

FAQ #4

FHA LOW INCOME HOUSING TAX CREDIT PILOT PROGRAM

Issued March 19th, 2013 and Updated April 5th, 2013

DEVELOPER AND CONTRACTOR FEES AND IOI RELATIONSHIPS

Q 1. Does the Pilot Program Restrict Developer and General Contractor Fees?

A. Yes, the Developer Fee limit is the lesser of either:

- 1) 15% of Total Development Cost or
- 2) the amount allowed by the Tax Credit Allocation agency.

No blanket restriction has been imposed on the amount of General Contractor (“GC”) Profit, though it must be reasonable based on the market and the scope of work. However, state allocating agencies often limit these as well as the Developer Fees. HUD’s limit on the Developer Fee applies to all Pilot Transactions, unless the FHA-Insured mortgage is limited to 80% of LTV.

Q 2. Are Developer Fees Treated as Mortgageable Costs?

A. Generally, FHA programs treat Developer Fees as mortgageable costs only for nonprofit borrowers who are not also claiming BSPRA.

Q 3. What Fees Are Included within the \$40K Rehabilitation Cost Limit?

A. All costs included within the construction contract, including the GC Profit, must be included in the \$40,000 per unit cost limit. Developer Fees and Architectural Fees are not included in the construction contract or in the \$40,000 per unit cost limit.

Q 4. What if there is an Identity of Interest (IOI) between the Owner/Developer and the General Contractor. Does this require a waiver?

A. No: An IOI between the GC and the owner does not require a waiver, but it should be disclosed in the application for purposes of HUD’s review of the fee structure.

Q 5. If the general contractor is affiliated with the borrower, is it acceptable to eliminate the GC Profit from the “mortgageable” rehab costs (and the \$40,000/unit program limitation) but still pay the profit from syndication proceeds after completion of the rehab?

A. If there is any GC Profit in the deal, it has to be included in the \$40,000 rehab limit, and the IOI relationship between builder and developer/owner has no bearing on it. Although the GC fee is sometimes viewed as a “soft cost” by the participants, it is treated as a hard cost in FHA underwriting.

This question also raises the issue of including both GC Profit and a Developer Fee when there is an IOI relationship between the developer/owner and the general contractor. HUD will generally rely on the policies of State tax credit allocation agencies, that often scale fees down to lower limits when a given party or set of related parties is receiving both the Developer Fee and the GC Profit, since combined these fees may be redundant and excessive. HUD's Designated Underwriters will evaluate the fees and profits and reduce them if necessary.

AGE RESTRICTED PROPERTIES: TENANT ELIGIBILITY AND SERVICES

Q 6. What is the Pilot's policy regarding senior projects? Can projects for Heads of Household (HOH) aged 55 or older qualify? Can senior projects accepting tenants with disabled HOH's who do not meet the 62+ years age test qualify under HUD rules? Can waivers be obtained for "grandfathering" a few younger HOH's, as long as the owner re-rents only to tenants with HOH's 62 years old or older over time?

A. The Pilot policy on this topic is the same as for all other FHA programs: Except for Section 231 transactions the only eligible senior projects are those in which:

- 1) all HOH's are 62 years of age or older, and
- 2) do not discriminate against other, younger people within the tenants' households.

Accordingly, none of the units may be used by other tenants, including those who are disabled but under age 62. There may be a very narrow exception to this rule, for a Hurricane Sandy-impacted property or a nonconforming property that has been continuously assisted ~~or~~ and insured since before March of 1991, but generally all tenants must qualify by age as described above, by the time the Firm Commitment is issued.

Q 7. The 202 refinancing guidance in Notice H 2012-8 allows for use of mortgage proceeds for funding services to residents and construction of auxiliary service structures. Is this allowed when a 202 is acquired and/or refinanced under the Pilot Program? Many states' tax credit programs provide incentives for services, which would present a conflict if HUD were to prohibit services.

A. Senior projects that provide extensive tenant services are not eligible for multifamily mortgage insurance and thus not eligible for the Pilot Program. However, projects providing services that are modest in scope and do not change the fundamental character of the project as an age-restricted project serving independent seniors would be eligible.

MARK TO MARKET PROJECTS

Q 8. Are Mark-to-Market Projects Eligible for the LIHTC Pilot Program?

A. Yes. However, if they have junior Mark to Market debt (Mortgage Restructuring Notes ("MRNs") or Contingent Restructuring Notes ("CRNs")) the owner or lender must request a Waiver of the Due on Sale Provision in the notes from OAHQ. This should be initiated well in advance of the FHA loan application, as approval of transactions requires an extensive review by OAHQ. Further guidance is

available in HUD Notice 2012-10: “Guidelines for Assumption, Subordination, or Assignment of Mark-to-Market (M2M) Loans in Transfer of Physical Assets (TPA) and Refinance Transactions.”

HAP CONTRACT RENEWAL TIMING

Q 9. If a project has a 20 year HAP contract renewal date of August 23, 2010, will a new contract be necessary? The guidance is unclear as to how much time may elapse in the contract period before it requires and extension: Notice H 2012-1 states the existing contract must have been executed no longer than one year prior to the Pilot Application, but page 26 of the Pilot Application Processing Guide states an exception may be requested if the borrower “recently” renewed the contract for a 20 year term. Has there been any determination on how we define “recently”?

A. The time elapsed since the latest HAP contract date should not exceed one year, consistent with the Pilot Notice language in two sections cited below:

Section IV. A.1.b. Housing with Rental Assistance. To qualify, the property must have a Section 8 project-based rental assistance contract which covers 90% or more of the units. The borrower must execute a renewal Section 8 HAP contract with a 20-year term with or in advance of the refinance transaction, with contract funding subject to annual appropriations. If the project is in the midst of a multi-year term, the Owner and HUD must, by mutual agreement, terminate the existing HAP contract and execute a Renewal Contract with a 20 year term, subject to the availability of appropriations. The Owner must also agree to execute an Exhibit to the Section 8 HAP contract agreeing to renew the HAP contract at the end of the 20-year term for the minimum of the number of years remaining on the contract in place at the time of the early termination and must execute the Preservation Exhibit.

Section V, H.3. Appraisal/Valuation review of assisted housing transactions (with 90% or more of the units covered by a rental assistance contract) will involve the following steps: The borrower must have a new or renewal 20 year Section 8 HAP Contract in place (executed no later than 1 year prior to the Tax Credit Pilot application), or must request a 20 year Section 8 HAP contract renewal in conjunction with the Section 223(f) refinance/acquisition.

USE OF RESERVES FOR DUE DILIGENCE REPORTS

Q 10. Can replacement reserve funds be used to pay for nonprofit owners’ due diligence reports required by HUD and by the lender?

A. With prior written approval from HUD’s Asset Management staff, Non-profit owners of projects financed with FHA-Insured loans may request withdrawals from the projects’ Reserve for Replacements accounts to pay for third party costs incurred for purposes of improving the project. Such costs are limited to the costs of third-party, lender-required reports such as appraisals, PCNAs, and RCSs. However, requests for such withdrawals up to the amount of \$20,000 must include a replacement reserve analysis acceptable by the field office and verifying end-of-year replacement reserve balances no lower than the minimum per unit amounts established by the field offices’ asset management staff.

STRUCTURING OF SECONDARY DEBT AND OTHER FINANCIAL OBLIGATIONS

Q 11. Do the payables listed below have to be documented as a surplus cash note? Do they count towards the 92.5% LTV constraint?

Deferred Developer Fee

A1. The deferred developer fee must be converted to a surplus cash note if it will encumber either the property or the ownership entity as debt, in which case it will be included in the 92.5% LTV ratio. Alternatively if the deferred developer fee is assigned to one of the principals of the ownership entity and will not encumber the project or become an obligation of the ownership entity, it is considered equity, not debt. Accordingly it will not be considered secondary financing and is not included in the 92.5% LTV ratio.

Bridge loans secured by Limited Partnership interests and repaid through future installments of tax credit equity

A2. As long as these obligations 1) are not secured with the property and 2) are fully paid by the time of the permanent loan closing (or completion of construction in the case of a 223(f) insured loan, which is fully funded at initial closing and has no permanent loan closing) then they will not be included in calculation of the 92.5% LTV ratio.

HOME Funds and an Affordable Housing Program (FHLB) Grant, each documented as a note directly to the borrower (or the GP of the borrower who will then loan it to our borrower)

A3. Both the HOME and the funds will be treated as public secondary financing sources, and as such need not be included in the 92.5% LTV limit.

PASSIVE INVESTOR CERTIFICATION

Q 12. Who can use the Passive Investor Certification in lieu of the 2530 form?

A. Both syndicators and direct investors may use the Passive Investor Certification in lieu of the 2530. However, if a syndicator is creating a GP or LLC managing member entity or is otherwise involved with the GP or Managing Member, the 2530 will be required. The Passive Investor Certification may only be submitted by entities that are acting exclusively as passive investors. The Passive Investor Certification can be used for any FHA/Tax Credit transaction, not just Pilot transactions. Please note, however, that the Passive Investor Certification is not a substitute for any financial information Housing may require to vet an investor's financial capacity.

APPLICABILITY OF NEW PCNA REQUIREMENTS

Q 13. Do Tax Credit Pilot projects have to conform to the new PCNA requirements in Notice H 2012-27 and Mortgagee Letter 2012-25?

A. Yes.

LIEN POSITION OF 223(F) INSURED MORTGAGE

Q 14. As a rule, HUD requires the first, FHA mortgage lien to be in first position, but the LIHTC Land Use Restriction Agreement is also required to be in first lien position. Has HUD waived this requirement for Tax Credit transactions and if so, are documents available indicating which particular elements can be revised?

A. By statute HUD is prohibited from accepting subordinate positions with respect to other monetary liens. However, on a case-by-case basis HUD may approve non-monetary use restrictions that run with the land and thus may be superior to HUD's first mortgage position.

REPAIR ESCROW AND COMPLETION ASSURANCE

Q 15. We have heard that the 100% Repair Escrow and the 20% Completion Assurance Escrow have been waived already. What circumstances allow for this? Would a 100% Payment and Performance bond escrow be an acceptable substitute? Could nonprofit sponsors get by with 10% rather than 20%?

A. HUD will generally approve a waiver to allow deferred funding of the 20% Completion Assurance Escrow for the Tax Credit Pilot projects. However HUD will generally not waive the 100% repair escrow funding requirement at closing. Exceptions would be considered in cases in which 1) the lender clearly demonstrates a significant negative financial impact of the requirement (i.e. if the cost of a bridge loan, or the impact on pricing of the Tax Credits was material) and 2) the risk associated with partial funding of the Repair Escrow is otherwise strongly mitigated by other elements of the deal.

Q 16. Is the 20% Completion Assurance Escrow like a construction contingency (as in the 221(d)(4) program) and thus included as a mortgageable cost? Or is it to be treated as a Completion Assurance Escrow as in the 223(f) program and therefore paid from other cash sources?

A. The 20% escrow is treated as a non-mortgageable cost under Section 223(f), including Tax Credit Pilot transactions.