and financial statements. This should help streamline the process for the applicant and reduce the need for redundant “paperwork.”

**2.1. Underwriting Guidelines Table**

Eligible Borrowers:	Any legal entity including individuals, partnerships, corporations, public agencies or any combination thereof. <sup>5</sup>
Eligible Projects:	Affordable rental and ownership housing including transitional housing, mixed income developments and mixed use projects. Loans for emergency shelters will be considered if there is an acceptable source of repayment for the loan. <b>Note – the HTF does not offer financing for individual home owners or buyers.</b>
Eligible Use of Funds:	Project planning and predevelopment, site acquisition, site development, construction, rehabilitation, acquisition of existing units or to fill other financing gaps.
Income Targeting:	Extremely low, very low, low and moderate income households and/or households with special needs. <sup>6</sup>
Location of Project:	The HTF will only finance projects located in San Luis Obispo County.
Collateral Required:	Real Estate, including junior and subordinate liens. <sup>3</sup> (Other collateral may be considered on a case by case basis.)
Location of Collateral:	Negotiable.
Interest Rate:	5.0% to 7.0% The HTF Board reserves the right to charge higher or lower rates depending on the specific characteristics of the project and borrower. Higher interest rates will generally be charged for projects that serve higher income households and/or involve a higher degree of risk.
Loan Fees:	1.0% to 2.0% plus actual costs for loan documents, environmental, legal, appraisal and other fees or services.
Max. Loan to Value Ratio (LTV or CLTV):	80% to 100% (including any senior debt) depending on the specific characteristics of the project and borrower.
Maximum Loan Term:	Generally 5 years. Longer-term loans may be made on an exception basis.
Required Payments:	Borrowers generally pay at least interest monthly. An interest reserve can be considered.
Debt Coverage Ratio:	1:1 or higher. An interest rate reserve, interest deferrals or other revenues of the borrower may be used to satisfy this requirement.
Source(s) of Repayment:	Must be identified and may need to be committed.

**2.2. Waivers and Exceptions**

The Board may, at its sole discretion, approve a loan that does not conform with all of these underwriting guidelines if approving the loan benefits the community or HTF. Each loan request is evaluated on its own merits. The Board has the authority to approve a loan with one or more waivers and/or exceptions to these guidelines. The nature and extent of these waivers and/or exceptions may vary at the sole discretion of the Board. The following are specific waivers and/or exceptions that the Board has indicated it will consider.

**2.2.1. Extremely Low Income (ELI) Projects**

The state LHTF program requires that a very high percentage of the units assisted with LHTF and matching funds 1) serve households with extremely low incomes (ELI – up to 30% of the area median income) and 2) be deed

<sup>5</sup> The HTF cannot provide financing that is secured by owner-occupied homes.

<sup>6</sup> We have various sources of funds. Some have specific income targeting requirements. We will finance mixed income projects that include market rate units. See our income limits at [www.slocthf.org/files/income-limits.pdf](http://www.slocthf.org/files/income-limits.pdf).

restricted for at least 55 years. The Board will consider approving a limited number of loans for ELI projects with lower interest rates to help us meet this contractual requirement.

**2.2.2. Low Income Housing Tax Credit (LIHTC) Projects**

*Our Tax Credit Project loan product is currently suspended due to insufficient funding.*

**2.3. Loan/Lending Limits**

The HTF has adopted various per project and per borrower<sup>7</sup> loan limits for all of its loans. Per unit loan limits only apply for Tax Credit Project Loans. Aggregate lending limits apply for Tax Credit Project Loans and all loans with a term that exceeds five years. These limits are summarized below.

Loan/Lending Limit	All HTF Loans (Generally & In Total)	Longer-Term Loans (over 5 year term)	Tax Credit Project Loans
Per Unit:	Cost/value of assisted units	Same as HTF Loans	<i>Suspended</i>
Per Project:	\$2.0 million	\$600,000	<i>Suspended</i>
Per Borrower:	\$4.0 million <sup>8</sup>	\$1.2 million	<i>Suspended</i>
Aggregate Limit:	Available Loan Funds	\$3.5 million	<i>Suspended</i>

**2.4. Fair Housing and Discrimination**

The HTF is an equal opportunity lender. We affirmatively support State and Federal fair housing and anti-discrimination laws and expect our borrowers to do the same. When considering applications and approving loans, we do not discriminate against any protected class and will not provide financing to borrowers or for projects that discriminate in such a manner. The HTF offers financing for housing that is targeted for special needs populations or for specific income groups. While this housing is not available for the general public, the owners and sponsors of these projects may not unlawfully discriminate based upon race, ethnicity, religion, source of income or other factors.



**2.5. Borrower’s Capacity and Financial Strength**

The borrower’s capacity and financial strength are very important considerations when evaluating whether an affordable housing project will be successful. Ideally, the borrower should have experience successfully completing housing projects that are similar in type and scale. When borrowers do not have direct experience, the experience of their advisors and other team members will be considered. We may also consider training and related experience when evaluating the borrower’s capacity.

We review the borrower’s financial statements and/or tax filings for at least the past two years plus the current year to date to evaluate whether there is sufficient income, equity and cash flow to undertake, carry out and successfully complete the proposed project. Co-borrowers and guarantors will be considered in this evaluation.

**2.6. Project Evaluation**

We review and evaluate the project from a number of perspectives, including the following:

**2.6.1. Project Budgets and Financing**

We review and analyze the project’s pro-forma budgets to determine and evaluate the project’s development costs, operating income and expenses, and sales proceeds. We also review and confirm the financing commit-

<sup>7</sup> Loans to a single borrower or related entities.  
<sup>8</sup> Including Longer-Term Loans and Tax Credit Project Loans.

ments that the project has received. We generally condition our loans on the receipt of financing for the project's development phase. For rental housing, we also generally want the project to have commitments for the key sources of permanent financing.

**2.6.2. Development Approvals**

We review the development approvals that are necessary to complete the project and the project's current status in the development review and approval process to identify and evaluate risks that the project may not be approved or that the approvals will be delayed significantly. This review is facilitated when the applicant provides a clear timeline or schedule that clearly lists the public reviews and approvals that are needed to complete the project, the project's current status and the dates that reviews and approvals have been and will be received.

**2.6.3. Environmental Assessment**

Another thing that we request after we determine that a project is eligible for financing is an environmental assessment for the property that will be used as collateral for our loan. We want to be assured that the property does not have any environmental hazards. If the applicant does not provide an environmental assessment, we will order an Environmental Analysis from VERAcheck or comparable source at a cost of approximately \$150, which will be billed to the applicant. If additional assessments are recommended, we will consult with the applicant before ordering them. (Loans funded with government funds may have additional environmental requirements.)

**2.7. Sources of Repayment**

As noted above, we are concerned that the projects we finance will be able to repay our loans on schedule. During the term of our loan, we are concerned that the project or the borrower have sufficient income and cash flow to at least make interest payments on our loan. For development projects, we will consider financing an interest reserve so these payments can be made.

When our loan will be taken out by investors or permanent financing, we generally want commitments from the source of these funds. We will consider making loans without take out commitments for single family homes and small multifamily projects for which financing is readily available in the market.

**2.8. Loan Collateral**

The HTF is concerned that the properties that serve as collateral for our loans have sufficient value to support the loan. The collateral for most of our loans is not required to be the project that we are financing. We will consider other property when necessary and appropriate. We may lend up to 100% of the value of the collateral for our loan if 1) the project serves lower income households exclusively<sup>9</sup> and 2) there are sufficient indications that both the project will be completed successfully and our loan will be repaid on schedule. Our loan to value ratio will be reduced for projects that serve higher income households and have a greater degree of risk. We will subordinate our liens to other financing under acceptable terms and conditions.

**2.9. Appraisals or Indicators of Value**

The HTF will not always require an independent appraisal of the properties it finances or uses as loan collateral if there are other prudent ways to establish the value of these properties. We will always request copies of existing appraisals that are obtained by our applicants or other lenders. When an applicant provides an existing appraisal to support its application, the HTF may require updated or supplemental information. The HTF may also require a new appraisal of the property by an appraiser selected by the HTF.

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<sup>9</sup> Households that earn no more than 80% of the area median income as adjusted for household size – see our income limits at [www.sloctf.org/files/income-limits.pdf](http://www.sloctf.org/files/income-limits.pdf).

The HTF is more likely to require an independent appraisal for development or construction loans when the project being developed will be the collateral for the loan. The need for an appraisal is particularly critical for ownership projects given concerns about absorption rates, marketing time and costs, and changes in the availability and cost of single family home financing.

The HTF, at its sole discretion, will determine whether an existing appraisal, existing appraisal plus updates, independent new appraisal or other indication of value will be required for each application.

**2.10. Other**

The HTF reserves the right to review and consider other matters as part of the review, underwriting and approval of loan applications.

For additional information, please contact the HTF at:

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