National Housing & Rehabilitation Association
2009 Spring Forum

May 11-13, 2009

Hyatt Regency Century Plaza
Los Angeles, California

RESURGENCE OF FHA/GNMA FINANCINGS FOR AFFORDABLE HOUSING AND OTHER MULTI-FAMILY HOUSING PROJECTS

Presented by:

R. WADE NORRIS, ESQ.
wnorris@enbonds.com
EICHNER & NORRIS PLLC
1225 19th Street, N.W., Suite 750
Washington, D.C. 20036
Phone: (202) 973-0100
Fax: (202) 296-6990
www.enbonds.com

JOE KNOLL, ESQ.
jknoll@krooth.com
KROOTH & ALTMAN L.L.P.
1850 M Street, N.W., Suite 400
Washington, D.C. 20036
Phone: (202) 293-8200 x8223
Fax: (202) 775-5872
www.krooth.com

MR. RICK ANDREWS
rrandrews@redcapitalgroup.com
RED MORTGAGE CAPITAL, INC.
655 W. Broadway, Suite 800
San Diego, CA 92101
Phone: (619) 471-0115
Fax: (619) 471-0125
www.redcapitalgroup.com

MR. NICK GESUE
ngesue@lancasterpollard.com
LANCASTER POLLARD & CO.
65 East State Street, Suite 1600
Columbus, OH 43215
Phone: (614) 224-8800
Fax: (614) 224-8805
www.lancasterpollard.com

RECENT MARKET DEVELOPMENTS DRIVE BORROWERS TO FHA

- Real estate/financial/economic **meltdown** which began in Summer of ’07 **has dramatically and adversely affected sources, availability and pricing of capital** for commercial real estate, including affordable housing.
- Securitization markets have dried up. **Conduit lending**, a major source up to a year ago, is now **all but non existent**.
- **Massive deleveraging at banks** has resulted in dramatic reduction in availability of letters of credit (only very best customers in CRA deficient markets) and increases in price (from 100 bps to 250-300 bps or more). **Construction period credit enhancement extremely scarce** or unavailable to many borrowers.
- **Fannie/Freddie have tightened underwriting standards** (from 1.10 DSCR to 1.15 or 1.20 and 90% LTV down to 80% or 85%) and significantly **increased credit enhancement fees** (from 65-85 bps to 125 bps).

RECENT MARKET DEVELOPMENTS

- **Liquidity** supporting variable rate bonds much **more scarce** (**Fannie is out** of the market due to FHFA cash reserve requirements) and **expensive** (Freddie raised from 25 bps to 100 bps + 1 point up front).
- For **market rate** or 20% affordable deals, **equity sources virtually non-existent** in light of increasing commercial real estate defaults.
- On **100% affordable deals, LIHTC equity proceeds dramatically lower** due to scarcity of buyers, downward pressure on pricing, etc.
- Severely constrained state and local budgets made **subordinate loan financing much less available**.

Result:

WIDE TIES ARE BACK IN STYLE!!!

WELCOME (BACK) TO FHA/GNMA FINANCING!!!

FHA/GNMA MAJOR ADVANTAGES

- Insurance of Advances – **No separate Construction Lender**
- **High percentage Loan-to-cost** (96-100%) – lessens equity requirements
- **Underwriting Criteria generous** & unchanged (1.11 DSCR, 98% L-T-C, 40-year loan amortization)
- **Fees low & unchanged** – 70 bps (13 bps GNMA, 12 bps Svcg + 45 bps FHA)
- Offers **competitive taxable as well as tax exempt alternative executions** in current market

FHA/GNMA HAS BECOME COMPETITIVE AGAIN

SUMMARY OF BORROWING/UNDERWRITING RATES:
Tax Exempt Bond Financed Rates

	Estd. Actual All-In Borrowing Rate	Underwriting Rate
1. VR Bank L/C **(if available)**	3.53%	Varies; negotiable
2. VR Freddie Capped (probably unavailable on tax credit deals)*	3.20%	6.34%
⇨ **3. VR Freddie Swapped**	**6.28%**	**6.28%**
⇨ **4. 18-Yr FR Fannie/Freddie**	**6.77%**	**6.77%**
⇨ **5. 42-Yr FR FHA/GNMA**	**6.60%**	**6.60%**
6. Bank Private Placement		
- In CRA deficient footprint **(if available)**	6.80%	6.80%
- Outside CRA deficient footprint **(if available)**	7.50%+	7.50%

* May be attractive on non-tax credit deals.

TAXABLE DEALS

§221(D)(4); §220; §232
New Construction/Sub Rehab

Market Rate on Taxable CLC/PLC Sale	**6.00%**
GNMA Guaranty/Servicing Fee	0.25
Stated FHA Insured Mortgage Loan Rate	**6.25%**
FHA Mortgage Insurance Premium	0.45
All-in Borrowing Rate	**6.70%**

§223(f); §223(a)(7)
Refinance/Acq. Light Rehab

Market Rate on Taxable PLC Sale	**4.75%**
GNMA Guaranty/Servicing Fee	0.25
Stated Mortgage Loan Rate	**5.00%**
FHA Mortgage Insurance Premium	0.45
All-in Borrowing Cost	**5.45%**

FHA MORTGAGE INSURANCE/GNMA WRAP

Concept: A mortgage loan insured by the FHA (full faith and credit of the U.S. Government) is used to secure the bond issue, often combined with a GNMA wrap. Bond Trustee or GNMA purchaser is secured by the GNMA Security; GNMA looks to the FHA insurance.

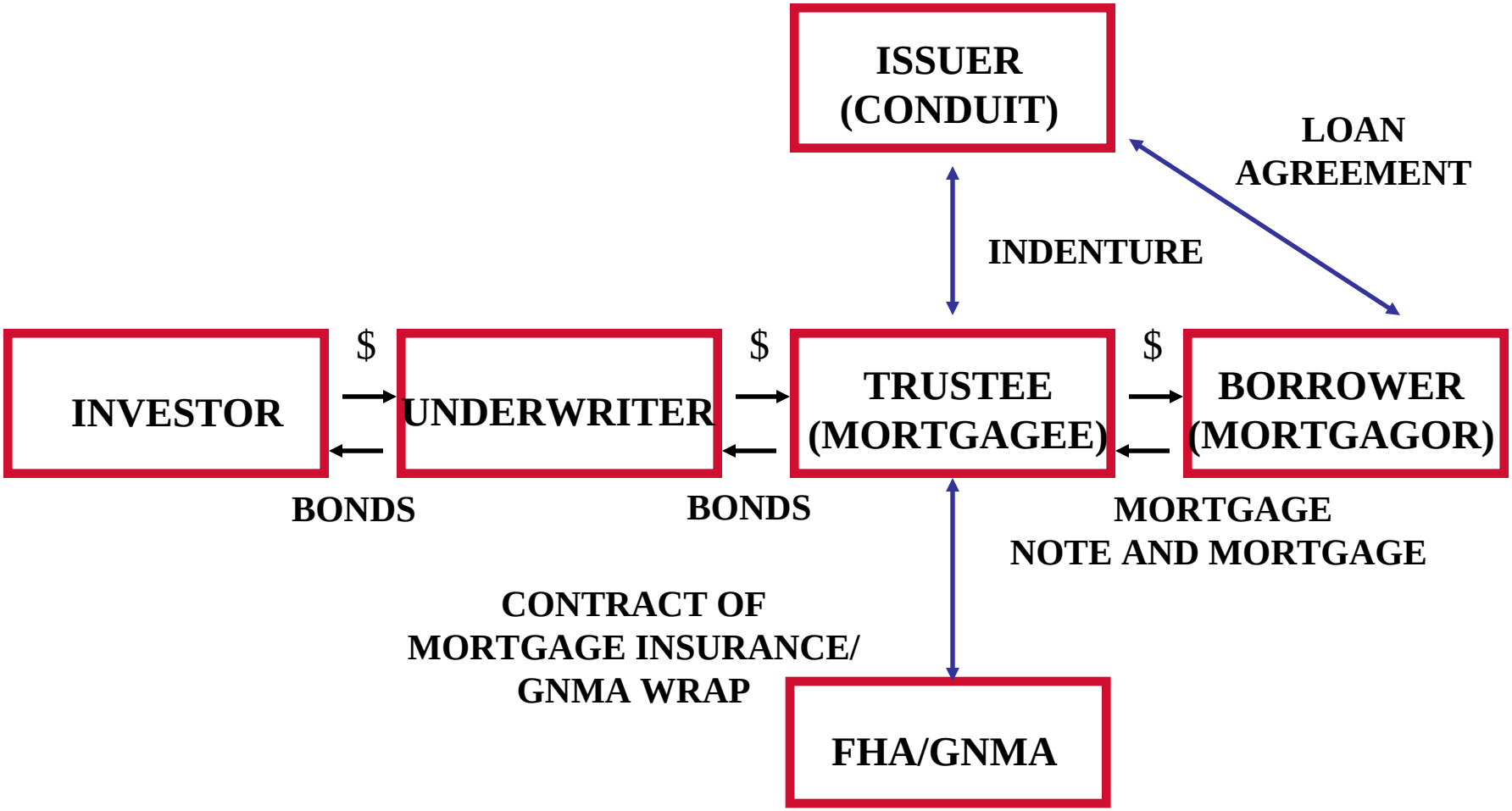
- Available programs for **housing**:
  - **New Construction** and **Sub. Rehab**
    - Section 221(d)(3) (Nonprofit) (Rarely used)
    - Section 221(d)(4) (Profit Motivated and Nonprofit)
- **Acquisition/Refinance**
  - Section 223(f) (Prior Loan not FHA insured)
  - Section 223(a)(7) (Prior Loan FHA insured)

FHA MORTGAGE INSURANCE/GNMA WRAP

- Available programs for **assisted living**:
  - New Construction and Sub. Rehab
    - Section 232
  - Acquisition
    - Section 232
  - Refinance
    - Section 223(f) pursuant to Section 232

FHA MORTGAGE INSURANCE/GNMA WRAP:

SECTIONS 221, 232, 223(f) and 223(a)(7)



FHA 221(d)(4) / GNMA

Program for New Construction/Substantial Rehab

- Qualified Projects
  - **New construction**
  - **Substantial rehab**
    - (i) rehab cost > 15% of replacement cost,
    - (ii) $6,500+/unit (adjusted (up to $15,000 in some markets) for high cost factor), or
    - (iii) 2 or more major building components (i,e., roofing, siding, etc.)

- Underwriting Terms
  - **Debt service coverage** requirements **1.11x**
  - **40-year loan** amortization
  - 90% of FHA replacement cost (including land); treat 10% “BSPRA” or 6% “SPRA” as cost = **96-100% of Cost**
  - Fixed rate only
  - **Operating deficit (3-6 months** debt service) and **2% working capital** reserves
  - **Negative Arbitrage** and bond lag deposit if bond financed

FHA 221 (d)(4) / GNMA

Program for New Construction/Substantial Rehab

- **Advantages**
  - **Provides both construction and permanent financing** – one lender
    - one origination fee/one underwriting process
    - **No reunderwriting of loan** to market at conversion/stabilization – just certification of costs
  - **Favorable underwriting terms**
    - Highest proceeds-senior debt programs (1.11 DSCR*; 96-100% Loan-to-Cost, 40-year loan amortization)
  - **Lowest credit enhancement cost**
    - 70 bps (GNMA 13; Svcg 12; FHA MIP 45)
  - **Non-recourse** construction loan
  - **Assumable** long term fixed rate financing
  - Less emphasis on borrower financial strength; no **financial covenants**

- **Disadvantages**
  - Timing – takes **6 to 10 months**
  - Subject to **Davis-Bacon wages** (residential, not commercial)
  - **Statutory Cost Limits** may be problem for upper end projects
  - Significant **Negative Arbitrage** Deposit if bond financed
  - Very limited structuring flexibility
  - **No variable rate option**
  - **No balloon option**
  - **Limited subordinate financing** options
  - **Surplus cash distributions** are only allowable twice a year. An operating lease can help to circumvent this issue.

* Tax Credit equity investor may require higher.

§220 FHA Insurance for Urban Projects in Designated Redevelopment Areas

- Terms very similar to 221(d)(4), except:
  - Higher percentage of revenue from **commercial** allowed (**up to 30% gross income**)
  - Higher percentage of gross **floor space** to commercial allowed (**up to 20% of gross** floor area)
  - **Higher HUD Statutory limits** may apply

FHA §223(f)/GNMA Program for Refinancing/Acquisition

- **Permanent Financing Only**
- Qualified Projects
  - Affordable and market rate multifamily (including age restricted independent living)
  - **Refinancing**
  - **Acquisition and Light Rehab**
    - Rehab < $6,500 (or up to $15,000 in high cost area)/unit
    - Cannot involve more than 2 major building systems
- **Generous underwriting standards:** 35-year level amortization loan; 1.17 DSCR and 85% of value (can cover up to 100% of eligible costs)
- Same **very low fees** – 70 bps
- **Very competitive interest rates** – 5.0% stated mortgage loan rate + 45 bps MIP = **5.45% all-in borrowing cost** in present market on 35-year loan
- **Assumable**
- **Shorter processing time** – **3-6 months** versus 6-10 on 221(d)(4)
- **No Davis Bacon**
- **No cash out** allowed on refinance

FHA §223(f)/GNMA Program for Refinancing/Acquisition

- **Properties within 3 years of** the issuance of the Certificate of Occupancy **(CO) now eligible for refinancing with Section 223(f)**, if:
  - CO issued prior to 7/31/2008
  - Conventionally funded construction
  - Permanent financing unavailable conventionally
  - Current on outstanding loan payments
  - 3 months sustaining occupancy prior to application submission
  - One full year audit available
  - Waiver of 3-year prohibition **may apply to acquisition**, but **borrower must provide HUD with evidence that it has tried to obtain permanent financing and was unsuccessful** (e.g., recently constructed projects that have lost or are unable to obtain permanent financing). Not intended to provide a source of acquisition financing UNLESS borrower can show HUD that the acquisition is the intended vehicle, i.e., it is bailing out a seller who can't find alternative permanent loan financing
  - Waiver authority expires August 6, 2009, but HUD may extend

FHA §232 Program (Nursing & Assisted Living)

- Generally for **nursing home and assisted living facilities**, at least 75% of which **licensed by state**
  - Nursing Homes
  - Intermediate Care
  - Board and Care Homes
  - Assisted Living
  - Specialized Use Facilities
- **New Construction & Substantial Rehabilitation**
  - Up to 95% LTV for Non-Profits
  - Minimum 1.11x Debt Service Coverage
  - Land can be pledged as equity
  - Up to 40-Yr Term Amortization
  - Davis Bacon Wage Requirement
  - 5-7 month processing (estimate)

FHA §232 Program (Nursing & Assisted Living)

- **FHA 232/223(f) – Refinance & Purchase**
  - Up to **90% LTV** for Non-Profits
  - Minimum **1.11x Debt Service Coverage**
  - Up to **35-Yr Term** Amortization
  - **4-6 months processing** (estimate)

LEAN Process Update for FHA 232

- HUD has rolled out LEAN process to make FHA 232 financing process more efficient
- Shortened processing and closing times
- Select offices for processing
- 232 program under oversight of OIHCF, rather than OMH
- Market standard appraisals (no proprietary earnings adjustment)
- More robust and detailed underwriting package on front-end

Section 242 FHA Insurance for Hospitals and Other Acute Care Medical Facilities also available

FHA – Cash Requirements to Close

- **Working Capital Escrow**
  - **2%** of mortgage loan amount
- **Initial Operating Deficit**
  - Cumulative losses incurred prior to stabilization **(generally, 3-6 months debt service)**
- **Bond Issuance costs** in excess of allowable 2%
- Rating Agency required **negative arbitrage deposit** for tax exempt **bond financed** deals
  - Not applicable in taxable GNMA deals due to forward delivery structure – absorbed in rate quote
  - **2-3 points actual** – typically **cash**
  - **2-3 points** of **potential back-end** – typically **letter of credit**
  - **New structures may minimize or avoid** on tax exempt bond financed deals
- **One month's interest deposit** for cash flow lag
- **Rate Lock Deposit** (typically ½ point on taxable deals, refundable at closing)
- **Lender warehousing loan cost fees**

Two-Stage versus One-Stage FHA §221(d)(4) Loan Processing

Months (Two-Stage)	Processing Steps	Months (One-Stage)
0	Borrower Approaches Lender	0
0.5	Engagement Letter Signed – Draft Appraisal, Market Study, Phase I Environmental Prepared	0.5
2.5	Pre App Submitted to HUD. Docs drafted	3.0
4.0	HUD Issues Invitation to Submit for Firm. ALTA Survey, 3rd Parties, Detailed Plans & Specs, Complete GC Bidding & Specs. Final Appraisal, Arch. & Cost Report	↓ 60 days
6.0	Firm App. Submitted to HUD	
7.5	HUD Issues FHA Commitment/Lender Commitment	5.5
8.5	Complete Items Needed for Rate Lock	6.5
10.0	Closing & Initial Endorsement of Loan	8.0

DIFFICULTY OF USING SUBORDINATE FINANCING WITH FHA

- **No more than 7.5%** of first Deed of Trust, unless public body lender*
- Security limited to surplus cash with **no second DOT, unless public body subordinate lender***
- Has to **mature after** 35 to 42-year **FHA insured loan**

---

* Tax exempt subordinate municipal bonds qualify for this exception

Coordinating FHA w/ LIHTC

- Housing Notice 08-19
  - Delayed equity pay-in; minimum of 20% of total proceeds required
  - Preliminary plans allowed with Firm App
  - Firm Commitments conditioned on 2530 approval
- HR 3221 – HERA 2008
  - Subsidy layering & compliance monitoring conducted by HFA, not HUD
  - Must pursue further streamlining through demo

LENDER SELECTION

- Should be **experienced** in §221(d)(4) loans **in the HUD office** that will process the loan.
- **Must have personnel to aggressively pursue** processing of loan in time of high & growing demand and willing to devote time and attention to aggressively processing deal
- **Should consider pricing &** financing and placement and other **fees**; when money at risk and **willingness to reduce charges if loan not feasible after FHA Commitment signed due to no fault of Borrower**.
- Should consider **willingness to offer some "transparency in pricing"** in taxable CLC/PLC Sale
- **Important for experienced FHA/GNMA borrower's counsel to have an opportunity to review** the Engagement Letter, Financing Commitment (if any) and Rate Lock Letter & Extension Agreements **before engagement letter signed.**

If Developer chooses FHA approach, then following questions will apply:

- Do I have time to make FHA work?
- Will Davis Bacon wages (if new construction, sub rehab) work?
- What debt service coverage is tax credit investor underwriting deal?
- What is pay-in schedule discussed with tax credit investor?
- Is your general contractor bonded?
- Do you have a HUD experienced architect?
- Do you have a HUD experienced accountant?
- Do you have significant funds available prior to closing?
- Have you previously worked with the local HUD office?

Taxable vs. Tax Exempt Financing of Section 221(d)(4)/220 Loans

Initial Question: **Is project subject to any income restrictions** on any of the tenants?

If no, under current market conditions, it is almost certain that a **taxable sale** of GNMA securities issued with respect to the FHA insured loan will provide the least expensive financing alternative, with minimal complexity, upfront issuance costs and no upfront deposits for construction period negative arbitrage.

Taxable CLC/PLC Sales

Lender solicitor bids from qualified institutional buyers to purchase CLC's and PLC's, when issued, based on expected loan draw schedule. **No negative arbitrage** on a construction fund, since GNMA's issued and sold as advances are made. Negative arbitrage is effectively embedded in yield quote.

In current market, with 18-24 months even draw schedule on $20-$30 million plus loan, quotes would be for GNMA securities yield of about 6.0%.

Taxable vs. Tax Exempt Financing of Section 221(d)(4)/220 Loans

Rate on GNMA Securities (CLC's/PLC)	**6.00%**
GNMA Guaranty/Loan Servicing Fee	0.25
Stated Rate on FHA Insured Mortgage Loan	**6.25%**
FHA Mortgage Insurance Premium ("MIP)	0.45
Effective All-in Borrowing Rate	**6.70%**

<u>Alternative</u>: **<u>Funding FHA Insured Loan from Proceeds of Tax Exempt Bonds</u>**

Likely to be attractive versus taxable CLC/PLC sale only if inclusionary zoning or other requirements mandate that a certain percentage of units required to be set aside for low income persons (e.g.; 10% at 50; 10% at 60 or 80% of AMI).*

* New York – Exception: Under Section 421a, with real estate tax relief on all units funded with tax exempt bonds and some inclusionary zoning, this alternative almost always wins, if private activity bond volume available.

Taxable vs. Tax Exempt Financing of Section 221(d)(4)/220 Loans

Traditional Structure – Issue long-term tax exempt bonds secured initially by bond proceeds invested in short-term AAA-rated GIC, used over time to purchase the GNMA securities, when each loan advance is made and insured by FHA and corresponding GNMA security is issued.

FHA/GNMA 42-year Fixed Rate Traditional Tax Exempt Bond Financing Structure

Underwriting		
Bond Interest Rate		**5.75%**
Remarketing Agent	0.0	
Issuer	0.125	
Trustee	0.025	
Bond Fee Stack		**0.15**
Stated Rate on GNMA		**5.90%**
GNMA Guaranty/Servicing Fee		0.25
Stated Rate on Mortgage Loan		**6.15%**
FHA Mortgage Insurance Premium		0.45
Effective Actual Borrowing Rate		**6.60%**

Upfront Fees (est.)	
Lender Origination	0.50 – 1.0%
HUD App.	0.3
Bond Costs of Issuance	1.0 – 2.0
	1.80 – 3.30%

Taxable vs. Tax Exempt Financing of Section 221(d)(4) Loans

- **Advantages** of Tax Exempt Bond Alternative
  - Pluses: Long-term **borrowing rate may be slightly lower** than taxable CLC/PLC sale, due to funding from tax exempt bonds.
  - Currently 6.0-6.15% mortgage rate versus **6.25%** if low or no issuer ongoing fee.
  - May result in **larger loan**, if loan is debt service constrained.
  - Other Advantages of Tax Exempt Bond Financing:
    - May get **real estate tax relief** on all bond financed units (NY) or on affordable units (CA).
    - Can **syndicate tax credit equity on affordable units**. (May produce proceeds = 4-6% of total development cost if 20% affordable).

Taxable vs. Tax Exempt Financing of Section 221(d)(4) Loans

- **Disadvantages** of Tax Exempt Bond Financing:
  - **Complexity**; Time and Effort; **Available Bond Volume**?
  - **Additional upfront costs; 1-2%** depending on deal size.
  - **Big issuer (e.g., state agency - 25-40 bps) ongoing fee** can substantially raise borrowing cost; will possibly lower loan size or project cash flow.
  - Upfront **construction period negative arbitrage** on project fund of **2-3% actual (cash)** and **2-3% potential back-end (L/C)**.
- **New short-term tax exempt bond structure may eliminate most of construction period negative arbitrage and ongoing issuer fees in some cases.**

§223(f) Refinance Loans

- Taxable execution (PLC sale) far superior at this time:

Taxable

Rate on PLC	**4.75%**
GNMA Gty Fee/Svcg	0.25
Stated FHA Insured Mortgage Loan Rate	**5.00%**
FHA Mortgage Insurance Premium	0.45
All-in Borrowing Cost	**5.45%***

Tax Exempt

Rate on 35 Yr Bonds	**5.70%**
Issuer, Trustee, Rebate Fees	0.15
	5.85%
GNMA Gty Fee/Svcg	0.25
Stated FHA Insured Mortgage Loan Rate	**6.10%**
FHA Mortgage Insurance Premium	0.45
All-in Borrowing Cost	**6.55%****

Difference: Tax Exempt > Taxable = 120 bps!!!

* Note: About **125 basis points** lower than taxable sale of CLC's/PLC's (see slide 32) in current market!

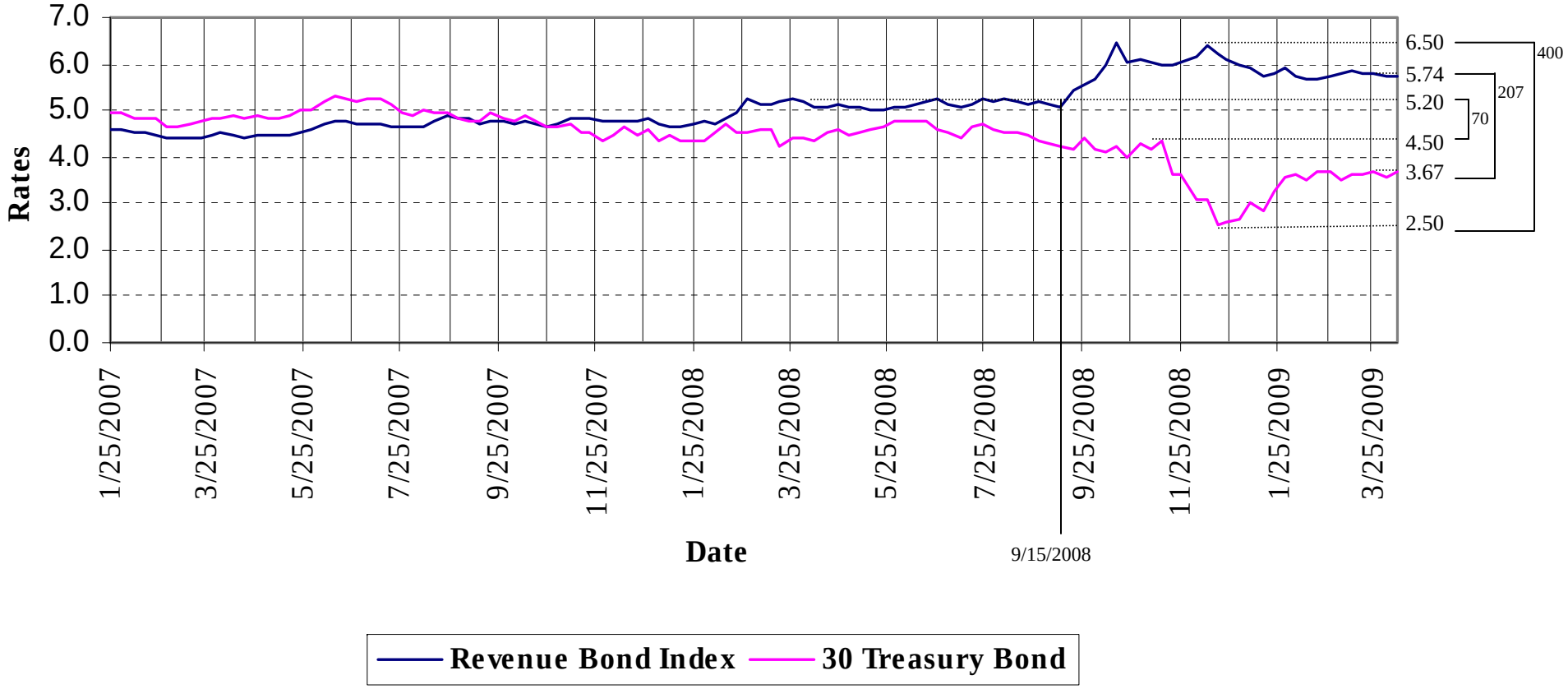
** Note: About 110 basis points higher than taxable PLC sale => **almost all stabilized transactions will use taxable versus tax exempt option.**

Transitional State: Tax Exempt Bond Finance Alternatives May become more attractive over next 6 – 12 months

- Following charts show that normal relationship of long-term taxable obligations versus long-term tax exempt muni bonds has “gone upside down” since market crisis following Lehman Bankruptcy and Primary Reserve Capital “breaking the buck” last September.

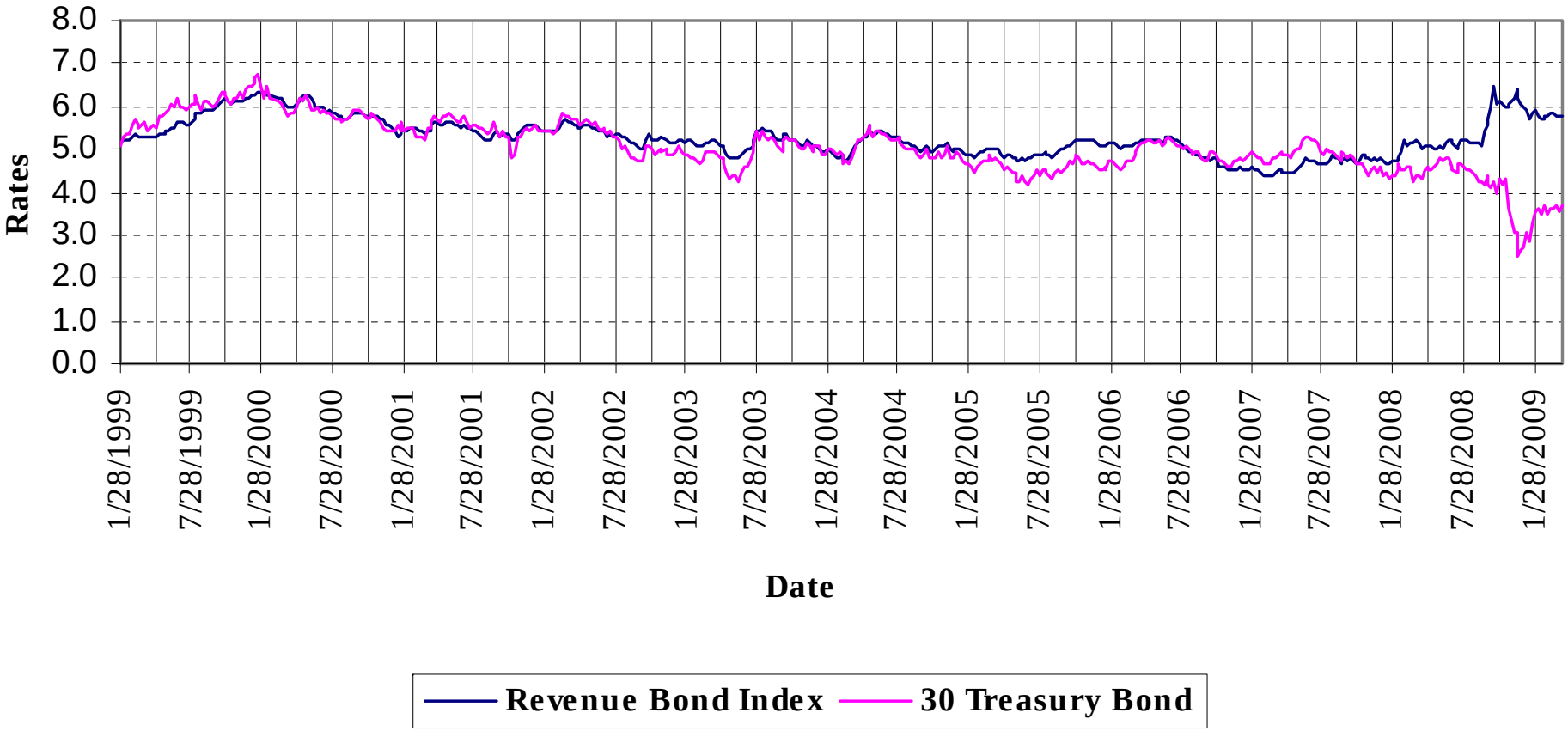
30 year T-bond vs Revenue Bond Index 2007-2009

Source: The Bond Buyer



30 year T-bond vs Revenue Bond Index 1999-2009

Source: The Bond Buyer



Transitional State: Tax Exempt Bond Finance Alternatives May become more attractive over next 6 – 12 months

- Normally, L-T TE's ~90% of LT Taxables.
- Went slightly upside down in fall of 2007 when real estate crisis began to emerge.
- Negative Spread widened to about 70 bps (tax exempts > taxables) in early 2008.
- Spiked to 400 bps (tax exempts > taxables) in late 2008.
- Now back down to 207 bps (tax exempts > taxables)
- Structuring Guidance: If no affordability requirements, start deals as taxable CLC/PLC sale, but watch market and potentially switch to bond financed alternative if the two markets continue to converge back to more normal yield relationship.
- Should decide prior to issuance of Firm Commitment; obtain Official Action Resolution if bonds likely.

Outlook for Working with FHA in the Year Ahead – Tips and Guidelines

- Get in line
- Suggestions for expediting getting through the process:
  - Can you take the risk of rising rates; other uncertainties
  - Have third parties ready

BRING ME

HUD Secretary Shaun Donovan*

YOUR DEALS!!!

_____

*** Not really!**