FHA MULTI-FAMILY PROPOSED CHANGES

2010 NCAHMA Spring Underwriting Forum

Wednesday, April 7, 2010

Rockport Mortgage Corporation & Oak Grove Capital

Current Events in FHA Multi-Family Financing

- **<u>Increased Volume</u>** - Significant increase in borrowers seeking to use the FHA multi-family loan programs due to severe and lengthy period of constriction in credit markets.

- **<u>Proposed UW Changes</u>** - New proposed underwriting changes for FHA multi-family programs as FHA seeks to improve its credit risk management.

- **<u>Expanding Use of 223(f)</u> -** Waiver of the "Three-Year Rule" to allow the 223(f) program to be used for projects constructed or substantially rehabilitated within the past three years.

- **<u>Increase to HUD Statutory Limits</u> -** Status of proposed legislative changes to increase the statutory limits on FHA programs, and a recent change by HUD in the way that the HUD statutory limits are calculated.

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Proposed Changes to FHA Underwriting

- **Debt Service Coverages**
- 221(d)(4) with 95% Section 8 Rental Assistance – remain at 1.11 dscr
- 221(d)(4) with LIHTC – increase from 1.11 dscr to 1.15 dscr
- 221(d)(4) Market Rate – increase from 1.11 dscr to 1.20 dscr
- 221(d)(3) Nonprofit Owner – increase from 1.05 dscr to 1.11 dscr
- 223(f) Market Rate – increase from 1.1765 dscr to 1.20 dscr
- 223(f) with LIHTC or Section 8 Rental Assistance – remain at 1.1765 dscr
- Elimination of two major building systems rule when determining 223(f) vs. 221(d)(4), new standard will be rehab (hard cost only) in excess of 20% of loan triggers Davis-Bacon wages.

221(d)(4) – **Proposed** Underwriting Changes

- Maximum LTC remains at 90% for projects with Section 8 rental assistance, but will be reduced to 87% for market rate and LIHTC properties.
- Minimum Initial Operating Deficit of 4 months' debt service, including principal, interest and MIP (not applicable to Section 8 deals).
- Construction contingency to be increased from 5-10% to 10-15% on substantial rehabilitation projects only.
- Working Capital Escrow increased from 2-4% to cover new construction cost overruns and change orders (not applicable to Section 8 deals)..
- Maximum underwriting occupancy of 93% (decreased from 95%) unless waived.
- Must be able to demonstrate ability to stabilize within 18-months of completion, unless waiver obtained for larger projects.
- For LIHTC deals, partnership held reserves may be used to cover the IOD and WCE increases if allowable uses mirror HUD requirements.

223(f) - **Proposed** Underwriting Changes

- Sustaining occupancy will be defined as average 85% physical occupancy and 80% economic occupancy for the six month period immediately prior to application. Occupancy also to be re-reviewed immediately prior to closing. Maximum underwriting occupancy is 93%.
- Clear all accounts payable, project liability, and deferred management fees at closing.
- On deals where borrower is taking equity out, the maximum LTV may remain 80% (compared to 85% where no equity out); however, a reduction to 75% LTV has been discussed, either way any release of equity will be deferred until repairs are completed.
- Fractured condos where some condos have been sold may not be eligible for HUD financing.

Comment Period and Potential Implementation

- Proposed underwriting changes are being discussed by HUD and FHA lenders and the industry to determine best solutions. **No changes have occurred yet but at least some are expected.**
- Proposed changes are expected to be implemented through a Mortgagee Letter issued by HUD. No date set for issuance, but may occur as early as May/June 2010.
- For purposes of implementation of UW changes, HUD has indicated there will be some "grandfathering." Submittal 60 days from the date of the letter for 223(f) and 'something longer' for 221(d)(4) is the latest estimate.
- If changes do occur, HUD may waive the more restrictive underwriting requirements in stronger, well-performing markets.
- HUD has stressed that any new underwriting changes are not necessarily permanent, but may change again when the multi-family markets improve.

What Will Not Change

- All FHA multi-family loan programs will be continued.
- All FHA multi-family loan programs will continue to be 100% nonrecourse.
- There will be no MIP increase on any of the FHA loan programs.
- There will continue to be no Loan-To-Value requirement for Section 221(d)(3) and 221(d)(4) loans.
- FHA underwriting will continue to focus on achievable rents and expenses, and will not be locked into the historical operations of the project. This advantage in the FHA underwriting orientation vs. other executions is significant.
- FHA will continue to provide the most generous underwriting criteria of any multi-family financing execution.

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Waiver of "Three-Year Rule" for 223(f) Applications

- Historically, the FHA 223(f) program could <u>not</u> be used to finance projects that were constructed or substantially rehabilitated less than three years prior to submitting an application for firm commitment. The so-called "Three-Year Rule" was meant to prohibit borrowers from obtaining construction financing without Davis Bacon wage and other HUD requirements, then taking-out the construction debt using the FHA 223(f) program.
- In July 2009, HUD issued a Mortgagee Letter granting temporary authority to Multi-Family HUBs to process waiver requests to use the 223(f) program on projects constructed or substantially rehabilitated less than three-years prior. Meant to assist fully-operating and self-sustaining projects that are not able to secure permanent long-term financing due to the freeze in the capital markets.
- There are thirteen conditions in the Mortgagee Letter that must be met to obtain waiver, including having achieved "sustaining occupancy" and => 90% occupancy for three consecutive months immediately prior to submittal of application. *See* HUD ML 2010-06.
- Waiver authority has been extended through February 17, 2011 by recent Mortgagee Letter.

HUD Stat Limits – Recently Proposed and Adopted Changes

- **Background –** Current FHA statutory loan limits are severely restricting the ability to use FHA insurance programs to financing rental housing in many urban areas, including Boston. Particularly true for mid- to high-rise steel frame construction. Stat limits are an issue in Boston, and are currently limiting FHA loan amounts for multiple projects in the City. However, stat limits generally are not an issue for projects outside the city (e.g., in Stoneham, Melrose, Waltham, etc.), where replacement cost / debt service mortgage constraints control.
- **Proposed Legislative Changes –** On September 15, 2009, the U.S. House of Reps passed the FHA Multifamily Loan Limit Adjustment Act, which provides for an increase in the elevator statutory limits for FHA multi-family insurance programs, setting the elevator limits at 50% above the non-elevator limits. Similar bill is currently being sponsored in the Senate by Senator Schumer (D) of New York, but looking for co-sponsor. Would materially increase stat limits for elevator projects and facilitate the use of FHA loan programs on urban projects.
- **Recent HUD Changes –** On March 19, 2010, HUD issued a Mortgagee Letter noticing a change in the way that statutory limits would be calculated to include the value of the land as a separate line item. This materially increases the statutory limits for urban projects.

Thank you.

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