

DEBT PRODUCTS - FHA

West Virginia Affordable Housing Conference

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Agenda

- Pros and Cons
- FHA Loan Programs
- HUD's Definition of Affordable and their Commitment to Affordable
- Underwriting Criteria
- 223f Eligibility and Requirements
- 221(d)(4) and D4 Pilot
- Costs – Reports and Fees
- Structuring with LIHTC Equity
- Process
- Good Candidates for FHA
- Critical Considerations
- Questions

Pros

- Competitive interest rates
- Long term
- Fully Amortizing
- Non-recourse
- No yield maintenance – prepayment penalty only
- Scattered sites often allowed
- Possible Cash Out on 223fs

Cons

- Need like-kind experience
- Paperwork
- Timing
- Transaction costs can be high
- Interest Rate Risk during Processing
- Annual Audit during loan term
- CNA required every 10 years

FHA Loan Programs

- *221(d)(4) - NC or SR
- 220 – NC or SR of mixed-use projects in urban renewal areas
- 231 - NC or SR of housing for the elderly
- *223(f) – refi or acquisition
- 223(a)(7) - refinancing of existing FHA deals
- 241(a) - Supplemental program for rehab/ additions to projects with an FHA 1st trust

HUD Definition of Affordable

- (a) Projects with minimum of 20% of units at 50% of the Area Median Income (AMI) or 40% of units at 60% of AMI,
- (b) Projects with mixed income if they also meet criteria (a) above, or
- (c) Projects with a project-based Section 8 contract for at least 90% of the units

Projects must be in compliance with a recorded Regulatory Agreement imposing the requirements in (a), above, and having term of at least 15 years after final endorsement.

HUD's Definition of Affordable

- **Broadly Affordable (25 basis points annually and upfront)**
- 90%+ affordable
 - Rent restrictions or PBRA at least 15 years *Achievable & u/w rents must be at least 10% below market
- **Affordable (35 basis points annually and upfront)**
- 90%+ affordable
 - LIHTC/rent restrictions at least 15 years (no 10% rent advantage)
- 10%-90% affordable
 - LIHTC or comparable use and rent restrictions for at least 15 years, or Project-based rental assistance with at least 15 years remaining
- **Green (25 basis points – on-going and upfront)**
- Must meet very specific guidelines to qualify as Green. Market rate deals can be green and receive the reduced MIP.

HUD's Commitment to Affordable Housing

- Lower MIP
- Higher LTC/LTV Ratios
- Lower Vacancy Rates
- No Cost Certification if $< 80\%$ LTC/LTV
- Mortgagable Developer Fees
- 20% Initial Equity Pay-In Requirement
- EBLs for up to 80% of Equity

HUD's Commitment to Affordable Housing

- Investor required reserves can be credited towards HUD's requirements
- 10% Assurance of Completion Escrows for 223f loans
- Passive Investor Certification only for Investor
- Straight-to-Firm Application submissions for D4 loans
- Streamlined A&E/Cost Review for D4 loans

Underwriting Criteria

* Affordable rents must be at least 10% below unrestricted market

** Properties where more than 20% of units are market rate or tax credit projects with without a significant rent advantage to market

Project type	Debt-service coverage factor	Loan-to-value/ Loan-to-cost ratios	Maximum underwritten occupancy
90% + rental assistance, Section 202	1.11	90%	97%
Affordable without rental assistance*	1.15	87%	97%, 95%, 93%
Market rate **	1.176	85%	93%

223f Program

- This is a Value program, based on Market value
- Max term < of 35 years or 75% economic life
- Mortgage is lowest of following criteria:
 - Value (after completion of repairs/improvements)
 - Debt Service Coverage
 - Stat Limits
 - Greater of 80% LTV or Cost to Refinance OR Cost of Acquisition

223f Eligibility

- Existing multifamily structures, at least 3 years old (possibly changing)
- Market rate, affordable, mixed income properties targeted to families and seniors (62+ HOH). 55+ eligible in certain cases with existing LIHTC
- Average physical occupancy of at least 85% required for six months prior to submission

223f Requirements

- **Critical repairs** - completed prior to closing
- **Non-critical repairs**- completed within 12 months
- **10% Assurance of Completion Escrow** for affordable projects/ 20% for market rate.
- **If Cash Out** - Max LTV of 80%
- **Replacement Reserve** – upfront and ongoing
- **Annual Audit**
- **CNA** every 10 years

“Heavy” 223f Requirements

- Up to \$43,019/unit repairs
- Often requires GC and/or Architect
- Plans and specs needed
- Modified AEC report
- Repairs completed within 12 months

221(d)(4) Program

- This is a Cost program
- Davis-Bacon wages required
- Max term < of 40 years or 75% economic life
- Mortgage is lowest of following criteria:
 - Replacement Cost
 - Stat Limits
 - Debt Service Coverage

221(d)(4) Requirements

- 5+ units with kitchens and baths
- Developer like-kind experience
- FHA-experienced Architect
- FHA-experienced GC and must provide assurance of completion (surety bond or LOC)
- FHA-experienced Management Agent

221(d)(4) Requirements

- Replacement Reserve
- Pre-Construction meeting with HUD
- Cost certification by an independent CPA (exception for Tax Credit deals)
- Annual Audits
- CNA every 10 years
- Working Capital and Operating Deficit escrows

221(d)(4) IOD/WC Requirements

- Loans < \$25M – 4-6 months debt service
- Loans \$25-\$75M – 9 months
- Loans > \$75M – 12 months
- Loans > \$100M -12 months (unless higher amount is identified through HUD analysis of risks and mitigants)

Working Capital - 2% vs 4%

New 221d4 Pilot

Mortgagee Letter 2019-03 Released 2/21/19 – changes the way HUD processes 221(d)(4)/220 LIHTC applications. Several changes since issuance of letter, for the better.

- 2 tracks – For both, loan size can't exceed \$25 million
- Concept meetings critical
- Items outside of multifamily – start early!

Eligible Projects – Expedited Processing

- 9% or 4% LIHTC NC – At least 90% LIHTC units with achievable rents at least 10% below market for each unit type. LTC < 65%.
- 4% or 9% LIHTC SR – At least 90% units with project based 20-year Section 8 (HAP) contract (15 years if PBVs). LTC < 75%
- Unit counts CAN'T exceed 200 units
- RAD – Only when close to receiving the RCC

Eligible Projects – Standard Processing

- 4% or 9% LIHTC SR - projects being re-syndicated with LIHTC/Tax Exempt Bonds w/o Section 8 rental assistance.
- 90% or more units must have LIHTC occupancy
- Achievable rents must be at least 10% below market
- DSC 1.0 and 85% or better occupancy for previous 6 months
- EGI can't be greater than 110% of previous calendar year
- Expenses can't be lower than 90% of previous year
- LTC < 75%
- Unit Count CAN exceed 200

221d4 Pilot Benefits

- Allows dedicated staff to focus on more complex deals
- Lets Lenders do what they do best - UW complex deals
- Faster processing times helps reduce interest rate risk
- Establishes Closing dates upfront
- Better Communication
- Allows additional lender oversight during construction phase (i.e. changes orders approved faster.)
- Encourages development in Opportunity Zones, which now have reduced application fees
- Creates & preserves affordable housing

New Pilot- Goals

Expedited Approval Process track:

- 30 day review + 60 days to Close

Standard Approval Process track:

- 60 day review + 60 days to Close

Costs - Required Reports

(paid to lender for payment to 3rd party report providers)

- Appraisal (\$8-\$12k)
- Market Study (\$8-\$12k) (not needed for 223f)
- Phase 1 and HEROs (\$4-\$7k)
- CNA and E-Tool (\$5-\$7k)
- Modified AEC Review for “Heavy F” (\$7-\$9K)
- AEC for 221d4 (\$18,000-\$20,000)
- Radon (\$3-\$7k)

Other environmental reports may be required depending on property's age/condition.

Costs - Fees

- Application fee - 0.30% of loan (paid to HUD) (reduced for OZ)
- Inspection Fee – the greater of \$30 per unit or 1% of the cost of the repairs for 223f. 0.50% of loan for NC/SR (paid to HUD)
- MIP – (paid to HUD)
 - Affordable/Green – 0.25% (0.50% at closing NC/SR).
 - Mixed Income – 0.35% (0.70% at closing for NC/SR)
 - Market Rate – .65% (1.30% at closing for NC/SR)
- Assurance of completion escrow for 223fs (10% or 20%)

Costs (cont.)

Lender fees – Financing and Placement fees up to 5.5% for bond deals, up to 3.5% non-bond deals (paid to lender)

Included in Financing/Placement Fees:

- Processing Fee – Typically \$7,500 non-refundable
- Lender Legal - \$20K-\$55K
- GNMA fee - \$500 on 1st \$1.5M, \$200 additional per each \$1M

Structuring with LIHTC Equity

HUD's LIHTC Equity pay-in requirements are as follows:

- At closing – Minimum 20% of Total Equity (may not be bridged)
- At 65% completion of repairs – Minimum 37.5% of Net Equity
- At 100% completion of repairs – Minimum 62.5% of Net Equity

NOTE: A bridge loan may be used for up to 80% of equity. Must be paid off at completion.

Process

- FHA team review
- Issue Term Sheet/Engagement Letter
- Borrower signs term sheet and wires funds for non-refundable processing fee and 3rd party reports
- Concept Meeting (if needed)
- Pre-Application and/or Firm Submission
- HUD Review (45 days-60 days)
- Loan Approval by HUD
- Firm Commitment
- Closing

What's a good candidate for FHA?

- New Construction/Substantial Rehabilitation
- Expired/expiring LIHTC properties
- Properties with Section 8 contracts
- Properties with above-market interest rates
- Stabilized Property Refinance/Acquisition or Repositioning with moderate rehab
- Workforce Housing/Mixed-Income
- PHAs are great candidates!

Critical Considerations for FHA

- Development Team
- Environmental
- Subordinate or Secondary Debt
- Rehab Repair Scope and Cost
- Existing or Proposed Age-Restrictions 55+ vs 62+. Section 221(d)(4) MUST be 62+ HOH. Section 231 available for 62+ exclusively for NC and SR.
- HAP contract extension
- Proposed equity Pay-in schedule

QUESTIONS??????



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