Affordable Housing Financing Fund

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ColoradoAffordableHousingFinancingFund.com

Proposition 123: Equity Program FAQs

The Equity program provides below-market-rate equity investments to eligible for-profit and nonprofit entities for the construction or preservation of low- and middle-income multifamily rental developments. A Tenant Equity Vehicle (TEV), funded through Proposition 123 program earnings, will be established by OEDIT, CHFA, and a third-party administrator to benefit the residents of developments that receive Equity financing.

Eligibility

Is the Equity program available to local governments or just for-profits and nonprofits?

The Equity program is available to local governments, tribal governments, housing authorities, for-profits, and nonprofit entities that are developing affordable housing.

Are there any restrictions on a project's ability to apply?

The jurisdiction in which the project is located must have completed a Proposition 123 Local Government Affordable Housing Commitment with the Colorado Division of Housing in order for the project to be eligible to apply for the Equity program. The opt-in has specific housing increase requirements that the jurisdiction must meet over a three-year period. More information about local commitment filings is available on the DOLA website at https://cdola.colorado.gov/prop123.

Will there be an opportunity to pair the Equity program with state or federal Housing Tax Credit equity?

No, the return structure is different for tax credits (credits and losses) than private equity (cash flow and sale/refinance returns), and the Equity program is structured more like a private equity investment.

Do developers need to have land acquisition in place before applying for the Equity program?

Yes, developers will need to have site control to apply.

Priorities

What are the priorities of the Equity program?

The statutory priorities outlined in the Proposition 123 statute are high-density housing, mixed-income housing, and projects consistent with the goal of environmental sustainability (the requirements for which are specified in the guidelines). Strategic policy priorities include shove-ready projects that result in new units (meaning projects must be ready to close within 12 months of the Equity award), use of Colorado manufactured modular/offsite building technology if it's reasonably cost-competitive with traditional construction methods, inclusion of home-based child care or commercial child care facilities, and geographic diversity (meaning equitable distribution of funds around the state). Please see the full program guidelines for strategic priorities specific to the latest funding round.

Affordability Requirements

Does every unit need to be 90 percent AMI?

No, the 90 percent AMI limit for projects is the average of all restricted units. Individual units may be more or less than 90 percent AMI. Additionally, projects may average below 90 percent AMI if they choose to do so to meet the housing need in their community.

Are market units or unrestricted units allowed in a project with the Equity program?

All units will be required to designate to a specific AMI for the jurisdiction in which the project is located, for purposes of calculating the 90 percent AMI average. "Market" units are allowed but must be designated to the AMI to which their rents are equivalent.

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Will a greater than a 90 percent AMI average be allowed?

Proposition 123 allows for Rural Resort Communities to petition the Colorado Division of Housing for policy flexibility to allow a project to serve households with higher incomes than would otherwise be allowable. More information is available on DOLA's website at https://cdola.colorado.gov/prop123.

Will there be a preference for projects serving lower AMIs?

No; however there is a preference for projects serving a mix of incomes. For instance, if presented with two otherwise identical projects, the project with units at 60 percent AMI, 80 percent AMI, and 100 percent AMI would be preferred over the project that had all units at 80 percent AMI.

Is there a specific difference between Option 1 and Option 2 in terms of AMI units?

No. In general, Option 1 projects are intended to be mission-driven investments with lower return expectations in exchange for deeper or longer-term affordability. We anticipate these projects will serve lower AMI households but there is no requirement for specific AMI designations. Option 2 is intended for market-driven investments focused on delivering middle-income units with higher return expectations than Option 1 but still below market. We expect these projects to serve slightly higher AMIs than Option 1 but, again, there are no specific AMI requirements other than the 90 percent or less average AMI of all restricted units.

Will mixed-income projects with retail be considered?

The Equity program is only available to fund residential unit costs. As long as the retail space is condominiumized and under a separate ownership entity with separate financing, this type of mixed-income project would be considered.

Returns

How are returns calculated on Sponsor Equity?

"Sponsor Equity" refers to all outside equity brought to the deal by the project sponsor. This equity may come from the sponsor itself, or one or more outside equity providers that the project sponsor has arranged. Returns on sponsor equity are calculated such that, each year until the targeted exit year, the outstanding amount of sponsor equity is multiplied by the preferred return rate specified by the sponsor in their application. If there is not sufficient annual cashflow to cover the amount of return calculated for that year, the return accrues into the principal amount until there is a capital event that pays off the entirety of the accrued value of the principal investment. An example calculation, which assumes a capital event in year 4, is below:

	Assumption	Year 1	Year 2	Year 3	Year 4
Sponsor Equity	$(4,500,000)	$(4,500,000)	$(4,889,199)	$(5,307,163)	$(5,756,624)
Return on Equity	10%	$(450,000)	$(488,920)	$(530,716)	$(575,662)
Return of Equity		$60,801	$70,956	$81,256	$6,332,286
End	$(4,500,000)	$(4,889,199)	$(5,307,163)	$(5,756,624)	$-

During application review, if there are not sufficient proceeds from an assumed capital event to repay the accrued amount, the deal will be restructured with a reduced preferred return to ensure there are sufficient proceeds.

If a project is placed into service and underperforms its underwriting, there will be no guarantee of the underwritten level of return. If a project is placed into service and meets or overperforms its underwriting, it is eligible for the promote structure incentive.

What is a "promote structure" and how does it work?

A promote structure is a type of financial incentive whereby project sponsors may participate in additional profit sharing if certain performance benchmarks are met. For the Equity program, Sponsor Equity may elect to receive up to 15 percent of remaining profit after the preferred return is met. For instance, if there is $1,000,000 in remaining profit after achieving the preferred return, the sponsor equity may receive an additional $150,000 payment from the promote structure. Any remaining profit is used to pay down the principal of the Equity investment and is reinvested in the following year's funding round.

Will it be possible that the Equity program is the only equity source in the project's capital stack?

Yes, particularly in smaller projects with fewer sources in the capital stack. In most cases, it is anticipated there will be private equity in addition to the Equity program.

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What does it mean to say that the Equity investment shall have a "pari-passu" cash flow and capital event participation rate commensurate with its equity share?

Pari-passu is a financial term that means "equal footing." In practice, what this means is that rather than there being two investors in a first or second position, they are in an equal priority position. Typically, this also means that the investors will agree on some set percentage sharing of cashflows and capital event proceeds.

Can the Equity program be used with other Proposition 123 funding sources, such as Concessionary Debt or Land Banking?

Yes, but more Proposition 123 sources in a project will likely make it less competitive if the demand for the Equity program exceeds the supply of funds.

Developer Fees

What are the developer fees based on?

The developer fee is calculated based on the total development costs, less investor costs and capitalized reserves.

Are there deferral options?

Yes, a sponsor may elect to defer their fee as a soft source or capital contribution.

Why aren't they higher, like in the 12 percent range in tax credit projects?

Returns on tax credit projects are typically generated from fees, annualized losses, and claiming credits against taxable income, whereas returns on market-rate transactions are typically less reliant on fees and more reliant on annual cash flow and proceeds from a capital event. The Equity program investments are structured more like market-rate transactions in this regard, so developer fees are lower.

The guidelines state the developer fee can be paid at permanent loan conversion. Can any developer fee be paid during construction?

The non-deferred developer fee will be paid in installments: 30 percent at construction, 60 percent at completion, and 10 percent at conversion.

Tenant Equity Vehicle

How does the Tenant Equity Vehicle (TEV) work with the Equity program?

Projects funded by the Equity program will be required to participate in a tenant equity program. The TEV is funded by the annual returns on the Equity program investment, and the interest from Concessionary Debt loans. Distributions from the TEV will then benefit the residents of Equity-financed properties with wealth-building opportunities or additional cash to pay for household needs.

Will program guidelines be developed for structuring and administering TEV programs?

Yes; the program will be administered at the portfolio level by CHFA, OEDIT, or another third-party administrator. Property managers will only be responsible for ensuring residents are aware of and sign up for the TEV program.

Compliance Requirements

Will these projects have compliance requirements similar to Housing Tax Credits?

The Equity program will have abbreviated compliance requirements in comparison to Housing Tax Credits. Income certifications will only be required at move-in, and tenant households can provide their own income documentation. Annual audited project financial reports will be required, and periodic physical inspections of the project will be made. More details about compliance will come at a later date.

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