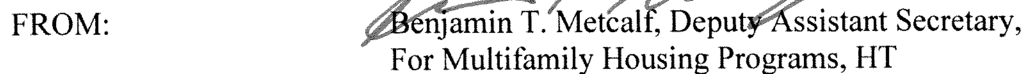
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

JAN 30 2015

MEMORANDUM FOR: All Multifamily Regional Center/ Hub Directors
All Multifamily Satellite Office/ Program Center Directors
All Multifamily Operations Officers



FROM: Benjamin T. Metcalf, Deputy Assistant Secretary, For Multifamily Housing Programs, HT

SUBJECT: Affordable Housing Clarifications

Financing affordable and Low Income Housing Tax Credit (LIHTC) housing is a top priority for Multifamily Housing at HUD. In 2011 we launched the FHA LIHTC Pilot and followed it in 2012 with a series of memos, Q&As and clarifications. Our goal was to better align FHA's underwriting process with the unique timing constraints of LIHTC projects, to increase FHA's affordable housing production and preservation and to test the Single Underwriter operating model. The LIHTC Pilot has been immensely successful and well-received. FHA-Insured LIHTC projects more than doubled from 2013 to 2014, from roughly $0.9 to $1.8 billion in mortgages. Pilot processing times remain very low, at less than 100 days from Firm Application to Closing.

Building off the strides we already have made, HUD is pleased to announce a new series of initiatives to support affordable housing production. These initiatives include **operational changes** and **clarifications of existing policies** memo of February 28, 2014 and the Multifamily Accelerated Processing (MAP) Guide. The areas addressed are all a function of clarifying existing guidance and will be reflected in the revised MAP Guide.

The revised MAP Guide which we will release for public comment will include further affordable housing initiatives that we are developing. We plan to announce new affordable initiatives to our Risk Share programs this spring as well.

We have made three significant **organizational changes** to support affordable housing finance:

1. **Single Underwriter Model.** The Single Underwriter model tested in the LIHTC Pilot is being rolled out across our platform nationwide as part of our Multifamily for Tomorrow initiative. The experience and feedback that we received through the Pilot allowed us to expand and improve the model, and is now one of the four hallmark features of our Transformation. Our Southwest Region comprised of our Fort Worth and Kansas City offices have completed the Transformation and are operating fully under the new model

which includes dedicated LIHTC teams. Any tax credit deal (not only Pilot deals) in the Southwest Region is hereafter handled by a specialist team in Fort Worth led by branch chief Liz Arteaga.

2. **Dedicated Rental Assistance Demonstration (RAD) Teams.** With the cap recently lifted to 185,000 units, we expect one third to half of RAD units to seek FHA financing. Many of the opportunities will be coupled with tax credits and strict timelines. In order to efficiently support RAD financing, we announce the creation of dedicated teams of FHA/RAD underwriters in four hubs and regionals centers around the country: Seattle, Chicago, Atlanta and Fort Worth. Our new teams are trained to meet the unique timelines and complexities of RAD and LIHTC.

3. **Expansion of Pilot to 221(d)(4).** Our current Pilot with 223(f) financing offers tax credit developers multiple benefits:
   - Single Underwriter model (prior to full adoption in all offices in 2016 through the Transformation);
   - Faster processing times;
   - Straight to Firm commitment underwriting; and
   - Streamlined processing through reduced forms.

   We are currently testing expansion of the Pilot to the 221(d)4 product in California through our San Francisco Hub. California's Tax Credit Allocation Committee (TCAC) raised its minimum threshold for rehab per unit to $40,000 to qualify for 9% tax credits, which precludes use of the current Pilot. We will study closely and apply lessons learned from the California experience to our nationwide rollout. Before then we will invite staff and representative stakeholders to preview the changes and to provide feedback and recommendations for the final product.

Based on feedback from stakeholders, in tandem with our operational changes we are announcing a series of **clarifications to our existing policies outlined in our memo dated 2/28/14 and in the MAP Guide**. The areas addressed below are not new guidance and will be reflected in the revised MAP Guide:

1. **Equity Pay-In.** The "generally pari passu" language we provided previously resulted in multiple interpretations and a lack of consistency across our platform. Going forward, we will underwrite the fixed minimum pay-in schedule summarized below for all LIHTC transactions (Pilot and non-Pilot). This approach has three major benefits: 1) it aligns our standards to those of conventional lenders and tax credit investors, 2) it simplifies the calculations, and 3) it eliminates varied treatment by HUD Offices. The new standard maintains a "generally pari passu" structure that is not precisely proportional to advanced FHA insured loan funds, and therefore more flexible than the prior approach.

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[3]	45%	95%
At Delivery of IRS Form 8609 or, Within one year of the Date of Delivery of the Form to Investors	5%	100%

As described in more detail below, equity investors may substitute bridge loan proceeds for all or part of the payments defined above, until the date of the final deadline when the bridge loan must be repaid in full.

2. **Bridge Loans.** Bridge loans play an important role in maximizing LIHTC equity. Any or all of the LIHTC equity paid according to the schedule above can be funded out of partners' cash, Tax Credit syndication proceeds, or a temporary bridge loan. If the equity is funded by a bridge loan, the borrower may be the project sponsor or an upper tier entity. The term of the promissory note evidencing a bridge loan may extend to one year following the date of the delivery of the 8609 forms to investors.

3. **Identity of Interest.** To respond to the greater presence of direct investors in the market, FHA has increased the number of transactions in which the MAP lender holds up to a 100% ownership in the LIHTC limited partner from 5 to up to 10 transactions per calendar year. This exception is available to certain supervised or publicly held MAP Lenders. FHA allows any MAP lender to carry a 25% or smaller interest in the tax credit equity on any number of projects.

[1] Additional equity is 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.

[3] Defined as the time at which the project's operations have achieved a minimum debt service coverage ratio of 1.0:1 for 6 months.

4. **Subordinate debt.** Subordinate debt sources are also critical to financing affordable housing and frequently have underwriting policies that were not compatible with FHA. Going forward, subordinate debt including seller financing on LIHTC deals may represent up to 100% of total project costs and be secured by the project so long as the subordinate debt provider agrees to HUD's standard form of subordination agreement and standstill. Temporary bridge loans are discrete from subordinate debt and addressed above. Subordinate debt must remain subject to the following conditions:

   - Payments only from surplus cash, if available;
   - Payments for all secondary debt combined not to exceed 75% of surplus cash;
   - Documentation with a promissory note; and
   - Subject to automatic resubordination in any refinancing of the first mortgage.

5. **Vacancy Rates.** Reflecting our experience across our insured and assisted portfolios, we are revising our minimum underwritten vacancy and collection loss rates to distinguish between classes of multifamily housing. The standards below also better align FHA practice with the broader multifamily lending market.

   Underwriting will continue to be at the greater of the minimums below and actual levels.

Minimum Vacancy and Collection Loss Rate	***Property Type***
3%	• HUD-assisted property with HAP contract on 90% or more of the units; <u>or</u> • In-place rehab with greater than 90% occupancy and greater than 90% of the units set aside as LIHTC units, with attainable tax credit rents at least 10% below market (i.e. a "discount to market).
5%	• 80% of the units are set aside as LIHTC units, with attainable tax credit rents at a 10% discount to market.
7%	• LIHTC without a 10% discount to market; or • 20% or more of the units are Market Rate.

6. **Developer Fees.** FHA has broadened its underwriting of Developer Fees. We will now underwrite any developer fees up to 15% of Total Development Costs that comply with IRS regulations for the LIHTC program and the prevailing Qualified Allocation Plan (QAP) for any project that is not claiming Builder's and Sponsor's Profit and Risk Allowance (BSPRA) or Sponsor's Profit and Risk Allowance (SPRA). Projects eligible for BSPRA and SPRA can opt for those costs or a Developer fee. The Developer Fee now may also be treated as a mortgageable cost. Waivers of the MAP Guide will be required to implement these changes for individual transactions until such time as the change is published in the MAP Guide later this month.

These changes are effective immediately through this memo to the field and subsequently will be incorporated into the MAP Guide. Please contact Lynn Wehrli, Senior Production Advisor in the Office of Multifamily Housing Production with any questions or comments at lynn.wehrli@hud.gov or 202.402.5210.