



FEDERAL HOUSING FINANCE AGENCY
Division of Housing Mission and Goals

ADVISORY BULLETIN

AB-2024-05

**AFFORDABLE HOUSING PROGRAM:
DETERMINING THE NEED FOR AFFORDABLE HOUSING PROGRAM
SUBSIDY IN RENTAL PROJECTS**

October 31, 2024

Purpose

This Advisory Bulletin (AB) contains guidance to the Federal Home Loan Banks (FHLBanks) on determining the need for Affordable Housing Program (AHP) subsidy in rental projects, and related matters. This AB includes a Summary and Background, followed by a detailed discussion in the Guidance section.

Summary

- *Need for AHP Subsidy.* FHLBanks' need for AHP subsidy determinations are based on a rental project's development budget, as required by the AHP regulation (12 CFR 1291.24(a)(3)), and not on its operating pro forma.
- *Project Cost and Project Feasibility Guidelines.* FHLBanks must assess the reasonableness of rental project costs as reflected in a project's development budget, in accordance with the FHLBanks' project cost guidelines, as required by the AHP regulation (12 CFR 1291.24(a)(4)(i)(A)). The FHLBanks' project cost guidelines must enable the FHLBanks to determine that rental projects' development costs are reasonable. *Id.* FHLBanks must also assess rental projects' developmental and operational feasibility in accordance with the FHLBanks' project feasibility

guidelines, as required by the AHP regulation (12 CFR 1291.23(b)(1) and (2)). The project feasibility guidelines must support sound determinations that the project is likely to be completed and occupied and will operate in a financially sound manner. 12 CFR 1291.23(b). This AB provides guidance where FHLBanks establish guidelines that align with those of other affordable housing funders or FHLBanks, and that allow for exceptions to the guidelines for individual projects on a case-by-case basis.

- *Capitalized Reserves.* This AB provides clarification on determining the need for AHP subsidy when a rental project includes capitalized reserves and whether the capitalized reserve amounts are reasonable.
- *Supportive Services.* FHLBanks may determine, in their discretion, whether to require rental projects that provide supportive services to submit separate supportive services budgets, or to include the supportive services' sources of funds and expenses in the project's overall operating pro forma, in determining operational feasibility.

Background

Statutory and Regulatory Requirements

All AHP funds must be used for eligible projects and eligible uses, which are described generally in the Federal Home Loan Bank Act (Bank Act) and more specifically in the AHP regulation. 12 U.S.C. 1430(j)(1)-(2), 12 CFR 1291.23, 1291.24. This AB discusses the following four key related regulatory requirements:

- 1) **developmental feasibility:** FHLBanks must determine that a project is likely to be completed and occupied, as described in 12 CFR 1291.23(b)(1);
- 2) **operational feasibility:** FHLBanks must determine that a project must be able to operate in a financially sound manner, as described in 12 CFR 1291.23(b)(2);
- 3) **need for the AHP subsidy:** FHLBanks must determine the maximum amount of AHP subsidy a project may receive, which is the difference between the project's sources of funds (excluding AHP subsidy) and uses of funds, as described in 12 CFR 1291.24(a)(3); and
- 4) **project costs reasonableness:** FHLBanks must determine that a project's development costs are reasonable, as described in 12 CFR 1291.24(a)(4).

Eligible Projects (12 CFR 1291.23)

Project Feasibility Requirements. The AHP regulation requires that rental projects be both developmentally and operationally feasible. A rental project is considered *developmentally feasible* if the project is likely to be completed and occupied, based on relevant factors contained in the FHLBank's project feasibility guidelines, including the project development budget, market analysis, and the project sponsor's experience in providing the requested

assistance to households. 12 CFR 1291.23(b)(1). A rental project is considered *operationally feasible* if it is able to operate in a financially sound manner for the duration of the AHP 15-year retention period, in accordance with the FHLBank’s project feasibility guidelines, as projected in the project’s operating pro forma. 12 CFR 1291.23(b)(2).

Eligible Uses (12 CFR 1291.24)

Eligible Uses of AHP Subsidy – In the case of rental housing, AHP subsidy may only be used to fund the purchase, construction, or rehabilitation of the housing. 12 U.S.C. 1430(j)(2)(B); 12 CFR 1291.24(a)(2). As a result, AHP subsidy may not be used to pay for a project’s supportive services or capitalized reserves. 12 CFR 1291.24(b)(4).

Need for AHP Subsidy – The AHP regulation provides that a project’s estimated sources of funds must equal its estimated uses of funds, as reflected in the project’s development budget. The difference between the project’s sources of funds (excluding AHP subsidy) and uses of funds is the project’s need for AHP subsidy, which is the maximum amount of AHP subsidy the project may receive. 12 CFR 1291.24(a)(3)(i).

Reasonable Project Costs – The AHP regulation provides that project costs, as reflected in the project’s development budget, must be reasonable, in accordance with the FHLBank’s project cost guidelines, taking into consideration the geographic location of the project, development conditions, and other non-financial household or project characteristics. 12 CFR 1291.24(a)(4)(i)(A).

Timing of Eligibility Determinations

The AHP regulation provides that an FHLBank must assess and determine that the project meets the AHP eligibility requirements, including those described above, at the following key milestones in the application and development process: at the time of project application submission; prior to each disbursement of AHP subsidy to the approved project; and within a reasonable period of time after completion of the approved project. 12 CFR 1291.22(b)(1), 1291.30(c), and 1291.50(a)(2).

Historical Guidance; FHLBank and Stakeholder Input

FHFA has received input from FHLBanks and other stakeholders on the issues discussed in this AB, including, most recently, in response to FHFA’s *Request for Input: Federal Home Loan Bank Affordable Housing Program Competitive Application Process* (published on June 20, 2024). FHFA considered this input in developing the Guidance section below.

Need for AHP Subsidy Determination for Rental Projects. Longstanding practice has been for the FHLBanks to review a rental project’s development budget in conjunction with its operating pro forma when determining the project’s need for AHP subsidy. The purpose of

this review was to ensure that the AHP subsidy was being used for AHP-eligible uses (e.g., development costs and not supportive services or capital reserves) and that projects were not over-subsidized. While acknowledging the primary role of the FHLBanks' review of the development budget to confirm a funding gap between the sources and uses of funds, review of the operating pro forma was intended to assess the reasonableness of the projected cash flow and assess whether the project generated sufficient cash flow to support additional debt financing and, therefore, receive less or no AHP subsidy.

FHFA has considered input from the FHLBanks and stakeholders on the process for reviewing the need for AHP subsidy. Based on this input, FHFA developed the Guidance section below, in part to:

- provide consistency with the AHP regulatory language at 12 CFR 1291.24(a)(3)(i), which points to the review of a rental project's development budget and not its operating pro forma when determining its need for AHP subsidy;
- reduce unnecessary obstacles to effective implementation of the AHP, such as uncertainty about the AHP subsidy amount or amount of debt financing at later project stages; and
- recognize the potential benefits of positive cash flow that is unanticipated before project development, which can be used, for example, to lower the rents, augment reserves, pay for supportive services, pay down soft debt, invest in improvements to support increased resilience to natural disasters, or avoid deferred maintenance problems.

Capitalized Reserves in Rental Projects. FHFA has periodically raised questions with the FHLBanks about whether they should re-evaluate and reduce or recapture the amount of AHP subsidy approved for rental projects that have capitalized reserves that exceed the FHLBanks' guideline for such reserves, to ensure the need for the subsidy and that the subsidy was not being used for such reserves, which is an ineligible use of AHP subsidy (12 CFR 1291.24(b)(4)).

Stakeholders have emphasized the importance of capitalized reserves to the long-term operational feasibility of AHP projects and have expressed concerns that excessive FHLBank limitations on such reserves may jeopardize project viability or conflict with requirements of other funding sources in the project that mandate minimum levels of capitalized reserves. For example, Low-Income Housing Tax Credit (LIHTC) projects may require capitalized reserves designed to ensure project viability over their 15-year LIHTC compliance periods, which may result in capitalized reserves that exceed an FHLBank's project cost guideline. Stakeholders have further contended that if an FHLBank must re-evaluate the need for AHP subsidy based on the level of capitalized reserves, this may require the FHLBank to independently underwrite a project, which they believe is unnecessary and increases the burden on project sponsors in cases where other funding sources have already underwritten the project.

After considering this input in light of the requirement in the Bank Act that FHFA implement regulations that enable the FHLBanks to coordinate AHP activities with other federal or federally-subsidized affordable housing activities “to the maximum extent possible” (12 U.S.C. 1430(j)(9)(G)), FHFA is providing guidance on capitalized reserves, as further discussed in the Guidance section below.

Separate Supportive Services Budget for Rental Projects. Longstanding FHFA guidance has recommended that for AHP rental projects providing supportive services,¹ the projects submit separate supportive services budgets from their operating pro formas showing the sources and uses of funds for all supportive services activities. This was intended to help verify that the AHP subsidy was not being used for supportive services activities, an ineligible use of AHP subsidy (12 CFR 1291.24(b)(4)). FHLBanks and stakeholders have stated that the industry trend to provide supportive services in conjunction with affordable housing projects indicates that supportive services expenses are viewed as standard operating expenses and, therefore, should be treated as such and included in the overall operating pro forma. They have also noted that other funders do not require separate supportive services budgets. In addition, stakeholders have stated that the creation of an operating pro forma for housing and a separate one for supportive services could result in an inaccurate accounting of expenses.

In response to this input and to support streamlined AHP requirements and coordination with other federal or federally-subsidized affordable housing activities to the maximum extent possible, FHFA is updating its guidance on supportive services, as further discussed in the Guidance section below.

Guidance

Need for AHP Subsidy Determination for Rental Projects. In determining a rental project’s need for AHP subsidy, an FHLBank must review the project’s development budget, as required under 12 CFR 1291.24(a)(3), and not the project’s operating pro forma. The development budget is used to confirm the difference between the project’s sources of funds (excluding AHP subsidy) and uses of funds, which, as provided in 12 CFR 1291.24(a)(3)(i), is the maximum amount of AHP subsidy the project may receive. The FHLBank must, however, continue to review the operating pro forma to determine, under 12 CFR 1291.23(b)(2), whether it is consistent with the FHLBank’s project feasibility guidelines.

¹ Supportive services expenses do not include purchase, construction, or rehabilitation costs. Generally, these are expenses that help residents in a housing project obtain and maintain housing, such as counseling, referrals for government or community assistance, childcare, job training, or transportation. Supportive services are often present in housing projects serving the elderly, people experiencing homelessness, and other special needs populations.

Capitalized Reserves in Rental Project Development Budgets. Because the AHP regulation prohibits the use of AHP subsidy for capitalized reserves (12 CFR 1291.24(b)(4)), an FHLBank should confirm during its review of a rental project’s development budget that other sources are available to fund the capitalized reserves. An FHLBank’s project cost guidelines should reflect what the FHLBank has determined to be a reasonable maximum level for capitalized reserves. An FHLBank may adopt project cost guidelines that establish a generally applicable cap on the amount of capitalized reserves and sets standards for permitting a project to exceed the cap in cases the FHLBank considers to be reasonable (e.g., on a standing basis for a class of AHP projects or on a case-by-case basis as an exception for an individual project). Examples include: 1) permitting higher caps for a class of AHP projects where the affordability restrictions of another funder extend beyond the AHP 15-year retention period; 2) incorporating into the FHLBank’s guidelines a standard allowing higher capitalized reserves when required by another funder that is providing material financial assistance to the project; or 3) considering exceptions to the FHLBank’s guidelines on a case-by-case basis based on a review of the specific facts and circumstances of the particular project, such as for a project reserving a significant share of units to households at or below 30 percent of area median income.

If an FHLBank’s project cost guidelines permit higher capitalized reserves for a particular class of AHP projects, the guidelines should summarize the justification for the higher capitalized reserves. If an FHLBank is considering a case-by-case exception for a particular project whose capitalized reserves exceed the amount allowed by the FHLBank’s guidelines, the FHLBank should require that the project sponsor provide a written explanation for the project’s higher capitalized reserve amount. The project sponsor’s explanation, and the FHLBank’s justification for the higher capitalized reserves if the FHLBank grants an exception, should be retained in the FHLBank’s project file. If an FHLBank finds at project application submission, at AHP subsidy disbursement, or within a reasonable period of time after project completion, that a project’s capitalized reserves exceed the maximum level in the FHLBank’s guidelines and the FHLBank does not grant an exception to allow the higher capitalized reserves, the FHLBank must pursue appropriate remedial actions applicable to noncompliant projects, as described in the AHP regulation (12 CFR 1291.60).

Supportive Services in Rental Projects. Because the AHP regulation prohibits the use of AHP subsidy for supportive services (12 CFR 1291.24(b)(4)), an FHLBank should confirm during its review of operational feasibility of a rental project that other sources are available to fund the supportive services. The FHLBank may determine, in its discretion, whether to require rental projects with supportive services to include the sources to fund and expenses to provide these services in the project’s overall operating pro forma, or to submit a separate supportive services budget showing those sources of funds and expenses. The FHLBank may defer to project sponsors for determinations of supportive services operating expenses, as they are best positioned to assess those expenses.

Development and Implementation of Rental Project Feasibility Guidelines. Each FHLBank must adopt rental project feasibility guidelines that address developmental feasibility (whether a project is likely to be completed and occupied) and operational feasibility (whether a project is able to operate in a financially sound manner), as required under the AHP regulation (12 CFR 1291.23(b)(1), (b)(2)). Each FHLBank should periodically review and, when necessary, revise its project feasibility guidelines to support sound determinations of developmental and operational feasibility as described in the AHP regulation. An FHLBank's project feasibility guidelines should enable the use of AHP subsidy with other affordable housing funding sources, particularly federal or federally-subsidized sources, to the maximum extent possible (12 U.S.C. 1430(j)(9)(G)). Therefore, in developing its project feasibility guidelines, an FHLBank has the option to establish guidelines that generally align, in whole or in part, with those adopted by other affordable housing funders or FHLBanks when those guidelines will support sound determinations of project feasibility. This may be accomplished by including in the FHLBank's project feasibility guidelines a provision that enables the FHLBank to review the project's feasibility under the developmental and operational feasibility guidelines of a material funder of that project, provided that use of that funder's guidelines will support sound determinations of project feasibility. Alternatively, an FHLBank's project feasibility guidelines may allow for exceptions for individual projects on a case-by-case basis, as further discussed below.

An FHLBank should summarize the basis for its determination that its project feasibility guidelines will enable it to make sound determinations of developmental and operational feasibility consistent with the AHP regulatory requirements (12 CFR 1291.23(b)). This could be, for example, a description in the FHLBank's files, or in the guidelines themselves, of the source of the guidelines, their applicability to the types of projects that the FHLBank funds, and if based on another funder's guidelines, the relevant affordable housing expertise of that funder.

Development and Implementation of Rental Project Cost Guidelines. Each FHLBank must adopt rental project cost guidelines that enable the FHLBank to determine that AHP projects' development costs are reasonable, as required under the AHP regulation (12 CFR 1291.24(a)(4)(i)(A)). Each FHLBank should periodically review and, when necessary, revise its project cost guidelines to enable the FHLBank to make such determinations. An FHLBank's project cost guidelines should enable the use of AHP subsidy with other affordable housing funding sources, particularly federal or federally-subsidized sources, to the maximum extent possible (12 U.S.C. 1430(j)(9)(G)). Therefore, in developing its project cost guidelines, an FHLBank has the option to establish guidelines that generally align, in whole or in part, with those adopted by other affordable housing funders or FHLBanks when application of those guidelines will enable the FHLBank to determine that AHP projects' costs are reasonable. Using project cost guidelines developed by other affordable housing funders or FHLBanks may help to establish reasonable limits on common cost drivers in affordable housing projects; however, FHLBanks should consider that those other funders' or FHLBanks' project cost guidelines may not reflect or accommodate the needs of all projects

requesting AHP subsidy, or the unique geographic or cost considerations of the FHLBank's AHP and district.

Alignment with other funders' or FHLBanks' project cost guidelines may be accomplished by incorporating flexibility into the FHLBank's project cost guidelines, e.g., by adding a provision in the guidelines that permits the FHLBank to review an AHP project (or a class of AHP projects) under the project cost guidelines of a material funder of the project or a state housing finance agency, provided that use of those guidelines will enable the FHLBank to determine that AHP projects' costs are reasonable. Alternatively, an FHLBank's project cost guidelines may allow for exceptions for individual projects on a case-by-case basis, as further discussed below.

An FHLBank should summarize the basis for its determination that application of the FHLBank's project cost guidelines will enable the FHLBank to determine that AHP projects' costs are reasonable. This could be, for example, a description in the FHLBank's files, or in the guidelines themselves, of the source of the guidelines, their applicability to the types of projects that the FHLBank funds, and if based on another funder's guidelines, the relevant affordable housing expertise of that funder.

Exceptions to Rental Project Feasibility Guidelines or Rental Project Cost Guidelines. As stated above, an FHLBank's rental project feasibility guidelines and rental project cost guidelines may allow for exceptions to the guidelines for individual projects on a case-by-case basis. For example, an FHLBank may determine that an exception is appropriate for a particular project to address unique or special circumstances, extraordinary market conditions, or special community characteristics, or to better align with the guidelines of another funder of the project. If an FHLBank decides to adopt guidelines that allow for individual project exceptions, the FHLBank should develop and implement internal written policies and procedures for reviewing and granting such exceptions.

AHP Implementation Plan and Internal Written Policies and Procedures. An FHLBank's AHP Implementation Plan must include rental project feasibility guidelines and rental project cost guidelines that address and reflect the AHP regulatory requirements.² The guidelines should also reflect the guidance provided in this AB. In addition, an FHLBank should adopt internal written policies and procedures for the establishment of its project feasibility guidelines and project cost guidelines, review of projects' feasibility and costs, and consideration of exceptions to the guidelines. The written policies and procedures should establish how the FHLBank will analyze, document, and support its decisions, and should specify the FHLBank management and staff with the authority to approve decisions.

² The AHP regulation requires each FHLBank's board of directors to adopt an AHP Implementation Plan that contains "requirements for the General Fund" and "requirements for the Targeted Fund." These requirements for the two Funds include the project feasibility guidelines and project cost guidelines. 12 CFR 1291.13(b)(2)-(3), 1291.23(b), 1291.24(a)(4).

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