

## FAQ #6 (March 18<sup>th</sup>, 2014)

### On Ted Toon Memo Regarding Low Income Housing Tax Credit Pilot Program Revisions Dated February 28<sup>th</sup>, 2014

#### Policy Question 1: Total Debt Load Under 223(f)

Q. Does the guidance regarding subordinate debt apply to all 223(f) transactions or only those processed by the Pilot program?

A. The new guidance on debt limits applies to all LIHTC transactions under the 223(f) program, including but not limited to Pilot projects. Further detail as to applicability of various provisions of the memo is provided in the attached matrix.

Q. Does a transaction need to have new LIHTC to benefit from the new subordinate debt limits, or can existing LIHTC projects with subordinate debt be included when they come in for a 223(f) refinance?

A. Projects with new or existing LIHTC benefits are eligible for the new debt limits, so long as the projects will have Tax Credit use restrictions remaining in place for at least 15 years from the date of the transaction.

#### Policy Question 2: Three Year Rule Waiver Transactions

Q. The first sentence describing the 223(f) program refers to projects completed “less” than three years ago. Shouldn’t it say more than 3 years ago?

A. Yes, it should read “...more than three years ago...” in reference to the original three year rule language.

#### Policy Question 3: IOI and Mortgage Calculations

Q. The memo noted that we can treat LIHTC projects with Identity of Interest transfers as acquisitions, rather than as refinancings. Which mortgage sizing criteria on the HUD 92264-A would apply in such cases?

A. For tax credit projects using Section 223(f), whether Pilot transactions or not, HUD will allow an Identity of Interest transfer to be treated as an acquisition rather than as a refinancing: Thus the mortgage would be based on Criteria 1, 3, 4, 5, or 7, whichever produces the lowest result. For most transactions, this revision in policy is more permissive than the current MAP Guide language. Lenders will still have the option of treating a transaction involving a partial change in ownership (for example, an Identity of Interest acquisition) as a refinancing transaction, in which case criterion 10 would apply rather than criterion 7. Criterion 11 may be used at the Lender’s option but is not required.

#### Policy Question 4: Completion Assurance

Q: The 20% required Assurance Completion was regularly being waived down to 10%. The memo allows 10% to be the new standard. When warranted, can this 10% be waived down to 0?

A. No. We will, however, consider escrows required by the Tax Credit Investor for the same purpose as substitutes.

#### Policy Question 5: Timing of Repair Escrow Funding and General Equity Pay In Schedule

Q. The funding of the repair schedule and the equity pay-in schedule are supposed to be done on a pari passu basis, but only 20% of equity has to be paid in at closing, which may not be proportionate to the full, 100% funding of the FHA insured loan at closing. How is this meant to work?

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A. At closing, 100% of the FHA-insured loan and 20% of the total equity proceeds must be paid in to the closing escrow. At closing, funds will be advanced to cover both mortgageable and non-mortgageable costs from the two (and more in some cases) sources of funding. After acquisition and closing costs have been paid, remaining mortgage proceeds placed in the repair escrow are to be disbursed approximately pari passu with equity funds. Accordingly if, for example, \$1million in HUD funds and \$4 million of equity were available after closing (amounting to \$5 million total) then each draw after closing should be comprised approximately of 20% FHA loan Funds and 80% equity. The disbursement agreement and the equity pay-in schedule should generally be structured to accommodate this proportionate application of funds.

Q. This question pertains to #5, concerning how equity is paid into the repair escrow on a pari passu basis. In the past when we had funded 100% of the repairs at closing we would also fund 100% of the Assurance of Completion Escrow. If the repair escrow is being funded gradually, when should the Assurance of Completion Escrow be funded?

A. The Completion Assurance Escrow should be funded proportionately to funding of the Repair Escrow: For example, by the time 15% of the funding of the repair escrow has been paid in, 15% of the Completion Assurance Escrow should also be in place. Note that the Completion Assurance can be funded in cash or irrevocable letters of credit.

#### Policy Question 8: Tax Abatements

Q. In some cases the “Value” for Criteria 3 could be higher or lower depending on whether you use “Market Rents with Full Taxes” or “Restricted Rents with a Tax Abatement”. Does the Lender choose the approach that gives the higher value? How is the mortgage sized?

A. Two general principles apply: First, Criterion 3 is based on market value. The market valuation is determined by the third party Appraiser based on the various applicable approaches (including Direct Capitalization based on NOI and Cap Rate), and should be internally consistent. Secondly, Criterion 5 is based on how the project will actually operate.

Further Comments: Per HUD’s longstanding policy (see for example the MAP Guide chapter 7 FAQ dated 5/22/03), HUD will allow Tax Abatements or Tax Exemptions that run with the ownership rather than the land for tax credit transactions since they are presumed to be low leverage first mortgage loans and/or to have significant investments of other public funds. In such cases, the debt service approach (Criterion 5) would reflect the tax abatement, and other factors affecting NOI, including for instance, variations in subsidized rents or terms of the tax abatement (which could require an A / B piece structure if the abatement expires prior to the term of the mortgage.) As noted above, the Valuation used in Criterion 3 should be based on market expectations, and for tax credit projects, can include the tax abatement even if it does not run with the land. The capitalized value approach should include any other adjustments to NOI (including rent restrictions if they are tied to the Tax Abatement) and Capitalization rates that reflect market expectations of similar transactions.

Q. Does the Appraisal for LIHTC deals financed under Section 223(f) need to provide multiple values or just the value that provides the highest figure?

A. The Appraisal for a Section 223(f) refinancing should assume market value, including and assuming repairs funded through the transaction. See the previous answer for additional comments regarding internal consistency in assumptions around NOI and Capitalization rates for the (as repaired) market value. For transactions with Project

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Based Section 8, the Section 8 rent comparability study included within the Appraisal should address the rents prior to and after the repairs are completed.

Other estimates of value and analyses may be appropriate in specific transactions but are not generally required. For example, if the per unit rehabilitation levels are greater than the Section 223(f) program limits, it is appropriate to require both an “as is” and an “as repaired” value.

Q. Does HUD have a problem with an acquisition price in a Section 223(f) LIHTC transaction being materially greater than the market value?

A. The FHA insured loan will be sized based on a reasonably conservative market valuation. The sources and uses will be evaluated per existing HUD guidance, including the revisions in our 2/28/14 memo.

#### **Policy Questions: 6. Through 12.**

Q. The memo notes that these items do not require waivers and will be incorporated into the MAP Guide. Can you confirm whether these changes apply to all projects (unless specifically noted otherwise)? For example, item #11 which clarifies that 2530s are required only for Board officers and not board members and neither personal financial statement nor credit checks are required for regular board members or officers of the board – does this apply to all nonprofit transactions going forward or just non-profit-sponsored Pilot deals?

A. Item #11 applies to all affordable projects, including all Tax Credit projects. While additional credit analysis is not generally expected for non-profit board members or officers, there may be specific cases where such analysis is appropriate and required, for example if publicly or otherwise available information suggests that the integrity or creditworthiness of the non-profit owner is impacted by a board member or officer’s history.