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# Demystifying FHA for Multifamily Housing

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**PHFA Housing Forum  
Harrisburg, PA**

# FHA Financing Overview

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## Primary Loan Types for Construction/Acq-Rehab

- 223(f)
- 221(d)4

## Process

- Concept Meeting
- Application Submission
- Firm Commitment

## Practical Considerations for Structuring Your Transaction

## Best Practices-Tips for a Smooth Transaction

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# Loan Types – Permanent and Construction/Perm

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# Loan Types – Permanent & Construction/Perm

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## **A. Permanent Loan – Section of the Act is 223(f)**

1. Fully amortizing for up to 35 years; no refinance risk, balloon payment, or exit test.
2. Can be used for acquisition or refinance
3. Up to \$40,500 per unit in repairs; higher level of repairs could require an architect and/or GC
4. Cash out allowed
5. Loan amount is determined by DSCR or Loan-to-Value
6. Non-recourse. Carve-out for fraud.

## **B. Construction/Permanent – Sections of the Acts are 221(d)(4) or 220**

1. Fully amortizing for up to 40 years; no refinance risk, balloon payment, or exit test.
2. No conversion risk. Conversion to permanent period is at construction completion.
3. Can be used for new construction or substantial rehabilitation.
4. Architect and general contractor required; contractor must be bondable
5. 100% complete plans and specs need to be submitted to HUD
6. Permits required for closing
7. Loan is determined by DSCR or Loan-to-Mortgageable Cost
8. Non-recourse. Carve-out for fraud.

# HUD FHA 223(f)

**Maximum LTV:** 87% 90% Loan to Replacement Cost

**Minimum DSCR:** 1.11 - 1.15x

**Term:** 35 years or 75% of remaining useful life

**Amortization:** 35 years (fully amortizing)

**Prepayment:** 0 or 1 year lockout with 10 year declining prepayment penalty

**Index:** 10-year U.S. Treasury

**Spread:** 100-125 bps over 10-year U.S. Treasury

**Funding Type:** Immediate

## Typical Fees:

- Lender Fee: Varies
- HUD Fee: 0.30% of Loan
- Inspection Fee: 1%
- Mortgage Insurance Premium: 25-60 bps

## Product Benefits:

- Non-recourse
- Cash out allowed
- Competitive interest rates

## Considerations:

- For Acquisition and/or Refinance of existing projects
- Repair Cap of \$40K per unit
- Davis Bacon wages NOT required
- Timing to close is typically longer than that for a Fannie/Freddie execution

# HUD FHA 221(d)4

**Maximum LTV:** 87% 90% Loan to Replacement Cost

**Minimum DSCR:** 1.11 - 1.15x

**Term:** Construction term plus 40 years

**Amortization:** 40 years (fully amortizing)

**Prepayment:** 0 or 1 year lockout with 10 year declining prepayment penalty

**Index:** 10-year U.S. Treasury

**Spread:** 150-175 bps over 10-year U.S. Treasury

**Funding Type:** Immediate. Funded through construction and held through perm

## Typical Fees:

- Lender Fees: Varies
- HUD Fee: 0.30% of Loan
- Inspection Fee: 0.50%
- Mortgage Insurance Premium: 25-65 bps

## Product Benefits:

- Loan is funding through construction, eliminating need for separate construction loan
- Non-recourse
- Completion Requirement but no re-sizing test at conversion
- Competitive interest rates; single interest rate locked at construction closing

## Considerations:

- For New Construction or Substantial Rehab projects.
- Davis Bacon wages required
- Timing to close is typically longer than that for a Fannie/Freddie execution

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# Process: From Concept to Closing

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# Loan Process – From Concept to Close

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## A. Concept Meeting

- Opportunity to introduce deal and deal team to HUD; in person or conference call.
- HUD's opportunity to note any concern about the deal.
- Basic information of deal needed – income and expenses, sources and uses, deal team anticipated waivers, mark-up-to-market requests, other issues or guidance needed from HUD.
- Can all be preliminary, but the more detail the better. Nothing needs to be set in stone. Discuss the "concept" of the deal. Feedback from HUD may change the deal some.
- End result is an "Encouragement Letter" in which HUD encourages the lender to submit the application. Letter may contain guidance for items to be specifically addressed in the Firm Application.

## B. Application Submission

### 1. Affordable Transactions = Straight to Firm

- HUD's way of speeding of affordable transactions that often have hard deadlines.
- All checklist items needed.
- Plans & Specification may be 80% completed, but 100% will be needed before closing.
- Transaction will be assigned to an affordable experienced underwriter.
- Make HUD aware of true hard deadlines for closing.



# Loan Process – From Concept to Close (continued)

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## 2. Market Rate Transactions = Two Stage Processing

- Pre-Application with Limited Submission Requirements – Appraisal, market study, Phase I, limited drawings. End result is an “Invitation Letter” in which HUD invites the lender to submit the Firm Application, with rents determined.
- Firm Application with All Checklist Items – Updated appraisal, full mortgage credit review on principals and general contractor, plan and specifications fully reviewed and permit ready

## C. Firm Commitment & Closing

- Firm Commitment issued after local and/or headquarters committee approvals.
- Firm Commitment may contain deal-specific Special Conditions.
- Rate Lock occurs after receipt of the Firm Commitment.
- Lender counsel and borrower counsel prepare closing package to submit to HUD.
- Closing date generally set only after HUD counsel has reviewed closing package.
- Closings are in person with borrower, GC, architect, and bonding agent present.
- Pre-Construction Conference held simultaneously with closing.

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# Practical Considerations for Structuring Your Transaction

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# Practical Considerations for Transaction Structuring – Underwriting/Loan Sizing #1

## 4%, 9%, or No Tax Credits

1. Size of the transaction will determine the most economical pursuit of tax credits.
2. Smaller transactions will benefit most from 9% credits. A 1.15x DSCR is allowed. For 4% transactions a 1.20x could be required (possible equity investor requirement).
3. Larger transactions should be able to handle the additional financial burden of the bond cost of issuance, which can be in excess of \$250,000 and higher. Also, a 1.20x DSCR, may be required.
4. Depending on the current rent level and the amount of rehabilitation needed, additional equity from sale of tax credits may not be needed.
5. Be cognizant of closing deadlines dictated by credits or bonds.

# Practical Considerations for Transaction Structuring – Underwriting/Loan Sizing #2

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## Rents

1. Are the rents high enough to create a viable transaction?
2. Are the rents listed in the CHAP Letter below, at, or above market? This will be a very important factor for your lender.
3. Rents used for underwriting will be the lower of market or the HAP rent.
4. If the HAP rent is higher than market, the difference is called the “overhang”.
5. The overhang can be used to size a B-piece loan that will have a shorter amortization period than the real estate loan.

# Practical Considerations for Transaction Structuring – Underwriting/Loan Sizing #3

## Operating Expenses

1. Historical expenses as public housing of the project may not reflect future operations as a LITHC/affordable project. New expenses should reflect stand-alone, project-specific operations.
2. Identify a local or regional management company that has experience managing LITHC/affordable properties to partner with.
4. What impact will the renovation have on expenses? Solar, low-flow plumbing fixtures, new windows, Energy Star appliances, LEED certification.
5. New expenses to be aware of: Allocation agency monitoring fee, compliance and audits, reserves for replacements.
6. Expenses comparables from the management companies portfolio will be extremely helpful for the lender and investor in determining underwritten expenses.

# Practical Considerations for Transaction Structuring – Creating the Development Budget

## Davis-Bacon Wages

If using FHA-financing or other government funds Davis-Bacon wages will need to be used.

## Reserves and Escrows Required by Lender and Investor

1. Operating Reserve (investor) – Generally three to six months of expenses, escrows, and debt service
2. Contingency (both) – Typically 10% of substantial rehabilitations; 5% for new construction
3. Relocation (All)
4. Working Capital and Operating Deficit Escrows (FHA only)
5. RAD-required
6. Other as determined on case-by-case basis by lender or investor

# Practical Considerations for Transaction Structuring – Other Items to Consider

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1. Will a seller carry-back loan be necessary for the purchase of the property? Very likely the answer will be “yes.”
2. What will be necessary to secure a real estate tax abatement?
3. Will there be a ground lease? Ask for lender requirements before drafting.
4. Are additional HA funds necessary and available to cover any financing gap?
5. Specialized counsel will be needed – RAD, HUD or bond financing, negotiating limited partnership agreement – in addition to HA’s general counsel. Ask for recommendations from lender or investor.
6. Secondary debt from other government sources will need to be subordinated to first mortgage lender. Ask for subordination requirements from lender and share with subordinate lender as early as possible.
7. Will HA be the Developer or will a turn-key developer be the best option (experience)?
8. Hire an experienced consultant to assist in credit/bond application and financing. For FHA financing, make sure consultant understands the FHA programs.

# Practical Considerations for Transaction Structuring – What to Expect from Your Lender #1

## Third Party Reports

Standard for all lenders. Typical reports, ordered by HA or lender, include:

1. Appraisal
2. Phase I Environmental Site Assessment
3. Lead-Based Paint Inspection (pre-1978)
4. Asbestos-Containing Material Inspection (pre-1978)
5. Geo-tech/Spoils Report (for any new structures)
6. Construction Plan & Cost Review – Final plans and specifications needed
7. Termite Reports
8. Miscellaneous Reports – Flood zone, zoning, crime, and noise
9. ALTA Survey
10. These reports are in addition to the RAD PCNA, Environmental Report and any reports needed for credit/bond application.
11. Coordinate early with your lender about using same firms or same reports for application or financing. If this is planned, let the lender order the reports, especially any market study or appraisal.



# Practical Considerations for Transaction Structuring – Third Party Reports

Report	223(f)	221(d)(4)
Appraisal	X	X
Market Study	N/A	X
Phase I Environmental Site Assessment w/ Radon	X	X
Phase II Environmental Site Assessment	If needed	If needed
Lead-based Paint & Asbestos Containing Material	Pre-1978	Pre-1978
Termite Report (ordered by borrower)	X	X
Property Condition Report/Physical Needs Assessment	X	Sub-Rehab
Intrusive Testing (sewer scoping, electrical testing)	Pre-1987	Sub-Rehab
Soils/Geo-technical	N/A	New Constr.
Noise Analysis	N/A	X
Architectural Plan & Construction Cost Review	Level 3	X
ALTA Survey (ordered by borrower)	X	X

# Practical Considerations for Transaction Structuring

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## Due Diligence

1. Due Diligence requests will be consistent from lender to lender.
2. Investor due diligence lists will be very similar.
3. Expect to provide: CHAP Letter; HA financial statements; organizational docs for borrower and GP; information/qualifications on architect and general contractor; any existing reports; credit/bond application and award notification; information on subordinate debt; information on management company; relocation plan; and more.
4. Weekly due diligence calls to monitor delivery of due diligence and keep all parties focused on meeting necessary deadlines.
5. All due diligence items needed for application must be submitted; cannot submit incomplete application to HUD.

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# Best Practices: Tips for a Smooth Transaction

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# Tips for a Smooth Transaction

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1. Hire your FHA lender as soon as possible.
2. Understand that your FHA financing will be processed by HUD's Multifamily Production and their rules are far different than PIH rules. You will be following Multifamily rules.
3. Multifamily version of forms and documents will need to be used, not PIH's.
  - a. 2530 Previous Participation
  - b. Architect Agreement
  - c. Construction Contract
4. Partner with an FHA experienced developer who also understands financing with bonds and tax credits.

## Tips for a Smooth Transaction

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5. When requesting RFPs from general contractors and architects include the HUD-required forms in the bidding package. Your FHA lender can provide the form documents.
6. Partner with contractors and architects with FHA experience. The FHA requirements are numerous and unique. The learning curve for inexperienced firms will slow the process.
7. Look for savings during design that will lower operating costs.
8. Plan on meeting Section 504 accessibility requirements in new construction or substantial rehab.
9. All permits must be available at closing. Will-Issue Letters are not sufficient.

# HUD Loan Processing and RAD

## Tips from HUD RAD Transaction Managers #1

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### On the RAD Property Condition Report

“One of the biggest hurdles our office has experienced to date is having the PHA contractors’ comply with RAD Scope of Work as it pertains to the third party work (RPCA, Energy Audit, etc.) It is imperative that the Scope of Work be complied with in order for the deal to proceed. This is the crux of the deal making sure the immediate as well as long term capital needs are met for the long term physical integrity of the properties. The lack of quality work product has resulted in longer timeframes in processing the deals.”

“I would impress upon the contractor’s to actively engage with the Transaction Managers to discuss the Scope of Work for full understanding of what is required so that we don’t have to continue to go back and forth two or even three times to get a complete and satisfactory work product. The sole purpose of the Scope of Work was to provide a tool for contractors’ which when followed would provide work product in sync with RAD requirements.”

# HUD Loan Processing and RAD

## Tips from HUD RAD Transaction Managers #2

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### On the Financing Process

“The most important item that I cannot underscore enough to potential RAD applicants (in Component 1) is trusting and relying upon their FHA lender. I’ve wasted so much time with sponsors who try to get involved in the FHA process without understanding it... while we’re all happy to help folks learn, more often than not, the PHA’s attempt at moving the process along wastes time.”

“I’d also emphasize working with an FHA-experienced architect/GC etc. As you know, a majority of our lack of progress has been due to “standard” FHA items being overlooked as the construction side of the PHA’s house was still stuck in public housing mode. Changes to costs and scope bleed time, so I have been telling all of our new projects to find a team that has the FHA experience.”

# HUD Loan Processing and RAD

## Tips from HUD RAD Transaction Managers #3

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### On the RAD Program

“In terms of key items worth encouraging, I think innovation is overlooked. This program is so neat in that it allows equity/debt to come into “public housing” while we flip the congressionally dependent subsidy into permanent rental assistance. Owners should be innovated! Think outside the “public housing” box. They need to really look at what they want their families to experience for the next 15-20 years... and get excited about it!”



Questions or comments?

# Contacts

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