RAD FHA Lenders Frequently Asked Questions
Updated: January 2, 2015

I. Collateral

A. Scattered sites. What is FHA's policy on scattered sites for RAD projects?

- Answer: A number of RAD transactions are proposing FHA financing with scattered sites. Some of them make sense and others don't. Basically, under FHA multifamily programs, a scattered site project must meet the following criteria to be eligible for insured financing:

  1. Constitute one readily marketable and manageable real estate entity.
  2. Have 5 or more units on each individual or continuous parcels.
  3. Be in the same market or submarket.

  Any scattered site deal which has less than 5 units on individual parcels or on contiguous parcels, does not meet the regulatory standard in 24 CFR 200.73(c). Several field offices have been approached with projects composed of single family structures scattered through a neighborhood on non-contiguous lots. These should not be considered.

  It is a judgment call on what constitutes a single marketable, manageable real estate entity. Things to consider in underwriting are:

  - Distance. Generally you would be more permissive in a rural area than an urban one, but we should <u>never</u> be seeing two projects greater than 15 or 20 miles away from each other.
  - Physical condition, construction type, and age. If individual sites in these criteria are different, it starts to get harder to make the case they are one entity, and definitely harder to evaluate the collateral (e.g. requiring separate PCNA and Appraisal analyses, which are then combined. If they can't analyze it with one PCNA and one Appraisal, it is hard to say it is one real estate entity).
    - Occupancy type and turnover history.
    - Unit configuration and project layouts.
    - Expense volatility, particularly for single family structures or more widely disbursed properties. Risk in those cases need to be mitigated by high-end expense estimates, and in some cases shorter amortization periods.

B. Do FHA seismic load resistance requirements apply to RAD transactions?

- Answer: Yes, FHA seismic standards apply to RAD transactions. The lender's due diligence must include assessing the seismic risks and obtaining required engineering studies needed, particularly for projects in seismically active areas, previously referred to as seismic Zones 3 and 4.

C. Is a RAD Property Condition Assessment (RPCA) required on the Section 221(d)(4) transaction?

- Answer: No, a <u>RPCA narrative report is not required</u> on any 221d4 transaction.

  However, the *RPCA Excel tool* is required on all 221d4 sub-rehab projects where the scope of rehab does <u>not include</u> "the removal and replacement of substantially all interior finish surfaces exposing the underlying building frame (i.e. gut rehab). For these non-gut rehab transactions, the RPCA tool will be required 1) to size the project's reserve for replacement account's deposit, and 2) to capture the its utility consumption baseline data. The required portions of the RPCA tool which must be completed include:

  - Utility Baseline - Summary
  - Utility Baseline - Monthly
  - Cap Needs Input

  For FHA 221d4 new construction and gut rehab transactions, Lenders should use the FHA Section 221(d)(4) formulas to size the reserve for replacement account deposit.

D. What percent of the units should the RPCA provide tenant utility baseline consumption data?

- Answer: The PCA provider should seek to obtain data on resident-paid utilities from 25% of the units, which is a threshold percentage for the PCA provider to provide reasonable estimates of whole-building energy consumption.

- Please note that in the near future HUD anticipates the publication of tools that will help PHAs and other industry partners manage the UCB data, so the flexibility and the 25% threshold provided in this FAQ is subject to change pending new HUD guidance and tools. Any UCB data submitted to HUD prior to publication of these standards will be grandfathered in to this sampling standard.

E. Can the owner provide the RPCA utility baseline consumption data provided after the FHA closing?

- Answer: No. On all FHA RAD transactions, HUD requires the tenant UCB data to be included in the RPCA report submitted with the firm application. The UCB is an important feature of the RPCA and is part of HUD's broader initiative to establish baseline utility data for our entire rental housing stock.

In the near future HUD anticipates the publication of tools that will help PHAs and other industry partners manage the UCB data, so the flexibility provided in this FAQ is subject to change pending new HUD guidance and tools.

F. Do Davis-Bacon prevailing wage rates apply to RAD FHA 223f transactions, if so, when?

- Answer:
  - For public housing conversions under RAD first component (RAD I), any repair work at closing will be subject to Davis-Bacon, even when using 223(f), which otherwise doesn't require D-B (i.e., this is a RAD program requirement, not an FHA rule).
  - For RAD second component transactions (RAD II), the Department issued additional guidance, on December 23, 2014, clarifying when Davis Bacon requirements apply to existing PBV housing. The Notice is available at the HUD RAD website under "More information": http://portal.hud.gov/hudportal/HUD?src=/RAD/info. Pursuant to the Notice, HUD will exercise its enforcement discretion in the following manner:

    a. Unless the applicant expressly has stated its intention to be bound by Davis-Bacon requirements, HUD will not enforce such requirements with respect to applications for RAD II projects that qualify as existing housing under 24 CFR 983.3(b) that (i) were submitted to HUD and approved to proceed by HUD pursuant to Section 3.4 of the RAD Notice before June 25, 2014, or (ii) were submitted to HUD and approved to proceed by HUD pursuant to Section 3.4 of the RAD Notice prior to December 31, 2014 and that involve the receipt of Low-Income Housing Tax Credits due to expire on or before December 31, 2014; and,

    b. HUD will enforce Davis-Bacon requirements with respect to applications for RAD II projects that qualify as existing housing that are submitted to HUD and approved to proceed by HUD pursuant to Section 3.4 of the RAD Notice after December 31, 2014. For RAD II transactions approved to proceed by HUD after December 31, 2014, which will undergo rehabilitation (or repair) in connection with RAD conversion (either pre or post HAP contract execution), the Lender should underwrite the construction/repairs costs assuming Davis Bacon wage rates will apply.

    HUD notes that its exercise of enforcement discretion in the manner described above is exclusive to HUD and is not binding on other parties, including the U.S. Department of Labor.

G. Davis Bacon: Monitoring and enforcement

- Lender Reminder on Davis-Bacon on 223f transactions. Under RAD, Davis-Bacon is required. Lenders should assume it will be monitored and enforced. MAP Lenders are responsible for ensuring the underwriting, closing documents, and servicing protocols are in place so that Davis Bacon compliance does not become a problem.

H. Will HUD change the Section 223(f) completion of assurance escrow requirements for RAD projects from 20% to 10%, like FHA's Tax Credit Pilot?

- o Answer: No. HUD is not changing the standard outside of the Section 223(f) Tax Credit Pilot. However, Hub Directors have discretion on a case-by-case basis to consider a waiver and allow a lower amount for the completion assurance on such a deal. Though, in such cases, there must be significant mitigants -- e.g. the PCNA actually addressed the "bones" of the project and it's clear the scope of work / cost estimate is refined to the point there is little risk the cost will exceed the escrow plus the proposed reduced contingency.

I. On a RAD FHA transaction, is the developer fee a mortgageable cost?

- o Answer: FHA permits a developer fee on RAD transactions per ML 12-20. However, the developer fee is a mortgageable cost, only if the mortgagor is a nonprofit entity (see MAP Guide 13.16.N), <u>and the project does not include BSPRA.</u> Should the mortgagor be for-profit, the fee is not a mortgageable cost (regardless of whether BSPRA is included). In that latter case, the cost would have to be paid from another source.

II. Cash Flow

A. Flat Rents: PIH Notice 2014-12. Does the Office of Public and Indian Housing's (PIH) "flat rent" policy have any impact on a RAD project's CHAP rents?

- o Answer: No. PIH's flat rent policy will not impact a project with a CHAP award. Every RAD project with a CHAP award has been assigned a RAD Contract Rent Schedule. PIH's flat rent policy will not change a project's CHAP rent schedule. The Lender should use the project's CHAP contract rents in underwriting the RAD transaction.

B. On a RAD Component 2 Mark-Up-to-Market transaction, can the Lender ordered MAP appraisal be used in lieu of an RCS?

- Answer: The Owner needs to obtain a Rent Comp Study for a Mark up to Market transaction. If it is in conjunction with an FHA MAP application, the Lender needs to obtain an independent third party appraisal. If the lender's appraisal includes a Rent Comp Study meeting the requirements detailed in HUD's August 7, 2014, memo on this topic, HUD can rely on the lender's appraisal RCS rather than contract for another (third) RCS. A copy of HUD's policy memo on this topic may be downloaded from HUD's website at: http://portal.hud.gov/hudportal/documents/huddoc?id=Lender_Ordered_AP_Appraisa.pdf).

C. Does ML 2012-20/Notice H-2012-20 effectively waive the requirement for a market rent analysis and estimate in some or all cases?

- Answer: Mortgagee Letter 2012-20, Section IV, sub-section I, addresses this issue of market rents. It permits the appraiser to claim jurisdictional exception when applicable. The general rule is that a detailed market rent analysis (e.g. 92773) is only required on RAD FHA deals with market rate units. If a project has a Section 8 contract which covers 100% of the units, than a detailed market rent analysis is not required.

D. If the CHAP Section 8 rents exceed market rents, how should the lender underwrite the excess rent overhang?

- Answer: In cases the Section 8 rents for a RAD transaction are different than market (either higher or lower), Mortgagee Letter 2012-20 provides guidance for loan sizing under criterion 3 (Loan-to-Value) and criterion 5 (Debt Service Coverage).

  As noted in that Mortgagee Letter, the value constraint (criterion 3 for a Section 223(f) loan) should be based on the actual RAD rents established by the CHAP, and taking into account any rent restrictions on unsubsidized units if applicable.

  The Mortgagee Letter instructs the underwriter to use a bifurcated "A" piece / "B" piece structure in analyzing the supportable mortgage under the debt service approach (criterion 5). Unlike all other mortgage insurance transactions with Project Based Section 8 assistance, RAD transactions place a statutory obligation on both the owner and HUD to continue Section 8 assistance. Except in the case of a lapse in appropriations or an abatement of the HAP Contract as an enforcement action, the Owner must accept and HUD must offer the Section 8 contract without regard to market rents.

  Accordingly, if and only if, a project has 100% of the units covered by a RAD Section 8 contract, HUD will waive the requirement for an "A" piece constrained by market rents and a separate "B" piece based on NOI supported by above market rents, and allow the debt service mortgage to be sized with the actual expected Section 8 rents over the entire amortization period. This assumes the project is otherwise approvable, with particular consideration given to the long term physical and managerial integrity of the project and the owner. A HUD-2 waiver form is required until such time we formally amend the guidance in Mortgagee Letter 2012-20. Also, note that a bifurcated "A/B" piece structure in criterion 5 may still be appropriate for RAD deals if there is a difference in NOI due to tax abatements which may expire, or other material potential adjustments to the NOI during the term.

E. Can tenant services (i.e. non-residential services) be included as an operating expense? And a corollary question, should the 3rd party appraiser include tenant services as an expense, both when determining "as is" value and when determining operating expenses post-rehab?

- Answer: Under FHA, any tenant services or other non-residential services must be paid for from surplus cash or external funding source They are not to be included in the property appraisal's estimate of "as is" or "after-repaired" operating expenses or included in the underwritten Operating Expenses. The non-shelter and/or supportive services expense are to be underwritten separately. The project's tenant and/or non-residential services must be shown to be self-supporting. This is consistent with FHA guidance in the RAD Mortgagee Letter 12-20. The ML is clear that the 1) the non-shelter services are to be underwritten separately, and 2) no more than 15% of the project's EGI (via surplus cash) may be used for supportive services of any type.
  - *Per ML 12-20, Section IV, sub-section 6(a) and (b):*
    - *Underwriting of non-shelter services. An Owner/PHA may propose non-shelter services in RAD projects. For underwriting purposes, the Owner/PHA may propose an external funding source for the services, or may use surplus cash. Form HUD-92013-E or a similar presentation must be submitted with the MAP application when non-shelter services are proposed. No more than 15% of the project's effective gross income may be used for supportive services. The underwriter will need to evaluate and determine the expenses are generally reasonable, sustainable, and commensurate with the level and type of services. FHA cannot provide multifamily mortgage insurance for projects proposing services such that the project would be commercial in nature or they undermine the predominantly residential character of the property.*
    - *Supportive services in PBV projects. If the PHA/owner is proposing to convert more than 50% of the units in the property to PBV assistance using the supportive services exemption described in PIH Notice 2012-32, the PHA/owner will be required to carry forward non-shelter services in place prior to the RAD conversion (or to ensure that residents will begin to receive these non-shelter services at the time of execution of the HAP contract). In such projects, the lender must carefully review the proposed services, and if they will be funded from an external source, should look for*

a memorandum of understanding or other written agreement that demonstrates the services will be in place at the time of closing.

F. Can you clarify what the Rehab Assistance Rents are and what triggers the transition from one rent level to the other? This question relates to the timing different Section 8 rent levels which may come into play during the course of construction. I was told that there were three different rent levels:

- ***Existing or current rents in place prior to construction/loan closing,***
- ***Something called "Rehab Rents", and***
- ***CHAP rents.***

- Answer: <u>The bottom line is that FHA Lenders should only be underwriting to CHAP rents per HN 2012-20</u>. Lenders have been very confused but the take home points are as follows:
  - (i) The HAP contract is effective 1st day of month after closing, no exceptions.
  - (ii) If there is significant construction resulting in what Section-8 would determine as "offline" units, the affected units may be eligible for "rehab assistance payments".
  - (iii) Eligibility is for units that are under the RAD HAP contract which are "offline" due to rehab work.
  - (iv) A unit can only receive rental assistance payments or HAP rents—never both at the same time.
  - (v) Rental assistance payments begin from the date a unit goes offline due to construction until the earlier of: estimated construction completion date (see RCC) or certificate of occupancy date. When the "rehab assistance payments" end, the normal HAP payments begin.

  Under Section 8 rules, an "offline" unit would NOT receive HAP rents, nor obviously, tenant rent. However, under RAD, because often public housing units are eligible for HUD subsidy during rehab, HUD permits RAD units to similarly be eligible for subsidy during rehab (i.e. rehab assistance payments, rental assistance payments), but only for units that were receiving subsidy prior to conversion. If there are long-term (24+ months) vacant units, those would likely not receive the rental assistance payments.

  - (i) To determine eligibility, please discuss with your RAD transaction manager. Their determination occurs at the RAD approval stage, as it's a required input of the RCC.
  - (ii) As the units will be "offline" the rental assistance payments can be treated as if it was interim or construction period income. However, please note the typical rental assistance payments is <u>approximately</u> 80% of the HAP rents and it supplements in cases when a HAP rent would not be provided due to the length of the unit being "offline".

(iii) We encourage lenders and PHAs to reach out to one another to discuss how their transactions dealt with this income, especially in cases of new construction. Each case is unique. HUD can provide eligibility determination and the rental assistance payments amount, but not a “one case fits all” plan of action.

III. Creditworthiness

IV. Cash & Financing Structure

A. What should an underwriter do when the loan’s financial stress test shows the project’s DSCR dropping below the minimum FHA requirement in years 11 – 20?

- Answer:

  It is a risk if the stress test indicates a project’s DSCR will fall below the minimum initial DSCR required in the year 11- 20. With older subsidized projects with higher Operating Expense Ratios and below market rents, this issue comes up from time to time, as typically the stress test assumes the operating expenses increase at 3% rate and the revenues increase at a 2% annual rate.

  We don’t have (and won’t issue) a blanket policy on this. Underwriting judgment is required and should consider all factors including and especially, whether the project would go below 1.0 debt service coverage at any point. Declining debt service coverage obviously would stress the project, so strong mitigants including project condition, sources of additional subsidy and assistance, location, long term track record and expected longevity of the borrower/sponsor/principals would all be relevant factors to consider.

B. If a state’s LIHTC program offers greater than 15% developer fee, will FHA allow it and if so under what conditions?

- Answer: RAD will allow (whether FHA or non-FHA financing) the higher fee for deals with non-FHA financing, provided the amount over 15% is re-contributed to the project (and not expected to be repaid). <u>FHA financed deals will not at this time allow developer fees greater than 15% (whether mortgageable or not).</u>

C. On a RAD 221d4 tax credit project, can the borrower get both BSPRA and the LIHTC developer fee?

- Answer: No, on RAD 221d4 transactions, the borrower can get either BSPRA or Developer Fee, but not both. In the case where the developer fee is less than the maximum, we would consider a structured hybrid – e.g. the 7% of the developer fee, and a standard GC profit, but not BSPRA. But check with the field office and deal with the issue prior to submission.

D. If a project has LIHTC, what is the minimum LIHTC equity pay-in required at closing for a 221d4 and 223f transactions? Does the requirement differ by program (Section of the Act)?

- Answer: The "generally pari passu" language in FHA's recent (2/28/14) LIHTC Program guidance has produced multiple interpretations. To clarify FHA's approach, the following guidance is provided.

  The phrase "generally pari passu" is defined as a fixed pay-in schedule. The table below identifies the minimum equity installment payment due at each stage on a FHA tax credit transaction. It is to be applied going forward on all LIHTC transactions regardless of the FHA program. It applies for both 223(f)s and New Construction/Sub Rehab deals.

Benchmarks for Equity Installments	Minimum Equity Installment (Percent of Total Equity)[1]	Cumulative Equity Paid In[2]
On Or Before Initial Closing	20%	20%
At 65% Construction Completion	30%	50%
At Stabilization	45%	95%
At Delivery of IRS Form 8609 or, Within one year of the Date of Delivery of the Form to Investors	5%	100%

  This approach has three major benefits: 1) it mirrors conventional lenders' and tax credit investors' typical requirements, 2) it simplifies the calculations considerably, and 3) it eliminates varied treatment by HUD Offices.

  The new standard maintains a "generally pari passu" structure, but does not necessarily keep equity infusions exactly proportional to the expenditure of FHA-insured loan funds. Waivers of the timing or amount of the first 20% equity pay-in will not be considered.

[1] Additional equity is of course acceptable at each benchmark date shown, or at one or more additional dates. However the cumulative percentages shown represent the minimum amounts required at or prior to any given benchmark.
[2] All percentages used in this chart represent percentages of total equity being deposited into the projects' closing or repair escrows, from initial closing through the final pay in at the delivery of IRS forms 8609 to investors.

E. How is RAD responding to concerns of commercial lenders and Low-Income Housing Tax Credit (LIHTC) investors with regard to foreclosure matters and continued rental assistance?

- Answer: HUD has posted a standard rider to the public housing conversion RAD HAP contracts to address the concerns LIHTC investors have raised while also protecting the long term affordability of properties converting under RAD, and adhering to the statutory provisions for ownership and control.

  These riders document and set forth conditions for: providing notice to LIHTC investors; accepting the investor's offer to cure on behalf of a defaulted owner; providing HUD consent to the transfer of the investor's interest in the ownership; and pre-approving replacement of the general partner or managing member with the special limited partner or similar entity for a limited period of time in order to facilitate an acceptable permanent replacement. To access these riders, go to: www.radresource.net > Contracts & Closing Documents.

  HUD is also in the process of drafting standard riders to the Use Agreement and the public housing conversion RAD HAP contracts to clarify that HUD will not assert an interest to prohibit a lender from foreclosing when there is cause, but that the Use Agreement -- which establishes affordability requirements -- survives foreclosure by its terms and that continuation of HAP assistance requires HUD consent. These riders should be posted by the end of August. It is also HUD's goal through these riders to provide for a limited continuation of HAP assistance if the lender or its designee comes into ownership of the project in accordance with its rights under the loan documents. When final, these riders will be published on the RAD website. Until these riders are finalized, HUD has developed several provisions that can be provided by the RAD Closing Coordinator to assist with transactions currently moving into the closing phase. These provisions address lender concerns while also protecting the long term affordability of properties converting under RAD, and adhering to the statutory provisions for ownership and control. Importantly, neither rider changes RAD statutory and RAD notice requirements around ownership and control. The RAD Use agreement and RAD HAP contract – two means through which long-term affordability for residents are secured – survive foreclosure, leaving current and future residents protected.

V. General RAD topics

A. Mortgagee Letter 2014-05, Standardized Multifamily FHA Insurance Application list of application exhibits includes "Form FHA-1708", titled Agreement for Payment of Real Property Taxes. Is this Form/Agreement required on RAD FHA transactions?

- Answer: No, Form FHA 1708 is not required. It is an optional form that they Lender may use. We will advise the MF production offices that the form is optional later at this month's Development Call. Longer term, we anticipate the Department will revise its policy guidance (ML) to reflect this change in policy. For the interim, Lenders should put "N/A" beside the exhibit number when submitting the firm commitment application.

B. Can a PHA apply the RAD "de-minimis standard" for replacement across a group of properties in its portfolio?

- Answer: Yes, a PHA may apply the RAD de-minimis 5% standard for any group of properties that are undergoing conversion. For example, if the PHA has two CHAPs, each consisting of 100 units, and the PHA has six units at the first project that have rehab costs that would be exorbitant, the PHA could apply the de-minimis standard across both properties. Thus, because the PHA would, combined, be able to reduce 10 units (5% de-minimis limit), the PHA would be permitted to reduce the 6 units at the first property (provided it does not reduce more than 4 units at the second property). However, the project utilizing the greatest reductions has to be the latest to convert (or converts simultaneously).

  The timing of the projects conversion is a critical, threshold eligibility issue. If a PHA is proposing to group properties to meet the RAD de-minimis, HUD requires the PHA to discuss their portfolio de-minimis plan as early as possible after award to ensure the timing is acceptable. This must be done prior to submission of the financing plan (i.e. FHA Firm Commitment application).

C. If a RAD project included temporary relocation of tenants for let's say 3 weeks to renovated units in the same RAD project while the units were being renovated and then the owner moved the tenants back into their original units, would it trigger the RAD relocation and URA requirements?

- Answer: Yes. An owner undertaking this kind of move would need to provide residents with at least two notices: 1) General Information Notice (GIN) as soon as feasible in the planning process, and 2) RAD Relocation Notice (which could be combined with 30-day notice prior to relocation). For templates of both Notices, please see the RAD Relocation Notice (H 2014-09/PIH 2014-17) available on the RAD website: www.hud.gov/rad .

  Also, the PHA would have to pay for any costs related to the move, including moving costs, utility connection fees, and increased housing costs. An owner can move the family to another unit in the project and then move them back once the renovation is completed. (Alternately, they could wait until another rehabbed unit of appropriate size is available and move the family only once, i.e., the right to return is to the converted site, not necessarily to the same unit.)

- **Assuming the same scenario as #1 above, could the owner/PHA meet the RAD "tenant right to return" requirements by moving the tenant permanently to another refurbished unit within the project of the same size?**
    - Answer: Yes.

- **Does the owner/PHA have to allow the tenant to move back to the exact same unit?**
    - Answer: No.

- **Assuming the same scenario as #1 however, this time the tenant (a 1-person family) is "over housed" in 3-bedroom unit, could the owner/PHA as part of the RAD conversion, permanently move the tenant to a smaller refurbished unit (appropriate for his family size) in the same project?**
    - Answer: Yes, the Borrower/PHA should be trying to do that both now, prior to conversion, and at the time of conversion. PHA should refer to their written occupancy policies when moving families to units of appropriate size.

D. Section 1.5A of the RAD Notice (PIH 12-32 Rev-1) says that "Prior to the approval of a project's Financing Plan, a PHA may expend up to $100,000 per project in public housing program funds in related pre-development conversion costs per project without HUD approval." Is that an absolute cap?

- Answer: No, it is not the absolute limit. With the approval of the HUD Headquarters Office of Capital Investments, a PHA may expend additional public housing program funds. Other potential strategies include: using the PHA's non-public-housing funds, and structuring the transaction so that development partners provide some of the pre-development capital (and receive repayment at the closing).

E. Lender alert on need for AFHMP on RAD FHA 223f transactions with Section 8 PBRA contact.

- Under the Section 223f program, FHA doesn't require the borrower to develop and submit an AHFMP plan with its FHA application. However, when a borrower opts for a PBRA contract, HUD requires the borrower submit an AHFMP as an exhibit to its draft RAD PBRA contract provided with its closing documents. MF Asset Management will need the AHFMP to be submitted to process, set up and approve the new Section 8 PBRA contract. We wanted to give all lenders a "heads up" about it, so you can have the borrower working on it earlier in the process. This is a Section 8 requirement not a function of the 223(f).