Operating Fund Financing Program

Summary

Under the Operating Fund Financing Program (OFFP), Public Housing Authorities (PHAs) are permitted to borrow private capital to finance development and modernization of public housing. Under this program, a PHA may use a portion of its Operating Fund reserve balances to collateralize financings and pay debt service and customary financing costs where the financing is used for public housing development or modernization (including public-housing mixed-finance developments).

Operating reserve balances are those funds accumulated through the operation of public housing, assistance from the Operating Fund program authorized by section 9(e) of the 1937 Act, and operating receipts as defined in section 2 of the Annual Contributions Contract (7/95) (ACC). The FFY 2012 Appropriations Act, P.L. 112-55, permits HUD to adjust the CY 2012 Operating Fund allocation by up to $750 million from excess reserve amounts by PHAs. For more information on the implementation of this offset, see notice PIH 2011-55.

PHAs may use Operating Funds as outlined by Section 9(e), 9(g) and 9(l) of the 1937 Act, notice PIH 2012-2, and HUD regulations. PHAs may use Capital Funds as outlined by Section 9(d) of the 1937 Act and HUD regulations. In addition to these statutorily permitted uses, pursuant to P.L. 112-55 and for FFY 2012 only, PHAs may use operating reserves above the HUD recommended minimum for capital improvements, except PHAs may not use operating reserves above the HUD recommended minimum for large modernization projects or development in the absence of an OFFP approval. Because of the added flexibility provided by P.L. 112-55, in FY 2012 there may not be a need for PHAs to undertake OFFPs unless they want to pursue large-scale modernization or a development project. For more information about the use of operating funds generally, and the use of operating reserves above the HUD recommended minimum for capital improvements in FFY 2012, see notice PIH 2012-2.

Written approval is required before a PHA undertakes an OFFP transaction. HUD is implementing the OFFP on a case-by-case basis and has approved a small number of transactions to date. PHAs interested in participating in the OFFP should follow the general guidelines and instructions outlined on this web page. PHAs should note that financing proceeds from an OFFP transaction will be subject to regulations associated with Capital Funds, including all applicable modernization or development requirements under the 1937 Act and HUD regulations (including procurement and environmental review).

In reviewing OFFP proposals, HUD will determine the amount of reserves available for financing by analyzing the PHA's financial statements over a two to three year period. The amount available for financing is calculated by taking short term assets, subtracting short term liabilities, and then subtracting an amount equal to four or six months of operating expenses, depending upon PHA size (four months for PHAs with 250 or more units, six months for PHAs with 249 or fewer units).

The results of the above noted calculations indicate the maximum amount of operating reserves HUD would approve for financing. PHAs may undertake smaller financings based upon their risk tolerance. PHAs should be aware that the decision to pursue an OFFP will not cause HUD to calculate operating eligibility in a manner different than provided for by statute and regulation. PHAs should consider these risks when determining whether or not to undertake an OFFP transaction, and the size of their borrowing if they do pursue an OFFP transaction.

Typical Transaction

A typical transaction involves a PHA requesting HUD approval of a loan for the purpose of modernization and/or development activities. The PHA collateralizes the loan with the Operating Fund reserves and at the completion of construction, utilizes the Operating Fund reserves to pay the principal and interest on the loan.

Suggested Guidelines and Required Documentation

PHAs interested in participating in the OFFP should follow the guidance provided below and submit the following documents:

1. **Approval -** PHAs must request approval from the Deputy Assistant Secretary, Office of Public Housing Investments. The Deputy Assistant Secretary for the Office of Public Housing Investments, the General Deputy Assistant Secretary and the Assistant Secretary for the Office of Public and Indian Housing are the only authorized HUD officials who can grant approval.

    - PHAs must submit a minimum of one hard copy and one electronic copy of the complete OFFP Proposal to:

      Attention: Shauna Sorrells, Director
      Office of Public Housing Programs
      Room 4232
      451 7th Street SW
      Washington, DC 20410

    - An electronic copy of a complete OFFP Proposal should also be sent to the Director of the Financial Management Division (FMD) and appropriate Director, Office of Public Housing in the Field Office.

2. **Operating Reserves Amounts -** To participate in the OFFP, PHAs should demonstrate that they have taken steps to maintain their operating reserves at a level that can be reasonably anticipated to sustain necessary operations given a moderate level of fluctuation in operations or appropriations. PHAs with 250 units or more should have at least 4-months worth of operating reserves available above the amount proposed as part of an OFFP transaction; PHAs with less than 250 units should have at least 6-months worth of operating reserves available. When reviewing OFFP proposals, HUD will also evaluate the impact of the allocation adjustment in the FFY 2012 Appropriations Act. To the extent that PHAs have reserve amounts in excess of 4 or 6 months as applicable, in addition to amounts associated with the proposed 2012 allocation adjustment, they may request approval to use excess operating reserves as

part of an OFFP transaction.

3. **Proposal -** PHAs interested in applying for participation in the OFFP should submit the following documentation as part of their initial application package:

   - **Cover Letter -** The cover letter must be signed by the PHA Executive Director (or Chief Executive Officer, if applicable) and should request HUD's approval of the OFFP Proposal. PHAs should also describe the proposed financing and the intended use of proceeds, as well as the amount of the Operating Fund reserves available. In the event that PHAs have experienced substantial fluctuations in reserve levels, PHAs should also provide an explanation of the variations in reserve levels. Finally, PHAs should include the amount of the Operating Fund reserves the PHA intends to use for debt service payments (principal and interest).

     The cover letter should describe any security interest or other encumbrance being provided as well as the recourse the lender will have in the event of a default, if any. This description will provide the basis of HUD's approval of any security interest.

     The cover letter must indicate whether the PHA has undertaken any other financing associated with its public housing program. If it has, it should include a schedule detailing the terms of the financing (original principal amount, current principal outstanding, interest rate, periodicity of debt service payment requirements, amount of debt service payments, source of debt service payments, security interest provided, description of what financing was used for).

   - **OFFP Financing Limit Spreadsheet -** As part of their submission PHAs should include the OFFP Financing Limit spreadsheet demonstrating the availability of the requisite reserve amounts listed in paragraph 2, based on their most recent unaudited financial statements. When making this calculation, the PHA should refer to the calculation of operating reserves in Notice PIH 2011-55. Be advised that the methodology to calculate operating reserves is based on data calculated with full accrual accounting. Therefore, PHAs must use accrual accounting when calculating their reserves.

     The PHA should also complete two OFFP Financing Limit spreadsheets based upon the most recent two years of approved Financial Assessment Submissions – PHA (FASPHA) in order to assess any fluctuations in reserve levels. Unless the current financial data reflects a decrease in financing capacity over the FASPHA data, PHAs are not required to use the current financial data. If a PHA chooses to do so, they assume the risk of any unrecognized expenses or accounting errors or adjustments.

     As part of its assessment, HUD will also complete two OFFP Financing Limit spreadsheets based upon FASPHA data from the most recent two years.

- **Financial Statements -** PHAs should also include, within their initial application package, the most recent, year -to-date financial documents available, which should support the OFFP Financing Limit spreadsheet submitted by the PHA.

- **Financial Schedules -** PHAs should include a debt service schedule in their OFFP application package.
    - The PHA should provide the terms of the financing, including:
        - The name of the lender
        - The term of the financing
        - The principal amount
        - The interest rate

- **Annual Statement/Performance and Evaluation Report (HUD-50075.1) -** PHAs should submit an Annual Statement budgeting the use of the proceeds from the OFFP financing.

    - http://portal.hud.gov/hudportal/documents/huddoc?id=50075.1.pdf

- **Disclosure of all Existing Financing -** PHAs must disclose any existing financing it has undertaken in their OFFP application package. The PHA should include a schedule detailing the terms of any financing (original principal amount, current principal outstanding, interest rate, periodicity of debt service payment requirements, amount of debt service payments, source of debt service payments, security interest provided, description of what financing was used for). If a PHA has no existing financing, it should include a statement to that effect.

4. **Transactional Documents -** Once HUD has received and reviewed a PHA's initial submission (as outlined above in paragraph 3), and determined that the proposal is acceptable to HUD, the PHA will then submit the following additional documentation to complete the application package:

- **Board Resolution -** PHAs must submit evidence of a PHA Board resolution that authorizes the PHA to undertake the loan up to a specified amount; provide all security interests required by the loan; and repay the loan with its Operating Fund reserves as required by the financing documents.

    - **Authorization -** The Board resolution must also provide authorization for the Executive Director, Chief Executive Officer, or other executive staff to negotiate and enter into all legal documents required as part of the transaction.

- **Counsel's Opinion -** The PHA must also submit PHA counsel's opinion, which opines that the PHA has the authority to enter into the transaction, and that the transaction complies with the requirements of the 1937 Act, as amended, federal regulations, and the ACC, as amended.

    - Sample Opinion of Counsel (MS-Word, 72 KB)

- **Depository Agreement -** The PHA must submit a depository agreement that covers all of the financing proceeds of the OFFP transaction. The Operating Fund reserves collateralizing the loan must also be subject to a depository agreement.

    - Sample Depository Agreement

- **Fairness Opinion -** If the terms of the transaction proposed by the PHA are outside the range of what is generally submitted to HUD, HUD reserves the right to request that an independent third-party fairness opinion be submitted.

- **OFFP Amendment to the ACC** - Where, pursuant to an OFFP approval, a PHA will use excess reserves to prepay a CFFP, they will need to amend their CFFP Amendment to the ACC. For information on prepaying a CFFP, please contact the Director of the Office of Capital Improvements. All other PHAs receiving an OFFP approval must execute an OFFP Amendment to the ACC.

- **Declaration of Trust (DOT)/Declaration of Restrictive Covenants (DRC) –** Where PHAs are providing a security interest or other encumbrance in a public housing project as part of their OFFP, the PHA must provide evidence of compliance with public housing restrictive use requirements.

    - If a PHA proposes to use OFFP proceeds for modernization, for any property the OFFP proceeds are used upon, or any property that is mortgaged or otherwise encumbered as part of the OFFP, PHA counsel must opine and HUD's Office of General Counsel will concur, that in each instance the DOTs are recorded prior (both in time and position) to the security interest or other encumbrance that will be recorded pursuant to the OFFP, and that they will remain current and effective for the term of the financing. PHA counsel shall further opine that a Development DOT has been recorded prior to the recordation of any other encumbrance. If the PHA Counsel is unwilling to offer such a certification, the PHA may submit a title report, along with a certification from the PHA that the DOTs and the title report cover all of the public housing properties, both real and personal property, that will be subject to the security interest or encumbrance related to the OFFP, or that will be the recipient of OFFP proceeds. Further, where HUD determines a higher level of documentation is needed, HUD reserves the right to require a title report.

    - Where OFFP proceeds are used for development, title insurance must be obtained in compliance with 24 CFR 941. The title documentation must establish that an effective DOT or mixed-finance Declaration of Restrictive Covenants will be filed in first position.

- PHAs that intend to fund mixed-finance development or modernization with OFFP proceeds are not required to submit DOT/DRC documentation as part of their OFFP proposal since that review will be completed as part of HUD's review of the mixed-finance proposal.

- DOTs/DRC documentation shall be submitted to the Director, Office of Public Housing at the appropriate Field Office for review by Field Office counsel.

5. **Reporting -** Once construction begins, PHAs should submit Performance and Evaluation reports (HUD 50075.1, see link above in Section 3 of this guidance, Annual Statement/Performance Evaluation) detailing the obligation and expenditure of OFFP proceeds on a quarterly basis to the Field Office until all borrowed funds are expended and included in the audited year-end financial statement.

   - Each OFFP transaction is subject to fiscal closeout in the same manner as a Capital Fund Grant. Fiscal closeout includes the submission of an Actual Modernization Cost Certificate (AMCC) or Actual Development Cost Certificate (ADCC), and audit, if applicable, and a final Performance and Evaluation Report.

6. **Loan Documents –** Loan documents are not required to be submitted as part of the OFFP proposal. Please find below sample language that may be used on loan documents at the discretion of the PHA. Please note that the OFFP amendment to the ACC contains certain requirements related to loan documents. Complying with those requirements is the responsibility of the PHA. The below language may help PHAs in drafting documents that comply with the requirements of the OFFP amendment to the ACC, but may or may not need to be modified to do so.

   a. **Non-Recourse Language -** "This financing is non-recourse to any public housing property (real or personal property including all public housing assets or income), or disposition proceeds approved pursuant to Section 18 of the United States Housing Act of 1937 (unless explicitly permitted by HUD in the Section 18 approval letter)."

      It should be noted that PHAs can provide lenders recourse to the reserve funds pledged as part of the proposed OFFP transaction and should modify, as needed, the language above if they chose to provide such recourse.

   b. **Indemnification Clause -** "The PHA's indemnification is limited to eligible non-public housing assets (assets not subject to the Declaration of Trust and not acquired or merged with assets acquired with public housing funding under the United States Housing Act of 1937)."

   c. **HUD Not Liable:** "Loans and bonds connected with the financing activities are obligations of the PHA and are not guaranteed or insured by HUD or the U.S. Government."

7. **Paperwork Reduction Act -** The information collection requirements contained in this document are approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 2510-3520). In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number. The OMB control number for the Capital Fund Financing Program is: 2577-0157

   If you have any questions or concerns regarding the necessary documentation required for an OFFP proposal, please contact Kevin Gallagher at 202 402 4192 or Kevin.J.Gallagher@hud.gov.