

FHA HOUSING TAX CREDIT PILOT PROGRAM
FREQUENTLY ASKED QUESTIONS
May 23, 2012

Eligible Projects

- Q. Can the Pilot Program be used to acquire and rehab an existing market-rate property that will be converted into a tax credit deal?
- A. No: Eligible projects must be projects with existing Project Based Section 8 Contracts, projects with prior tax credits ready for re-syndication, or projects recently built or rehabilitated using tax credits. None are market rate projects. This universe of transactions is considered relatively low risk and most amenable to streamlining by HUD. As the Pilot program expands to additional offices, HUD may consider incorporating new transaction types.
- Q. The Pilot's Assisted Housing category requires that 90% of the units are covered by Project Based Section 8 contracts. However, many projects are "80/20" or 80% affordable. Will HUD accept the 80% affordable projects into the Pilot?
- A. Most projects with more than 50% of the units covered by Section 8 rental assistance contracts have 90% or more of the units assisted. However, HUD is aware that a significant number of projects also have assistance on only 80% of the units. We will consider waivers for projects with 80% assistance on a case by case basis.

Rents

- Q. How will the Pilot work for Midwest projects, where the Tax Credit Rents are typically higher than 10% below market rents?
- A. This rent structure is a fundamental of the Pilot Program, intended to ensure that the Pilot in fact enhances affordability by providing below market rents. It is also critical to the integrity of the Pilot to ensure that LIHTC rents are below market comparables because it reduces risk and allows HUD to streamline certain processes, such as market study review. Because this is a Pilot program, HUD may reconsider this requirement in future phases.

Project Threshold and Application Requirements

- Q. The Pilot requires the borrower to have an allocation of tax credits in order to submit an application to HUD. California has rigid deadlines of less than 120 days for closing, which start when the allocation is awarded, so shouldn't there be more flexibility on this rule?
- A. HUD is aware of the allocation timing problem in California, and in fact the LA Hub Director has secured an extension to 150 days for its FHA-insured projects. Furthermore our language now includes an alternative of "other evidence acceptable to HUD" for an actual allocation when problems such as these arise. HUD will work with the allocating agencies as needed to resolve such issues.

- Q. Is it reasonable to ask for CPA-approved prior years' financials in acquisitions, when the sellers are often unsophisticated owners who work on a cash basis?
- A. This may be an issue for market rate projects but Pilot projects will most often have audited financials as a requirement of prior subsidies. However, CPA reviews cost only about \$5,000 and the requirement has not been problematic for the many Section 223(f) transactions (both refinancing and acquisitions) completed since the Risk Mitigation requirement was implemented in the fall of 2010. If there is a specific situation in which the requirement is not practicable, HUD may consider a waiver.
- Q. The Alta Survey can be waived at the field office level for 202s. Can the Hub make approve the same waiver for the Pilot Projects?
- A. The DU may recommend a waiver of the ALTA Survey for transactions involving the refinance of a Section 202 Direct Loan, where HUD is the mortgagee and where the new FHA lender submits a statement certifying that there have been no material changes or additions to the structure or property boundaries since the closing of the original loan. HUD may also accept an existing survey for the projects rather than requiring a new survey document.

Valuation

- Q. Will assisted projects generate sufficient loan proceeds with an LTV constraint of 87% and DSCR of 1.20? Shouldn't we use the 202 approach, with 90% LTV and 1:11 DSCR? Won't this push projects out of the Pilot and into the (d)(4) pipeline?
- A. The examples offered to demonstrate this problem are not compelling, since the cap rate used to model mortgage sizing was too high at 8.5%. We will track our experience and reconsider this program standard should it become necessary and appropriate.

Wheelbarrow

- Q. The Wheelbarrow still draws from Form 2013, which is no longer being used. Also, the 3rd page of the 2264 is no longer being used in the Wheelbarrow. Can these be eliminated from the Wheelbarrow?
- A. Yes: Lenders need not fill out the 2013-related info or the 3rd page of the 2264. Wheelbarrow updates will eliminate these elements shortly.
- Q. There is some duplication of input required by the Wheelbarrow and the Lenders Narrative: Can this be eliminated?
- A. Overlapping areas are to be eliminated from one or the other in future versions. In the meantime, Lenders participating in the Pilot need not fill out those forms or parts of forms that are redundant.

Processing, Timing Matters

- Q. For assisted projects, how long in advance of the application submission should the HAP extension/rent increase request and the prepayment request, if any, be submitted?
- A. They should be submitted at least 60 days in advance of the application, but are encouraged as early as 120 days in advance, and the sooner the better. Lenders should assist client borrowers with this, and make sure underwriting rents are consistent first with requested, and later with approved rents.

Investor Participation

- Q. Investors will want notice and cure rights, and the right to bring in a “Special Limited Partner” quickly in case of default or other failure of the initial General Partner. Is this going to be allowed?
- A. Provision of Notice to the Investor by HUD and pre-approval of a Special Limited Partner to step in and act as a General Partner for a limited period of time, under specific conditions, are being addressed in a new “Rider to the Security Agreement for LIHTC Properties” being prepared by OGC.
- Q. Is the LLC1 form still required?
- A. An alternative form, the “Identification and Certification of Eligible Limited Liability Investor Entities” is also being developed by OGC to better accommodate passive investors with limited liability.

Critical Repairs

- Q. According to 223(f) rules, Critical Repairs must be completed prior to endorsement. In acquisitions it will be awkward for the seller to complete the repairs or for the borrower to complete the work prior to ownership of the property.
- A. The Section 223(f) program has always allowed for acquisitions. Completion of repairs prior to endorsement has not been a problem over the last 5 to 10 years in other acquisitions undertaken with 223(f). The seller does the minimal life threatening repairs or the buyer does them after Firm Commitment but right before closing, or in some cases HUD allows the repairs to be deferred.

Rehabilitation Requirements

- Q. HUD’s requirement that the rehabilitation cost must be funded prior to construction start is burdensome and may diminish pricing since early investor pay-in amounts would have to be larger amounts than normal to fund the rehabilitation reserve. Can this be avoided?
- A. Because the Tax Credit Pilot is using the Section 223(f) program, it is crucial that funds to complete all non-critical repairs be escrowed up front. This will be accomplished with the use of FHA insured loan proceeds to the extent that it does not exceed the standard 223(f) limit on rehabilitation costs, and the balance will be funded by Tax Credit equity or other sources. However, HUD may consider reduction or deferral of the 20% in funds required for contingency/assurance of completion. However, HUD will not waive the requirement that the portion of repairs to be funded with FHA loan proceeds must be escrowed at the time of closing.
- Q. HUD’s requirement of up front funding of 120% of non-critical rehab work is a problem and a smaller 10% contingency is typical. Won’t requiring 20% reduce the amount of rehab that the investor will be able to count on?
- A. HUD is only requiring 100% of the rehabilitation cost to be funded at closing: Typically HUD will require an additional 20% completion assurance as well. As noted above, this may be deferred, with Hubs considering such requests on a case-by-case basis. HUD may also consider requests that the 20% be reduced to 10% if the specific scope of work and funding structure justify it.

Sources and Uses of Funds Tracking

- Q. Does HUD have a disbursement agreement that addresses amounts and uses of all sources of funds for the projects?
- A. Yes, some Hub offices are already using disbursement agreements and we are considering development of a form of agreement suitable for the Pilot.

Cost Certification

- Q. Are full or limited cost certifications required for Pilot projects?
- A. Abbreviated Cost certifications prepared on HUD Form 2205-A are required under the 223(f) program only for projects with mortgages exceeding 80% of LTV, and this would apply to Pilot projects as well.

Operating Reserves

- Q. For projects whose owners are requesting Section 8 rent increases, HUD requires a Section 8 escrow to fund the difference between current rents and post-rehab rents throughout the construction period. If the syndicator requires a similar operating reserve during the rehabilitation period, would HUD waive its reserve requirement to avoid overlapping reserves?
- A. HUD will not waive this requirement, but might be able to provide assurances regarding administration of the escrow and its disbursements that would enable the investor to reduce its requirements.

Annual Replacement Reserve Contributions

- Q. What rules are to be used for determining amounts of annual replacement reserve deposits?
- A. We will use 223(f) rules.

PCNA, Scope of Rehab Work, Architecture & Engineering

- Q. It is possible for the syndicator and owner to have different scopes of work: Which does HUD rely on?
- A. Neither: A single Scope of Work for Non-Critical Repairs must be fully negotiated and accepted by all parties in order to manage funds properly, complete all necessary repairs, etc. prior to closing. In addition, Critical Repairs identified through the PCNA will have to be completed prior to closing.
- Q. Does a licensed architect have to complete the PCNA? Who reviews it?
- A. Under the Pilot, a licensed architect may complete the PCNA but MAP Guide 5.1.A.2 states "Individuals without an architectural or engineering degree but with experience as a construction manager, inspector, estimator, or general superintendent of construction may also qualify to provide PCNA inspection services." Once it is completed the lender will engage a reviewer to review the report. If the scope of work is greater than \$15,000 per unit in hard costs, a licensed architect (or in some cases, an engineer) engaged by the borrower must complete plans, specifications, and work write up.
- Q. Does a licensed architect have to be used for plans and specs, supervision, etc. for all rehabilitations?

- A. A licensed professional is required if working drawings or specs are needed, if structural changes are planned, etc. Generally HUD prefers an architect to be the prime professional, especially if the scope of the rehab covers various building components that may not be the specialty of any one type of engineer. However, if the circumstances warrant it, an engineer can be the prime professional, as noted in Section 5.20 of the MAP Guide, which states:

Required Professional Services – Substantial Rehabilitation

The services of an architect or engineer, licensed to practice architecture or engineering in the state in which the project is located, will be required for design and construction of a rehabilitation project, when:

- A. Working drawings and specifications are necessary to properly define the scope and concept of the rehabilitation,*
B. Change of building use is proposed, existing spaces are to be altered, or structural changes are necessary, or
C. An addition is proposed to the existing structure.

Closing and Closing Documents

- Q. The syndicator may not know the precise amount of LIHTC Proceeds until immediately before or during closing: How can adjustments be made?
- A. HUD recognizes that adjustments in equity proceeds will occur during underwriting, but numbers should be firm at least immediately prior to closing. For changes from firm commitment to a few days prior to closing, lenders can simply revise and resubmit the Wheelbarrow and HUD can then do a letter amendment to the firm commitment letter for closing purposes.

Mortgage Credit

- Q. There is no GSE list to be used as a substitute for 2530s on limited liability partners, and some may not be rated by the rating agencies: How do lenders determine and DUs verify that passive investors can avoid 2530s, personal financial statements, etc.?
- A. GSE lists and rating agencies were intended to be used as substitutes for limited liability partners' 2530s, but this has proven to be impracticable. Instead, lenders will have to obtain evidence from the borrower with respect to its GSE financing experience and ratings, and then rely on their own internal research to make the case to HUD that the proposed limited liability partner is reliable.