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Boot Camp on Financial Reporting for Rental Housing Nonprofit Enterprises

Module 1:

Identify the Deal,
Grants, Contributions & Exchange Transactions
Predevelopment Best Practices

Wednesday, September 15, 2021
1:00 PM – 3:00 PM Eastern

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- Best practice guidance on financial statements, notes, etc.
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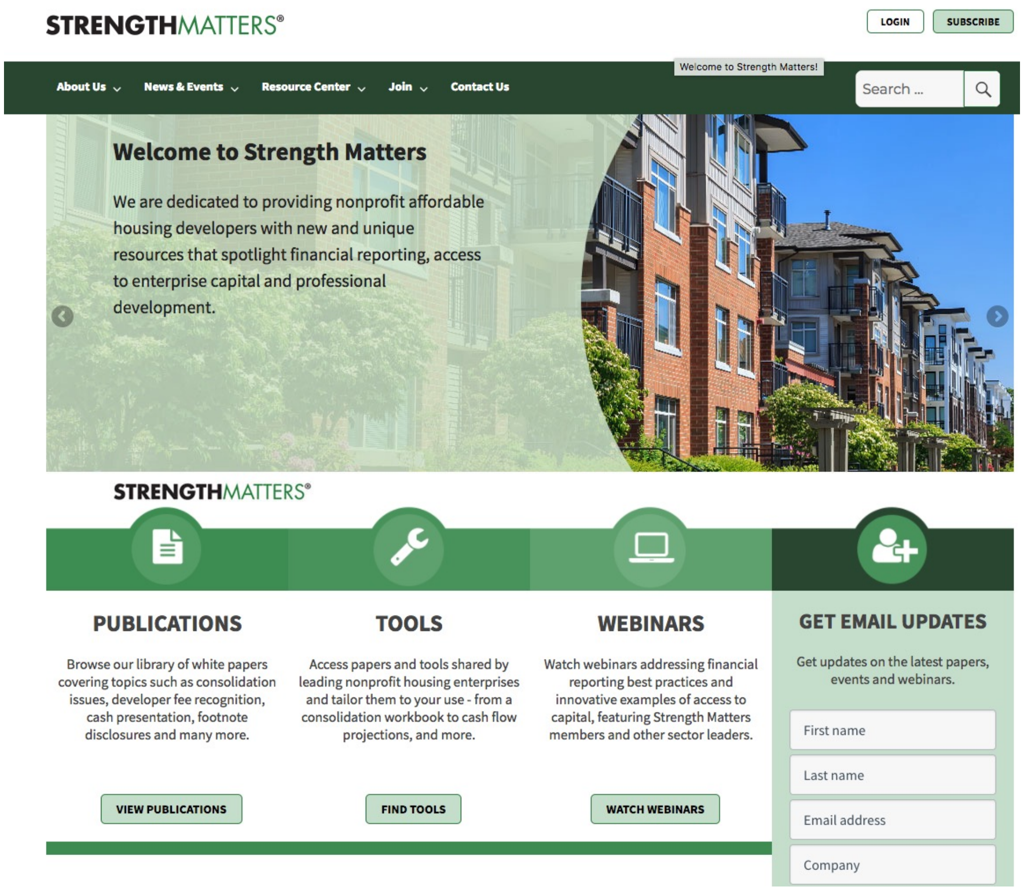
- Annual FASB updates



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Meet the Presenters

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CPE Credit Requirements

- We use polls and the Zoom attendance record to verify participation throughout the session.
- **Participants seeking CPE credits must:**
  - Participate fully in the learning activities and submit ALL polls throughout the course.
  - Log in to each session with first name, last name and email before the scheduled start time.
  - Request a certificate via the final evaluation or email.
- **If you plan to petition your state board of accountancy for CPE credits, please <u>submit ALL polls, including the final evaluation</u>.**

To request a certificate of completion or for more information on CPE credits, **contact Lindsay Wells at <u>consult.lwells@gmail.com</u>.**

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Getting Started

- If you have a technical issue, including issues with Polls, please contact the Host via **Chat**.
- Please use the **Chat** feature to submit all content questions.
- We will pause for questions during the presentation.
- Participants will be muted during the course presentation. Participant breakout rooms offer small group discussion with audio and video sharing.

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Module 1: Identify the Deal, Grants & Contributions, Predevelopment Best Practices

120 min/2.0 CPEs

- See CPE Summary handout for **Core Competencies and Learning Objectives.**

Please have your Handouts PDF available for reference.

Module 1 Materials

1. Request for Proposal – Development Project
2. Class Exercise – Grants, Contributions & Exchange
3. Predevelopment Best Practices Handout

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Module 1: Identify the Deal, Grants & Contributions, Predevelopment Best Practices

Topics for this session:

- Identifying the Deal
- Forgivable Loans, Contributions and Exchange Transactions
- Predevelopment Best Practices

Class Participant Introductions

*Please share the following in your **Breakout Room***

In 60 seconds or less…

1. Share your name, where you work and your organizational role.
2. What top question would you like to see answered in this course?

Please share your top question via Chat after the breakout.

Identify the Deal

- In a rural or suburban setting, the next deal will most likely involve the acquisition of vacant land and new construction or the rehab of existing properties

- In an urban setting, the next deal will most likely involve the acquisition of an existing property as vacant land is scarce. That property may be vacant or occupied. The development team may be responding to requests for acquisition proposals from municipalities or private owners. Urban developers will also be involved with the rehab of existing properties.

See the sample RFP for the development of a City owned parcel of land in California.

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Identify the Deal *(continued)*

- Most developers don’t capitalize the costs incurred during the early pursuit phase since multiple projects are pursued simultaneously and most of them never become viable development projects. However, once a project becomes financially feasible, predevelopment costs begin to be capitalized.

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Identify the Deal

Individual Reflection Questions

- How does your organization determine when pursuit ends, and predevelopment starts?
- What type of information does your organization/board need to move from pursuit to predevelopment?
- Who in your organization makes the decision?
- Is there a dollar threshold?

Either share your thoughts in the chat or provide your response directly to the group.

Identify the Deal

Poll 1

1. How would you classify your organization’s process for determining when pre-development has begun?
   a. Somewhat informal without a lot of documentation to support the decision.
   b. More formal with more of the organization’s staff involved and maybe documentation to support the decision.

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Predevelopment

Forgivable Loans, Contributions and Exchange Transactions

Loans or contributions (grants) are usually received to cover predevelopment costs.

Accounting requirements depend upon the type of entity that received those funds. Most accounting principles are the same for both for-profits and non-profits, except for contributions which may include grants.

If you are a non-profit organization, you will need to determine if you have a loan, a contribution or exchange transaction (i.e. fee for service) arrangement when funds are received. A non-profit must also differentiate between donor-restricted and unrestricted contributions.

Sounds like that would be easy but….

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Predevelopment

Forgivable Loans, Contributions and Exchange Transactions

Loans

You know it's a loan if repayment is required. However, what if the loan is forgivable?

A forgivable loan will state that the principal will be forgiven when certain conditions are met (as homes are sold, over the term of the affordability restrictions, etc.)

Be careful. If the loan says that it may be forgiven, do not treat the loan as forgivable until it is actually forgiven.

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Predevelopment

Forgivable Loans, Contributions and Exchange Transactions

Note: This program is not intended to do a deep dive into ASU 2014-09 and ASU 2018-08, rather an overview for informational purposes.

Loans:

Prior to January 1, 2019, if the loan is forgivable, the organization should determine if non-compliance is *remote*. If so, it is really a contingent liability that would be disclosed, so it may be treated as a contribution and recorded as income. The revenue may be posted to temp restricted net assets and amortized to unrestricted net assets over the term of the restriction.

Effective in 2019, ASU 2018-08 revised this guidance: now, contributions with **a "right-of-return" and a "measurable barrier"** are conditional until the barrier is overcome. You can no longer assess the probability of compliance to justify recording the contribution.

Transactions that were recorded under the rules prior to 2019 do not need to be restated.

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Predevelopment

Forgivable Loans, Contributions and Exchange Transactions

Examples of Rights of Returns/Releases:

- Payments are subject to your compliance with the terms of the agreement
- The grantor will reimburse the grantee for actual and authorized expenses after completing the scope of work in a satisfactory manner to be approved by the grantor.
- Return of funds if the barrier outlined in the agreement is not met

Examples of Barriers:

- A measurable outcome, like the number of meals served, a matching contribution found, delivery of the results of a study.

The probability of meeting the barrier is no longer relevant – you have to perform

Predevelopment

Forgivable Loans, Contributions and Exchange Transactions

Polling Question 2

1. The reporting of income received by an entity will be determined by the type of entity that received the funds.
   - True or False?

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Break

- We will take a 10-minute break.
- Remain logged in during the break.
- Please return promptly.
  - This is especially important for participants seeking CPEs so that you may receive full credit.

Checking In

Polling Question 3

*Please use the **Chat** to share what has been most helpful.*

1. Have you learned anything today that you already know will directly impact your work?

   A. Yes, definitely.
   B. Maybe.
   C. No, definitely not.
   D. Not sure.

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Predevelopment

Forgivable Loans, Contributions and Exchange Transactions

So, if its not a loan, what does this mean for revenue recognition?

Step One: Know which guidance to apply – ***Contract*** (ASU 2014-09) or ***Contribution*** (ASU 2018-08):

- Examples of Revenue from Contracts with Customers (ASU 2014-09)
  - Development fees
  - Fee for service contracts
  - Sales of goods and other services

- Examples of Contributions Received and Contributions Made (ASU 2018-08)
  - Foundation grants
  - Governmental awards
  - Other contributions

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Predevelopment

Forgivable Loans, Contributions and Exchange Transactions

Steps to Consider in Determining the Guidance to Apply

- Is the transaction Reciprocal or Nonreciprocal?
- Is the transaction Conditional or Unconditional?

Key Items:

- Focus on terms of agreement, not type of resource provider
- Focus on point(s) of entitlement, not the probability of it

If the resource provider **does not receive direct and commensurate value,** there is a contribution, and the provisions of ASU 2018-08 are applied.

If it's a contribution, determine if there are donor-imposed conditions for the use of the funds. Conditions must include a "right of return or release" and a "barrier".

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Predevelopment

Forgivable Loans, Contributions and Exchange Transactions

Differentiating Donor Restrictions from Donor Conditions:

Restriction: *How a contribution is **to be used** without a barrier to overcome*.

- The funds must be used to provide meals to local families

Condition: *A **condition** relates to something you have **to do** to earn the revenue which is a barrier.*

- *The funds must be used to provide meals to at least 50 families each week who live within the Mission Hill neighborhoods of Boston*

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CPE requirement

Predevelopment

Forgivable Loans, Contributions and Exchange Transactions

Polling Question 4

1. Which of the following statements are true:

   A. A contract never provides for a fee for services rendered

   B. A contribution can be recognized even if there is a barrier remaining to overcome.

   C. Generally, a contribution means that there is no expectation that the recipient organization provides a direct and commensurate value to the resource provider for the cash received.

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Predevelopment

Forgivable Loans, Contributions and Exchange Transactions

*Please use the **Chat** feature to share your response.*

- **Thought Question**: How would you account for a HUD Capital Advance with the standard type language of "*not required to be paid so long as the housing remains available to eligible very low-income* households for a period of 40 years?"

Predevelopment

Forgivable Loans, Contributions and Exchange Transactions

ANSWER: Effective for transactions in 2019 and thereafter, this would be treated as a liability.

- There is a measurable barrier which must be overcome to treat this as a contribution, namely maintaining compliance with HUD's affordability restrictions for 40 years, AND
- There is a requirement to repay the loan if compliance is not maintained for 40 years.

- Thus, this transaction would be recognized as a liability until the end of the 40-year compliance period at which point it would be recognized as a contribution. NOTE: This may differ from how HUD Capital Advances received prior to 2019 were treated and there is no change needed for those transactions occuring prior to 2019.

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Summary

Predevelopment: Loans, Contributions and Exchange Transactions

Grants received during the predevelopment period would either be treated as a fee for service (taken into income as services are performed), as a contribution, or as deferred income which is recognized over the compliance period if there are ongoing compliance requirements

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Predevelopment
Loans, Contributions and Exchange Transactions
Class Exercise

*Please use the **Chat** feature to share your responses.*

- ABC Housing Developer receives a $1,000,000 “grant” from the City of ABC to build affordable housing. Is this “grant” a contribution-type grant or a fee-for-service grant?
- What if the City says that ABC Housing Developer can decide which properties in their pipeline to use the $1,000,000 on (as long as they are located within the City of ABC)?
- What if the City specifies that the $1,000,000 must be used on a particular City-owned property which the City will continue to own and operate?
- What if the City specifies that the $1,000,000 must be used on a particular property that an affiliate of ABC will own?
- What would the answers be if the “grant” went to a limited partnership or LLC instead of directly to the developer?

Predevelopment

Loans, Contributions and Exchange Transactions

Polling Question 5

1. A non-profit organization receives a contribution letter from a City government specifying that the funds are to be used for a specific property to be developed. The non-profit hasn’t acquired development rights yet because someone else still owns the land. The non-profit should consider the contribution to be:

   A. Without donor restrictions
   B. Conditional and recorded as a refundable advance (liability) until the condition (obtaining site control through purchase of land) occurs
   C. Unconditional but donor-restricted and restrictions are released as qualifying development costs are incurred
   D. Unconditional but donor-restricted until the property is placed in service at the completion of development

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Predevelopment
Best Practices

It can be hard to determine when pursuit ends, and predevelopment starts. Each organization should setup standard guidelines to make this determination.

- Deciding factors could include parent company investment, award of RFP, land entitlement, site control and/or predevelopment funding
- Set up separate accounting entity "company" or use your job cost system in your financial software. Set up a construction bank account to track predevelopment costs once you determine that the deal is viable.
  - Can decide to set up new legal entity during this phase or consolidate with corporate entity
  - It is best to incur the predevelopment costs in a separate "company" to capture all the costs that are eligible for rehab credits (not acquisition credits).
  - Segregation of invoices and easier internal draw completion.

Predevelopment
Best Practices

- Any funds needed to pay for predevelopment should be **loaned** to the “Company” to pay its own bills to capture all predevelopment cost.
- Intercompany loans should be reconciled monthly
- Predevelopment costs should be budgeted for so that you have some sense of the cash that will be required whether you are funding it internally or from a third-party source
- The chart of accounts should mirror the financial projections included in the LIHTC application to the state and the accounts used in the funding requisition

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Predevelopment

Best Practices

- The construction budget should be input into your financial accounting software.

- CIP should be reconciled to the monthly funding requisition before it is distributed

- Funding Requisition **Budget** Matters to be Considered
  - Deposits should be reflected as both a source and use so that construction sources can be used to pay for deposits
  - Equity Funds received in advance should be shown on the funding requisition when received with a corresponding “use”, which is the amount held in escrow. This reserve will be released as used on the uses tab. See sample in the handouts.

Predevelopment

Polling Question 6

1. Which of the following is true?

   A. It is best to incur predevelopment costs in a single CIP account on the Parent Company's books labeled Projects in Development as you can separate the project's cost out in the future.

   B. Predevelopment costs should be budgeted for so that you have some sense of the cash that will be required whether you are funding it internally or from a third-party source

QUESTIONS?

- Please use the **Zoom Chat** to submit questions.
- Instructors will remain on the line to answer remaining questions.

Next Session: Entity Formation and Deal Structure
Date: September 22, 2021
Time: 1:00 – 2:30 PM Eastern

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EVALUATION POLL

Your feedback is important to us!

- ✓ **Please complete the evaluation poll for this session.**
- ✓ **Email info@strengthmatters.net with any questions or concerns.**

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