MSHDA is making several improvements to policies and procedures surrounding Activity Delivery Costs within the Michigan NSP2 Consortium. These changes are intended to reflect ongoing clarification of HUD requirements, to provide greater flexibility for consortium members, and to ease the practical burden of record keeping on a project-by-project basis. Specifically, MSHDA:

1. Will no longer require that most Activity Delivery Costs be tracked and billed on a project-specific level. However, consortium members need to carefully review the section below on Activity Delivery Costs and the Low Income Set-Aside to ensure they are not compromising their ability to meet the LISA requirement.

2. Is similarly replacing the 15% per-project limit on Activity Delivery Costs and instead imposing a 20% cap within the overall budget for each NSP2 Eligible Use, with the exception of Eligible Use C (Land Banking) where there is no cap. The specific OPAL system modifications are outlined in the OPAL Guidance section below.

3. Will conduct training on this topic in the near future. The training will be conducted via webinar.

Classifying Costs: NSP and CDBG, upon which much of the program’s regulations are based, allow grantees (including MSHDA, NSP2 participating cities and land banks, and subrecipients) to charge “Activity Delivery Costs” in addition to budgeted and eligible “Administrative Costs.”

Additionally, at a project level (i.e. investment in a specific property) NSP can pay for both “Hard Costs” and “Soft Costs” that are deemed necessary to complete the project.

It is necessary to understand both the overlapping nature of some of these cost categories as well as the specific distinctions between them.

Administrative Costs are generally associated with planning, carrying out, and reporting on the status of the NSP2 program. While Administrative funding can be used to pay for Activity Delivery Costs, certain functions can only be charged to Administration. These include the staffing and third-party costs associated with program and grant management functions such as:

- Program planning, management, and oversight;
• Development of program guidelines including construction/rehabilitation standards, underwriting requirements, program application materials, and marketing materials;
• Development of neighborhood plans, investment strategies, and other program guiding documents;
• Monitoring and program evaluation;
• Financial recordkeeping, billing, audits, and the like;
• Attending training;
• Completing grant and program level NEPA reviews, affirmatively furthering Fair Housing, Section 3 promotion and oversight, and meeting other such cross-cutting federal regulations;
• Progress and performance reporting;
• Overhead costs such as office space, copiers, computers, office supplies, phones, and the like (only the NSP2 portion of these costs can be charged); Etc.

**Activity Delivery Costs** are associated with the actual implementation of NSP-funded **projects, activities, or services**. While not specifically required to be tied to an address per se in MSHDA’s OPAL system, Activity Delivery Costs can conceptually be traced to specific properties (i.e. addresses) that are being considered for or actually receiving NSP2 investment. Under NSP Activity Delivery Costs are eligible even if a given project fails to go forward.

Activity delivery costs can include both internal staff costs incurred by an NSP2 consortium member and third-party professional services costs.

Staff costs chargeable to activity delivery include:

• Evaluation and due diligence on properties being considered for purchase/inclusion in the local NSP2 program;
• Preparation of purchase offers, negotiations with sellers of foreclosed/vacant property, and attending closings;
• Preparation of rehabilitation/construction specifications for specific NSP2 assisted properties, issuance and review of bids, and negotiation of construction contracts;
• Underwriting of specific development projects;
• Inspections of ongoing construction activity and related oversight; and
• Intake and screening of potential buyers, negotiating sales contracts, and preparing for and attending closing.

Additionally, various third-party costs associated with these functions can also be considered Activity Delivery Costs (*see discussion below about the overlap between activity delivery and project soft costs*). Examples include:

• Appraisals;
• Site-specific environmental reviews and testing (including lead based paint and asbestos assessments); and
• Title searches.

As noted herein, MSHDA will not *require* that Activity Delivery Costs be tracked and charged on a project-by-project basis. However, in order to distinguish between Administrative (program) and Activity Delivery (project) costs, it is important to understand that Activity Delivery Costs *could be* tracked to a specific physical address. Moreover, there are important reasons to continue to track as many Activity Delivery Costs to specific rehabilitation and redevelopment projects as possible, so OPAL will maintain the functionality that allows Activity Delivery Costs to be setup and charged to specific projects (*see the section on Activity Delivery Costs and the Low Income Set-Aside below*). Within this context,
there will continue to be two OPAL sub-categories for Activity Delivery Costs. These will be labeled “Activity Delivery Cost—General” and “Activity Delivery Costs—Project Specific.”

Project “hard costs” and “soft costs” must, in all cases, be tracked, reported, and billed on an address-by-address basis. Such costs are only eligible for NSP projects that actually move forward.

While no formal regulatory definitions exist, hard costs are generally those that result in tangible, physical improvements to real property. Examples include construction contract costs, appliance purchases, demolition, landscaping installation, etc. Acquisition is generally viewed as a hard cost as well, and in this parlance results in the ownership of real property.

Soft costs, on the other hand, are those related to the professional and technical services needed to complete a project—appraisals, environmental studies, architectural fees, counseling, and the like. In the case of development projects, soft costs also include items associated with the ongoing ownership, maintenance, and financing of a property—financing and interest expenses, property taxes, property insurance, lawn maintenance/snow removal, utilities, etc.

Activity Delivery vs. Soft Costs: Within this framework, certain third-party due diligence costs, such as appraisals, can conceivably be classified as either Activity Delivery Costs or project soft costs. The key differences are whether or not a project moves forward since soft costs can only be charged to a specific project that actually proceeds and whether the cost is incurred by the NSP2 grantee or subrecipient.

In order to address projects that do not move forward, MSHDA included the concept of “infeasible” projects within each NSP2 consortium member’s budget to ensure that third-party costs incurred in evaluating properties that ultimately do not proceed can be covered.

In terms of whether the cost is incurred by an NSP grantee/subrecipient or a developer, only NSP2 consortium members may charge Activity Delivery Costs. So when developers are carrying out a project with NSP2 funding, they can only include soft costs for projects that actually proceed (subject, of course, to the requirements of the developer agreement between the NSP2 consortium member and the developer).

The following scenarios may help sort through the differences. An NSP2 project is being considered at 129 Oak Street.

The NSP2 Land Bank Authority obtains an appraisal for the foreclosed property. The appraisal shows a value below the bank’s asking price, and the deal falls apart. The cost of the appraisal can be charged to General Activity Delivery Costs as an infeasible project on OPAL.

If the bank accepted an offer that includes the NSP required purchase price discount and the Land Bank purchases 129 Oak Street to rehabilitate it for resale, the cost of the appraisal is best charged as a project soft cost within the project’s individual OPAL setup.

In an alternate case, the NSP2 City has awarded funding to Neighborhood Improvement CDC through a developer agreement. Neighborhood Improvement is responsible for identifying and purchasing eligible properties. In the first instance, if the appraisal shows an ineligible purchase price and project never proceeds, the CDC cannot charge the cost of the appraisal to NSP2. Only if the project is purchased and proceeds is the appraisal an eligible soft cost.

Activity Delivery Costs and the Low Income Set-Aside: While it technically is permissible to charge all Activity Delivery Costs in a general way (as compared to tracking them on a project-by-
project basis), doing so will make it more difficult to meet the Low Income Set-Aside (LISA) requirements of NSP2.

By statute, 25% of the consortium’s total NSP2 award must be invested in projects that serve households at or below 50% of the area median income. Therefore, only costs that are tracked and billed to specific projects can be counted toward the LISA.

Already, NSP2 funding used for Administrative Costs, Eligible Use C (Land Banking), and Eligible Use D (Demolition) does not count toward the LISA. This means that more than 25% of the investment in Eligible Use B and E (housing rehabilitation and redevelopment) must result in housing units meeting the LISA requirements.

For example, assume the entire NSP2 consortium grant was only $100. The LISA requires that a total of 25%—$25—be invested in housing for households at or below 50% AMI.

Already, 10% of the NSP2 award—$10—is reserved for Administrative funding. Another 32%—$32—can be expended on demolition. If another 20%—$20—of the remaining funding is used for General Activity Delivery Costs not tracked to and setup within specific projects, then 62% of the total award could be accounted for without any funding that meets the LISA (even assuming that no land banking activity is completed, a false assumption in the case of the Michigan NSP2 Consortium).

The end result is that of the $38 of funding remaining in this simplified example, $25 of it—or 65% of the housing investment—would have to meet the LISA requirements.

On the other hand, if consortium members continue to limit billings of General Activity Delivery Costs to 5% of funding (representing a quarter of all Activity Delivery Costs that could be charged) and track and charge the other 15% of allowable Activity Delivery Costs within specific project setups, the LISA will be easier to meet. In the same $100 scenario, after Administrative, demolition, and General Activity Delivery only 47% of the grant would be taken up. As a result, slightly less than half—$25 of the $53 remaining, or 47%—of the housing investment would need to meet the LISA in order to meet the statutory requirement.

As a result, MSHDA strongly encourages NSP2 consortium members to use the flexibility surrounding Activity Delivery Costs carefully. In particular, we recommend:

- **Limit use of “Activity Delivery Costs—General” to:**
  - Land banking and demolition only projects (which cannot go toward the LISA requirement);
  - Third-party costs associated with infeasible projects; and
  - “Predecision” staff costs for properties to be rehabilitated or redeveloped under Eligible Uses B and E.

By “predecision,” we mean that staff time spent screening potential projects for eligibility and viability, completing initial due diligence to evaluate properties ahead of purchase, and the like. For properties already owned by the NSP2 consortium member, predecision functions would include the initial compliance and viability due diligence reviews prior to determining that you will use NSP2 to rehabilitate or redevelop the property. Examples of predecision screening tasks might include, but are not limited to:
  - Reviewing a property with Consortium partner;
  - Ordering and reviewing title work, appraisals, lead and asbestos reports;
  - Determining through review of documents if a property is foreclosed, abandoned, or vacant;
  - Completing Tenant Protections, SHPO and Environmental Review;
Conducting the initial cost analysis of the property; and
Negotiating for purchase and entering the purchase agreement.

Once a decision has been made to actually purchase a property and rehabilitate or redevelop it, track and bill staff time and any third-party Activity Delivery Costs within the individual project setup, billed to the “Activity Delivery Costs—Project Specific” line item.

• **Review your strategy to meet the Low Income Set-Aside in light of any budgetary changes you make with respect to Activity Delivery Costs.** MSHDA is adding a checkbox to the OPAL Activity Checklist to allow consortium members to indicate whether or not a project is planned as a LISA unit. This will allow MSHDA to track progress toward LISA even though dollars committed to projects do not actually count toward the LISA requirement until the buyer’s demographic information is entered and the project is closed. Expect to hear more about this issue in the months to come as we work to ensure that all consortium partners are on track to meet the LISA requirement.

**Common Requirements:** Within the broader discussion of how to classify various costs, several core and common requirements bear repeating:

• All costs—whether administrative, activity delivery, hard, or soft—must be actual, necessary, and reasonable;

• All costs must be appropriately documented with back-up information.

In the case of internal Administrative and Activity Delivery Costs, this still requires that NSP2 consortium members maintain sufficient timekeeping records to distinguish staff time between administrative functions and activity delivery functions. Furthermore, General Activity Delivery Costs still need to be tracked and billed on the basis of the NSP Eligible Use. And for those Project Specific Activity Delivery Costs being charged, timekeeping records need to identify specific projects being worked on.

• Third-party costs incurred by NSP2 consortium members and subrecipients are typically subject to procurement requirements (exceptions include property taxes, permits, and other government-required fees required of any such project whether funded with NSP2 or not).

**OPAL Guidance for Revising/Amending NSP2 Grants:** As noted earlier, OPAL will continue to use two categories of Activity Delivery Costs: *Activity Delivery Costs—General* and *Activity Delivery Costs—Project Specific*.

Each NSP Eligible Use will contain both line items, and the OPAL system will cap the combined total of these categories to 20% of the Eligible Use budget. The total is similar to the prior system programming that allowed 5% of an Eligible Use budget to be used for “infeasible activity delivery” and capped project specific activity delivery costs to 15% of each project. However, the functionality has been updated to allow consortium members to transfer funding between General and Project Specific Activity Delivery Costs using the revision process outlined below. (Note that there is still no cap on activity delivery within Eligible Use C—Land Banking.)

These changes have two primary impacts. First, an NSP2 consortium member can transfer funding within the overall 20% activity delivery cap between Activity Deliver—General and Activity Delivery—Project Specific within a simple revision process. Second, this will mitigate the unintended consequence of overly limiting Activity Delivery Costs on certain lower cost projects—for example, under the prior system a land bank purchasing a $1,000 property would have been limited to $150 in...
Activity Delivery Costs, but under the new system, all staff time devoted to processing this property could be billed.

While MSHDA expects to limit approval of such requests, consortium members seeking to exceed the 20% cap are required to request a formal amendment. Such requests will be reviewed on a case-by-case basis and will require justification from the consortium member along with evidence that the local consortium site’s LISA requirement is on track.

There are two ways in which NSP2 grant budgets may be edited; revisions and amendments.

**Revisions** allow consortium members to re-allocated funds WITHIN AN ELIGIBLE USE. Revisions can be completed by a consortium member and do not require approval by MSHDA staff. To initiate a grant revision, a Grant Administrator needs to select “Revise Grant” from the OPAL Grant Menu.

**Amendments**, on the other hand, involve changes BETWEEN ELIGIBLE USES. This process requires approval by MSHDA staff and leads to formal written grant amendments that must be executed by both MSHDA and an Authorized Signer of the NSP2 consortium member. To initiate a grant amendment, a Grant Administrator needs to select “Amend Grant” from the OPAL Grant Menu; submission of the amendment request must be done by an Authorized Signer.

OPAL is programmed to stop revisions or amendments as follows:

1: Line items within the grant budget cannot be reduced to an amount that exceeds the dollars currently committed to projects. Example:

   If $100,000 in demolition has been committed to projects set-up on OPAL, the demolition line item in the budget cannot be reduced to an amount less than $100,000. To do so individual activity budgets would need to be revised or the activities cancelled. Users will receive an error message indicating that they cannot reduce the line item to an amount less than what is committed to activities.

2: Consortium members wishing to increase their combined Activity Delivery Costs within an Eligible Use (General Activity Delivery Costs and Project Specific Activity Delivery Costs) to an amount greater than 20% of the dollars budgeted for that Eligible Use must initiate a Grant Amendment on OPAL. Users attempting to do so via the revision process will receive an error message instructing them to cancel the revision and proceed with an amendment request instead.

3: OPAL will not allow a consortium member to initiate a revision or amendment to its grant budget if an FSR is “in progress.” The FSR should either be submitted or cancelled before attempting to revise or amend the grant budget.

**Questions:** MSHDA has trained internal staff and embedded staff from Capital Access on these policy and procedure updates and will hold webinar training for consortium members in the near future. We also intend to cover this material at future in person trainings and will update the Policy and Procedures Manual to reflect these updates. If you have specific questions, please contact you CD Specialist.
Q&A Items:

Q: Is the preparation and review of a developer RFP an Administrative or Activity Delivery Cost?

A: If RFP is to identify developers generally who may seek to participate in the program generally (more like a NOFA), it’s Administration. On the other hand, if the NSP2 consortium member has identified a specific site or sites that it seeks to have redeveloped, the staff time associated with the RFP can be charged to Activity Delivery. Further, once a project is large enough to do an RFP for, it is likely that you should be tracking your time to the specific project such that this could be charged to Project Specific Activity Delivery Costs.

Similarly, if a consortium member is seeking bids from contractors on a specific property, the staff time can be charged to Activity Delivery. On the other hand, managing the RFP or other procurement process for service providers—like appraisers, title companies, etc.—is an Administrative Cost.

Q: A consortium member’s staff person spends day in one of the NSP2 target neighborhoods reviewing dozens of properties in the tax foreclosure pipeline to screen them for potential NSP2 investment. Some will end up as Use B Rehabilitations, some may be Land Banked under Use C, and others may simply be demolished. Is this Activity Delivery? If so, how should it be billed by Eligible Use?

A: It is Activity Delivery. Timecard records should clearly show time was spent on NSP2 activities, the only issue is how to allocate between Eligible Uses. The staff member should use his or her professional judgment based on likely mix of successful activities. For example, if you estimate that half of the properties that move forward will be Demolition only, bill half the time to Activity Delivery under demolition.