Kentucky Neighborhood Stabilization Program
Programmatic Guidelines

January 7, 2013

A. PROGRAMMATIC GUIDELINES

The Kentucky Neighborhood Stabilization Program is comprised of three types of funding:

- $37,408,788 in NSP-1 funding that is authorized and governed by the requirements of the Housing and Economic Recovery Act Section 2301(c)(3), and in the NSP Substantial Amendment (as amended) of the Kentucky Consolidated Plan.

- An estimated $5 million that will be received through the generation of program income from activities funded under NSP-1 (NSP-1, Round II).

- An additional $5 million allocated to the Commonwealth through the Dodd-Frank Wall Street Reform Act, and implemented through ARRA requirements. Baseline requirements for these funds are contained in the state's NSP-3 action plan, as amended.

The authorizing legislation, respective action plans, and NSP guidance from the U.S. Department of Housing and Urban Development (HUD) will collectively guide this program. As additional guidance and/or clarification is received from HUD, the Commonwealth will institute those requirements, and disseminate that information to recipients.

In addition, the Commonwealth of Kentucky has instituted additional restrictions for the administration of the NSP projects as listed below:

B. GENERAL REQUIREMENTS

1. Unless otherwise specified in the subgrantee's funding agreement, all NSP program income must be returned to the Commonwealth of Kentucky.

2. Generally, NSP sub-recipients are restricted to a five (5) percent administrative fee. This fee is based on five (5) percent of the requested NSP project funds. Developers may be allocated a modest administrative fee at DLG's discretion; funds may only be used to enter into third-party administrative contracts with experienced and/or certified Community Development Block Grant administrators. No administrative funds may be retained by developers. The purpose of the allocation of administrative funds to developers is solely for the purpose of ensuring compliance with federal and

state NSP requirements, inclusive of the CDBG and HOME regulatory framework upon which NSP is based.

Developer fee is calculated as 8 percent of the NSP-funded development cost (including acquisition) for rehabilitation and 10 percent of the NSP-funded development cost, including acquisition, for new construction.

3. In some instances changes in federal lead-based paint, asbestos and similar requirements or other rehab-related issues, which could not be foreseen until after rehab began, can cause individual unit cost overruns. Sub-recipients (and in limited circumstances, developers) that experience cost overruns may request additional funding up to a maximum of 10% of the original allocation. These funds may not be used to produce new units. A written request should be sent to DLG identifying the cost overrun, reasons and the amount of additional funding required to complete the scope of work.

   - DLG will consider, on a case-by-case basis, providing sub-recipients an additional pro-rata allocation of administrative funds, not to exceed 5% of the amount of the approved increase.

   - Developers must document that items causing overruns could not be anticipated prior to initiation of rehab or new construction. If this cannot be done, generally, DLG will require overruns to be paid first from developer fee, and will then consider providing additional funding. DLG recognizes that in rare instances, unexpected circumstances may produce significant unforeseeable cost overruns. DLG will consider requests on a case-by-case basis, and may require some or all developer fee to be utilized to cover all or a portion of the cost overrun. Holding costs are not considered an eligible cost overrun as it is the developer's responsibility to ensure timely disposition of units.

4. All homebuyer and rental assisted units must adhere to the provision for long-term affordability restriction meeting *at least* the following requirements:

➢ < $15,000 per unit	5 years
➢ > $15,000 < $40,000 per unit	10 years
➢ > $40,000 per unit	15 years
➢ New construction or acquisition of new constructed units	20 years

Subgrantees have the flexibility to extend the term of the NSP assistance, lower NSP interest rates for amortizing loans to zero percent, etc., as needed to provide affordable financing for homeownership clients. Subgrantees should make reasonable effort to maximize the amount of amortizing (repaid) NSP funds provided to homebuyers.

5. For subordinate position non-amortizing forgivable deferred loans where the ***total*** NSP investment is $14,999 or less, the amount of the loan will be incrementally forgiven over five years. Should the homebuyer default on the first mortgage loan or sell the home within these five years the unforgiven amount is due immediately.

   For subordinate position non-amortizing forgivable deferred loans where the total NSP investment is $15,000 or more, the term of the forgivable loan will be the minimum statutory affordability period stated in 3 above.

6. Any property acquired under Activity C-Land Banking may not be held for more than ten (10) years past the initial date of acquisition.

7. KY NSP encourages green building, energy efficient design and renewable energy sources in all projects. The cost for certification under these programs is an eligible NSP expense. New construction and rehabilitation should incorporate green building, renewable energy sources and energy efficient components. All costs for green building design and certifications, renewable energy sources, and energy efficient design are eligible NSP expenses. Additional detail regarding construction requirements is contained within each agency's funding agreement.

C. HOMEBUYER ACTIVITIES

1. All homes must be sold for the lesser of the total development cost, excluding holding costs, or the post-construction appraised value. Where the appraised value is the lesser of the two, the home must be sold for the appraised value.

   Note: If the land is donated, the appraised or assessed value of the land must be considered as part of the total development cost.

2. Once construction or rehabilitation has been completed, a post-rehab appraisal must be performed and the appraisal report submitted to DLG **PRIOR** to entering into any contract with prospective homebuyers.

   Additionally, appraisals that are more than 60 days old, but less than 120 days old, may be updated by the initial appraiser (letter or other documentation is acceptable vs. a new appraisal report.) However, appraisals that are more than 120 days old must be re-done (completely new appraisal).

3. The maximum sales price for a single-family dwelling cannot exceed the following:

   - $150,000-Households at 80% or below of area median income
   - $237,000-Households at 80.1% to 120% of area median income

4. The Kentucky Neighborhood Stabilization Program requires that each NSP-assisted homebuyer complete at least eight (8) hours of homebuyer counseling from a HUD-approved housing counseling agency before purchase. A certificate or other acceptable documentation must be provided to DLG prior to entering into a purchase contract with the buyer at the same time the interim set-up package is submitted.

   For homeownership units, Kentucky NSP recognizes that not every household that starts counseling will ultimately become the owner of an NSP home, so attrition is anticipated. To balance the cost of the unsuccessful buyers with those that purchase NSP homes, counseling expenses will only be paid after closing of the sale of the unit. Kentucky NSP has reviewed average housing counseling costs in Kentucky and surrounding states and determined that a reasonable counseling fee is $1,500 per successful buyer. Housing counseling costs for assisted buyers are eligible NSP activity delivery costs and funds should be requested through the eligible use under which the unit was produced. Housing counseling fees may only be requested at final unit draw.

   If the household has recently participated in a HUD-certified housing counseling program, the Kentucky Department for Local Government (DLG) may allow subgrantees to count this participation without monetary compensation. However, this prior attendance cannot be counted without written DLG approval.

   If an NSP homebuyer becomes delinquent with their mortgage, NSP funds may be used to provide delinquency counseling at a cost not to exceed $50 per hour, with a maximum of $200 per delinquent household.

   For traditional lease-purchase units, there is a maximum lease term of sixty (60) months within which the unit must convert to homeownership. During the course of the lease-purchase term, financial and homebuyer counseling is mandatory on a regular basis. Kentucky NSP has set the cost to deliver lease-purchase counseling at a maximum of $200 per quarter for lease-purchase unit, with a maximum per unit cost of $4,000. These housing counseling costs are eligible NSP activity delivery costs/soft costs and funds should be requested through the eligible use under which the unit was produced. Lease-purchase counseling draws may be submitted at the same time as the sub-recipient's quarterly report.

For rental developments, sub-recipients may request payment for counseling for up to three classes per tenant for the following: tenant rights and responsibilities, financial management and fair housing/equal opportunity. Sub-recipients may request counseling payment quarterly at a rate of $30 per household (pay request must include class roster). DLG will also reimburse up to $20 per client for tri-merge credit reports upon completion of a financial management class.

5. NSP subgrantees must ensure that each homebuyer obtains a mortgage loan from a lender who agrees to comply with the bank regulators' guidance for non-traditional mortgages (see the Statement on Subprime Mortgage Lending issued by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Department of the Treasury, and National Credit Union Administration. This statement is available at http://www.fdic.gtov/regulations/laws/rules/5000-5160.html).

   DLG does not allow first mortgage loans that are interest-only, have balloons, etc. Only fixed-rate, fixed-term loans will be approved. DLG strongly encourages subgrantees to review the appropriateness of interest rates and terms for non-NSP first mortgages and to consider long-term affordability implications. For some households that include targeted populations, 100% NSP financing (exclusive of homebuyer contribution) ensures greater affordability.

6. DLG will approve a non-NSP mortgage loan term of less than thirty (30) years **only if** one of the following occurs:
   - The homebuyer is a Section 8 Housing Choice Voucher holder
   - The NSP assistance to the buyer is fully amortized, excluding grant funds needed to achieve 100 percent LTV on government-insured or 100 percent NSP-financed loans.

7. Following RESPA law, all NSP amortizing mortgages must have a Good Faith Estimate (GFE) and a HUD-1 Settlement Statement separate from any non-NSP first or subordinate mortgage loan. In addition, for all NSP forgivable-deferred loans, KY NSP requires that the NSP homebuyer receive written disclosure via a GFE describing all NSP loan terms, repayment conditions and any costs associated with the loan.

8. Lease-Purchase programs **must** save a portion of the tenant's monthly rent to be used toward down payment and closing costs and/or principal reduction. In the event the client does not purchase the home, these saved funds must be returned to the client, excluding security/damage deposit.

9. Underwriting criteria:

- All homeownership households, excluding lease-purchase clients at the time of initial lease, must have a minimum credit score of **620**. If a household is able to qualify for a fixed-rate, fixed-term, non-NSP first mortgage loan with a credit score below 620, the Kentucky NSP program may defer to the first mortgage lender's credit score requirement.

- Prospective homebuyers cannot have had any bankruptcies (chapter 7 or chapter 13) or foreclosures within 36 months prior to purchasing an NSP home.

- Lease-purchase clients must have a minimum credit score of **600** at the execution of the lease. At such time the unit converts to homeownership, lease-purchase clients are required to follow the homeownership credit score requirements listed above.

- To determine NSP homebuyer eligibility, income and asset calculations must include income from ALL household members, per the HOME Part 5 method.

- Should lenders refuse credit to one or the other co-head of household, additional credit counseling must be provided to enable both co-heads of household to become credit-worthy. If long-term counseling is required, buyers are not appropriate for NSP.

- Prior to loan closing, legally married persons who are separated and are not divorced must have the non-occupying spouse sign a legally binding document waiving any courtesy or dower interest in the property.

- For households with incomes at or below 50% of area median income, as defined by HUD annually, the maximum front-end ratio (principal, interest, taxes and insurance) must be between 20.00 and 24.99% of monthly gross income. Households with incomes above 50% of area median must have front-end ratios of 25-29.99% of monthly gross income. For holders of Housing Choice Vouchers, front-end ratios follow 20-24.99% PITI.

- The maximum back-end ratio for all households receiving NSP assistance is 41% unless the household clears automated underwriting with a higher ratio. DLG will consider, on a case-by-case basis, providing a waiver of its 41% requirement.

- **Affordable PITI <u>must</u> be no less than the mid-point between the ranges of maximum PITI and minimum PITI as calculated on the NSP Ability to Pay and Loan/Subsidy Analysis worksheet unless there are mitigating circumstances (unreimbursed medical expenses, child care, etc.).**

- Where households have high consumer debt that drives the front-end ratio to or near the minimum requirement, DLG strongly encourages subgrantees to work with clients to defer homeownership, and provide additional counseling to improve financial management and credit-worthiness. DLG strongly discourages additional NSP subsidy created by high consumer debt in back-end ratios. Long-term debt on Interim Set-up must be payment amount indicated on credit report.

10. Maximum NSP Subsidy per unit:

- NSP encourages assistance to **<u>targeted populations</u>**, which include veterans/active military, households with persons with physical or mental disability (does not have to be head or co-head of household), homeless/formerly homeless, and households with Housing Choice Homeownership Vouchers (Section 8 homeownership vouchers).

- For **<u>targeted populations</u>** under the KY NSP program, NSP funds may be used for up to 50% of the lender's required down payment, up to 100% of closing costs, and up to 100% of the contract sales price. Subject to these caps, however, a minimum of 50% of the contract sales price must be in the form of either homebuyer contribution or amortizing, repayable loan. In no event may NSP funds or NSP funds in conjunction with other grant or forgivable subsidy provide more than 50% of the total transaction amount.

- For all other households/units assisted through the KY NSP program the NSP investment in a single-family unit is limited to 50% of the **<u>contract sales price</u>**. Additionally, the KY NSP program is limiting *all forms of subsidy* (including private and public funds that are in the form of non-interest bearing/non-amortizing loans and/or grants) to 50% of the contract sales price.

- **All households must provide a minimum of $1,000 from their own funds.**

11. Development subsidy is an eligible NSP cost. Development subsidy is the difference between the sum of the total development costs and the appraised value, **if** the appraised value is less than the total development costs.

All closing documents must be submitted to DLG no less than 48-hours prior to loan closing. This includes the draft HUD-1 settlement statement and Good Faith Estimate for all non-NSP mortgages, as well as the NSP mortgage, note, HUD-1(s), and Good Faith Estimate. **All NSP closing documents must be approved in writing by DLG staff before the closing may be held.**

D. MULTI-FAMILY ACTIVITIES:

1. NSP funds can be used to pay reasonable development fees. The KY NSP program has established the following as reasonable, thus they are the maximum allowable fees based on total development cost of:

    $0 - $250,000:

General requirements	up to 6%
Overhead	up to 7%
Profit	up to 12%

    $251,000 - $750,000:

General requirements	up to 5%
Overhead	up to 6%
Profit	up to 8%

    $751,000 and greater:

General requirements	up to 6%
Overhead	up to 2%
Profit	up to 6%

2. Unless otherwise approved by DLG, all multi-family projects must have a minimum debt coverage ratio (DCR) of 1.20 in the first year of operation and for the five years thereafter. The NSP program prohibits undue enrichment, thus any DCR above 2.0 per year must be returned to DLG as program income or, with prior written permission from DLG, invested in a reserve for replacement account to be maintained by the Commonwealth for the term of affordability. If funds remain at the end of the term of affordability the balance of the reserve account (if capitalized by NSP) will be returned to the Department for Local Government.

3. NSP funds may be used to fund an initial operating deficit reserve for new construction and rehabilitation projects for the initial rent-up period (the lesser of 18 months or 100% occupancy, whichever first occurs). The reserve can be used only for project operating expenses, scheduled payments to replacement reserves, and debt service.

- Initial operating deficit reserve funds may be accessed until the project reaches 100% lease-up or 18 months from Certificate of Occupancy, whichever is less.

  Funds remaining in the account at the end of this period may be moved to the project's reserve for replacement account or recaptured, at the discretion of DLG, based on the project's financial performance.

E. ENERGY EFFICIENT DESIGN (all NSP projects)

Utilization of the following combination of Energy Star rated products and energy efficiency technologies during construction helps to determine if a project is considered in compliance with NSP's energy efficiency requirements. New construction and rehabilitation projects should be Energy Star qualified and all of the following items utilized in each unit and incorporated into the specifications and/or work write-up for all units.

- Inclusion of Energy Star rated heating and cooling products. Homes equipped with heat pumps which have programmable thermostats are required to use "adaptive recovery" technology in order to prevent excessive use of electric back-up heating.
- All windows must be Energy Star rated.
- Three or more of the following Energy Star qualified appliances must be installed: clothes washer, dishwasher, refrigerator, freezer or range hood.
- All Energy Star qualified ceiling fans, light fixtures and ventilation fans must be installed. See www.energystar.gov for additional Energy Star guidelines.

F. GREEN CONSTRUCTION (all NSP projects)

For new construction and rehabilitation projects to be considered "green," they must receive a "Green" rating from a nationally certified program such as LEED, National Homebuilders Association or Earthcraft and incorporate at least six of the green construction criteria outlined below. Of the six, two must be water saving methods. For additional information please see http://www.usgbc.org/.

- Projects must be located project within ¼ mile of one or more stops for two or more public or campus bus lines available to building occupants.
- Smoking in the building is prohibited and designated smoking areas must be at least twenty-five feet away from entries, outdoor intakes and windows.

- All adhesives, sealants and primers used on the interior of all buildings and applied on site must comply with South Coast Air Quality Management District Rule #1168.

  Acceptable VOC limits are listed in the table provided at the following web address (http://www.arb.ca.gov/DRDB/SC/CURHTML/R1168.PDF).

- Use of fifty percent (50%) of wood based materials and products that are certified in accordance with the Forest Stewardship Council's (FSC) Principles and Criteria for wood building components.

- A minimum of fifty percent (50%) of parking spaces must be under cover (sheltered).

- Vegetated open space must be provided in an area equal to: 1) 20 percent of the project site area, or 2) equal to the building foot print. Vegetated open space is defined as lawns, gardens, plant beds, and fish ponds with plants, shrubs or trees.

- Easily accessible areas that serve the entire project and are dedicated to the collection and storage of non-hazardous materials for recycling, including (at a minimum) paper, corrugated cardboard, glass, plastics and metals must be provided. Property is responsible of ensuring the proper disposal and removal of recyclables.

- Compact florescent light bulbs (CFLs) must be installed throughout the project.

- Rapidly renewable floor materials, such as bamboo, linoleum, cork or eucalyptus, must be utilized to cover a minimum of 25% of the floor area of each unit. Note: linoleum is not vinyl.

- Covered storage facilities and racks for securing bicycles must be provided for fifteen percent (15%) or more of building occupants.

- A vegetated roof must be installed for at least fifty percent (50%) of the roof area.

- Programmable thermostats must be installed throughout project. (Note: If a heat pump is installed in the units, a programmable thermostat specifically designed for heat pump systems must be utilized.)

- A construction waste management plan that recycles or salvages at least fifty percent (50%) of non-hazardous construction and demolition debris must be developed and implemented.

- Tankless water heaters must be installed in each unit. (Note: Proper installation requires that the heating unit satisfies demand capacity and the manufacturer's energy requirements be strictly followed.)

- Recycled, salvaged, refurbished or reused materials must be used to the extent that the sum of these materials constitutes at least ten percent (10%) of the total value of materials on the project.

- Building materials which have been extracted, harvested, recovered or manufactured within five hundred (500) miles of the project site must be used for a minimum of ten percent (10%) of the total material costs.

- Only carpeting that meets the product testing requirements of the Carpet and Rug Institute's Green Label Plus program is to be used throughout project.

  http://www.carpet-rug.org/about-cri/cri-signature-programs/green-label-plus-carpet.cfm

- The average flow rate for all lavatory faucets must be ≤ 2.0 gpm (water saving measure).

- The average flow rate for all showers must be ≤ 2.0 gpm (water saving measure).

- The average flow rate for all toilets must be ≤ 1.3 gpf (water saving measure).

- Toilets must be dual-flush and meet the requirements of ASME A112.19.14 (water saving measure).

- Toilets must meet the U.S. EPA WaterSense specification and be certifies and labeled accordingly (water saving measure).

- All domestic hot water piping shall have R-4 insulation. Insulation shall be properly installed on all piping elbows to adequately insulate the 90-degree bend.

- Central hot water manifold trunk no more than 6 feet, insulated to R-4, with no branch line exceeding 20 foot.

- Compact hot water supply line design with no run over 20 feet from water heater.

- Prior to construction, create detailed framing plans or scopes of work and accompanying architectural details for use on the job site. Indicate the specific locations, spacing, and sizes of all framing members in the floors, walls, roof and ceiling (if different from the roof).

- Prior to construction, create a detailed cut list in lumber order that corresponds directly to the framing plans and/or scopes of work.

G. RENEWABLE ENERGY SOURCES (all NSP projects)

The NSP Program encourages the utilization of renewable energy sources in construction and rehabilitation. Renewable energy comes from several sources such as the sun, wind and water. Incorporating these sources into program design is encouraged and is an eligible expense of the NSP Program. For more information on Renewable Energy Sources visit: http://www.nrel.gov.

H. HOUSING CONSTRUCTION AND REHABILITATION STANDARDS

1) All NSP-funded projects

NSP-assisted units must meet the Uniform Federal Accessibility Standards (UFAS), Fair Housing Design Standards (Green Book), all local housing codes, and occupancy standards for new or reconstructed units. At a minimum, for rehabilitated units the Subrecipient must adopt the 2006 International Code Council (ICC) Property Maintenance Code. All newly-constructed units (including reconstruction) must meet 2007 Kentucky Residential Code.

On March 15, 2012, the Department of Justice's updated ADA Standards (2010) will become mandatory for new construction and alterations covered by the ADA. On the date, optional use of the original 1991 ADA standards will no longer be allowed. DOJ adopted the updated standards in September 2010, but permitted continued use of the 1991 standards for 18 months to allow time for transitioning to the 2010 edition.

Under DOJ's ADA regulations, the March 15, 2012 effective date applies to the date of the permit application or, where no permit is required, to the physical start of construction or alteration.

Copies of the 2010 standards and related information are available on DOJ's website at **www.ada.gov.**

Any construction or rehabilitation of residential structures with assistance provided under this Agreement shall be subject to HUD Lead-Based Paint Regulations at 24 CFR 570.608, and 24 CFR Part 35, Subpart B. Such regulations pertain to all NSP-assisted housing and require that all owners, prospective owners, and tenants of properties constructed prior to 1978 be properly notified that such properties may include lead-based paint. Such notification shall point out the hazards of lead-based paint and explain the symptoms, treatment and precautions that should be taken when dealing with lead-based paint poisoning and the advisability and availability of blood lead level screening for children under seven. The notice should also point out that if lead-based paint is found on the property, abatement measures may be undertaken. The regulations further require that, depending on the amount of Federal funds applied to a property, paint testing, risk assessment, treatment and/or abatement may be conducted.

2) <u>Additional requirements for NSP3-funded projects</u>

- All gut rehabilitation or new construction (i.e., general replacement of the interior of a building that may or may not include changes to structural elements such as flooring systems, columns or load bearing interior or exterior walls) of residential buildings up to three stories must be designed to meet the standard for Energy Star Qualified New Homes.

- All gut rehabilitation or new construction of mid -or high-rise multifamily housing must be designed to meet American Society of Heating, Refrigerating, and Air-Conditioning Engineers (ASHRAE) Standard 90.1-2004, Appendix G plus 20 percent (which is the Energy Star standard for multifamily buildings piloted by the EPA and the Department of Energy).

- Other rehabilitation must meet these standards to the extent applicable to the rehabilitation work undertaken, e.g., replace older obsolete products and appliances (such as windows, doors, lighting, hot water heaters, furnaces, boilers, air conditioning units, refrigerators, clothes washers and dishwashers) with Energy Star-46 labeled products.

- Water efficient toilets, showers, and faucets, such as those with the WaterSense label, must be installed.

- Where relevant, the housing should be improved to mitigate the impact of disasters (e.g., earthquake, hurricane, flooding, fires).

- Buy American Provision – Sub-recipient agrees that in accordance with ARRA, Section 1605, neither Sub-recipient nor its Sub-recipients/contractors will use ARRA funds for a project for the construction, alternation, maintenance, or repair of a public building or public work unless all of the iron, steel and manufactured goods used in the project are produced in the United States in a manner consistent with United States obligations under international agreements. The Sub-recipient understands that this requirement may only be waived by the applicable federal agency in limited situations as set out in ARRA, Section 1605.