U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

MEMORANDUM FOR: All Multifamily Hub Directors
All Multifamily Program Center Directors
All Multifamily Operations Officers

FROM: Theodore Toon, Director, Multifamily Development, HTD

SUBJECT: FHA Low Income Housing Tax Credit Pilot Program Revisions

The FHA Low Income Housing Tax Credit (LIHTC) Pilot was created in 2011 to better align FHA's underwriting process with the timing constraints of LIHTC projects, to increase FHA's affordable housing production and preservation and to test the Single Underwriter operating model. There are now 37 qualified MAP Lenders, 9 Pilot Hubs with specially trained Pilot underwriters, nearly 100 deals with 10,000 units in the pipeline, and 20 closed projects. As HUD has gained and evaluated its experience with the Pilot, Multifamily has identified several points to be clarified and several policy adjustments needed to standardize our practice and expand production.

The policy adjustments described below are intended to provide more flexibility to the Pilot and make it available to a wider array of projects. The areas to be addressed in this memorandum are all a function of guidance (MAP Guide, Notices and Mortgagee Letters, etc.), and therefore require no regulatory waivers or statutory changes. They fall into two categories: The first six elements, in Part I, are policy changes effectuated by this memorandum, and to be subsequently incorporated into the MAP Guide. Waivers will be required to implement each of these changes for individual transactions until such time as the policy changes are published more formally in the MAP Guide later this year. Hub Directors have the authority to sign off on these waivers, and should be favorably inclined to do so subject to the conditions and mitigants outlined below. For each of these waiver types, Appendix 2 of this memo specifies the appropriate section of the MAP Guide and/or other relevant guidance, which should be cited in each waiver request (HUD-2 form). Approved waivers are to be uploaded to the designated HUD 2 SharePoint site at the following address:
http://hudsharepoint.hud.gov/sites/DASMFH/OMHD/Lists/Hub%20Level%20Waivers/Standard.aspx

The remaining six elements described in Part 2 of this memorandum are simply clarifications of existing policy: As such they will not require waivers, and they too will be incorporated into the MAP Guide.

We will continue to look for opportunities to better align FHA products, policies and processing with LIHTC transactions, balancing alignment with our responsibility to manage risk. We intend to expand the LIHTC Pilot to the broader MAP platform as the Pilot proves out the potential for this way of business. We will be seeking your feedback and that of stakeholders in the year to come to better understand how best to achieve these goals.

PART I: POLICY CHANGES WITH WAIVER REQUIREMENTS

1. Total Debt Load Allowed Under 223(f): Current, long-standing 223(f) policy, though not statutory or regulatory, limits total debt load on a property to 92.5% of appraised value. FHA's definition of "total debt" has included the FHA-insured 223(f) loan plus any subordinate debt, including seller take-back notes, deferred developer fees converted to debt, and other partner debt, but excluding subordinate debt issued by a public source. HUD will continue to enforce the LTV and DSCR requirements of the 223(f) program for sizing the first mortgage at an 85% loan ratio for Tax Credit projects. (The 92.5% only applied when other debt was included.) However, for all future Tax Credit projects HUD will remove the 92.5% limit on total debt and allow subordinate sources, when combined with the first mortgage, to exceed 92.5% as long as that subordinate debt meets all of the following conditions:

a) The debt is "soft" cash flow debt, i.e., only payments from surplus cash, if available, can be required;

b) Any such payments required under the note(s) may not exceed 75% of surplus cash;

c) The debt is documented in a promissory note;

d) The debt is not secured with a lien against the property or evidenced by any recorded instrument; and

e) The debt is subject to automatic resubordination in any subsequent refinancing of the first mortgage.

Balloon payments on subordinate debt prior to maturity of the FHA-insured first mortgage are generally prohibited, but may be considered on a case by case basis when the issuer/holder of the subordinate debt is a nonprofit or public entity.

2. Three Year Waiver Transactions: The 223(f) program is limited to existing projects, defined by HUD as "...originally completed or substantially rehabilitated less than 3 years prior to the date of application for the Firm Commitment." HUD has issued Mortgagee Letters over the past several years waiving this "3 year rule" for 223(f) LIHTC transactions, to provide relief to projects coming out of construction but unable to secure other sources of permanent financing. The latest Mortgagee Letter providing this waiver authority will expire on September 18th, 2014. However, the uncertainty of permanent financing still hinders LIHTC construction starts. Under current practice a Firm Application must have been submitted prior to this deadline. Under this memorandum, HUD is adjusting the time at which the clock starts under the current Mortgagee Letter to allow eligible Pilot projects with building permits obtained before the current Mortgagee Letter expires, to be "grandfathered" and remain eligible for a 3 year rule waiver. This enables borrowers submitting Tax Credit deals that meet the amended timing to apply for 223(f) through the Pilot upon completion.

This change will broaden the pool of properties eligible for the Pilot under the 3 year rule waiver, but will limit the pool to a finite group of properties that have secured permits before the deadline. Furthermore, as noted in Mortgagee Letter 2012-13, all of the requirements of the original waiver will apply to these projects, except for the requirement for applicants to provide evidence of unsuccessful attempts to secure other permanent financing.

3. IOI and Mortgage Calculations: When there is an Identity of Interest between the buyer and seller, the MAP Guide requires treatment of the transaction as a refinancing (under criterion 10) rather than an acquisition (under criterion 7). This limits mortgage proceeds to 80% of value rather than 85% of value for LIHTC transactions (or 87% if there is a Project based Section 8 contract covering at least 90% of the units). Many LIHTC transactions involve a transfer in which at least one party remains in the transaction. All LIHTC refinancing transactions involving transfers of title, whether to an Identity of Interest entity or an arm's length party, will be treated as an acquisition rather than as a refinance. They will therefore be allowed to go up to the full 85% (or 87%) LTV. Please note that this policy applies to all Section 223(f) loans within or outside of the Pilot Program, so long as the projects meet the affordability definition in the MAP Guide.

4. Completion Assurance: The LIHTC Pilot, using 223(f) financing, has required a non-mortgageable Assurance of Completion Escrow in the amount of 20% of the rehabilitation cost in addition to the estimated non-critical repair costs. The Assurance of Completion Escrow may be used as a construction contingency at any time (contingencies are otherwise not a part of the 223(f) program), and it can be provided in the form of an irrevocable LOC or in cash. LIHTC borrowers frequently request and are granted reductions from 20% to 10%. This is appropriate in cases with relatively simple or clearly defined scopes of work and repair cost analyses, sufficient oversight of the construction, and/or non-mortgageable reserves. Other mitigants to justify reduced funding might include factors such as an architect on the job, use of plans and specs for any complex work, use of General Contractors and fixed sum contracts, etc. HUD intends to change the LIHTC Pilot policy in the MAP Guide to make 10% the standard requirement, with discretion to increase it if the scope of work and total cost suggest a need for additional protection. In the meantime waivers are to be treated favorably and approved by the Pilot Hub Directors. This provision applies to Pilot projects only.

5. Timing of Repair Escrow Funding and General Equity Pay In Schedule: The LIHTC Pilot has required 100% of Non-Critical Repair Costs to be funded at closing: Because a 223(f) loan is fully funded and insured at closing, HUD has considered it important for other capital sources to be at least partially funded at closing as well. However, rehab in LIHTC transactions is often funded with a combination of equity and FHA debt, so this requirement forces owners to call equity early or secure a bridge loan to fully fund the escrow at closing. The problem is exacerbated in projects with high acquisition costs and in refinancings with high existing debt that must be repaid at closing. HUD has waived the requirement when it had a demonstrated, material cost impact, when deferred funding was mitigated by high borrower liquidity, when the escrow disbursement agreement allowed for pari passu installment payments on construction along with an equity pay-in schedule matching that draw schedule, and/or when the borrower provided a guaranty of timely funding of the rehabilitation.

HUD will continue to allow for a gradual pay-in of equity, including the equity needed to fund the repair reserve, provided that two conditions are met:

a) At least 20% of the total project equity (syndication proceeds) must be paid in at closing, and

b) A disbursement agreement is provided by the lender and approved by HUD, specifying that the rehab escrow, including loan proceeds and initial equity remaining after closing and acquisition, and subsequent equity installments, is disbursed in approximate pari passu proportions.