



MEMORANDUM FOR: Minnesota MF Hub Lenders

SUBJECT: Secondary Financing (Debt or Equity)- Circular 03-11

Date: May 29, 2003

The purposes of this circular are to revise policy issued by this office on June 30, 1999, and articulate current Hub policy regarding secondary financing (defined to include any debt or equity financing provided to meet project costs in excess of the first mortgage) procured in order to meet cash requirements (defined herein as the gap between the Maximum Insurable Mortgage and Total Project Cost).

I. June 30, 1999 Bond Premium Use:

In this letter we indicated that Bond Premium proceeds could be used to meet cash requirements. HUD Handbook 4470.1 REV-2, ¶ 15-2A 2. c. (5) permits such costs to be covered, if approved by this office. Generally, this Hub prefers to limit the use of such proceeds to the “additional costs (directly) associated with the issuance of the obligations”.

At this time we are reinstating the more limited use of Bond Premium proceeds to only cover *added costs of issuance* (beyond the general 3.5% financing fee limit within the loan, up to a maximum of an additional 2%). Where Bond Premiums are proposed to generate cash to finance any other cash or escrow requirements, these:

- must be evidenced by the prescribed secondary instruments discussed below,
- are subject to this office’s explicit approval, and
- are subject to the limitations described below.

II. Current MN Hub Secondary Financing Policy:

A. *Purchase and Refinance*- For § 223 (f) projects, FHA Multi-family’s (MF) policy is stated in §8.10 of the MAP Guide. Essentially, secondary *public*-sourced financing may be made to the project for up to 100% of value. Private investors may not provide any more than 7.5% of value, for an overall limit of 92.5% leverage (after including an assumed 85% of the value first mortgage). ¶ 8.10D of the Guide spells out the required conditions for any inferior obligations on cash flow, as evidenced by the

required Promissory Note (Form HUD-92223; a Residual Receipts Note, Form FHA 1710, is substituted for Non-Profits, and is applicable hereinafter where NP's are involved).

B. New Construction and Substantial Rehabilitation (NC, SR) - There does not appear to be current national policy covering these FHA MF programs including §§ 220, 221 (d) 3 and (d) 4, and 232 (§ 213 cash requirements are essentially filled through buyer down-payments). The policy articulated below for this Hub, in the absence of national policy in these programs as of this date, is issued for comment. If you believe that we should consider additional references other than those listed below, then please reply with citations to the same. Otherwise, and if no comments are received, this policy becomes effective 15 days after the issuance of this circular.

- ✓ Notice H 99-33, "Revised Processing Instructions for the § 223(f) Program"; see also §8.10 of the MAP Guide
- ✓ Notice H 84-37, now Appendix G of HUD Handbook 4350.1 REV-1
- ✓ HUD Handbook 4350.1 REV-1, ¶ 13-15 (for consistency with Loan Management policy)
- ✓ HUD Handbook 4470.1 REV-2, ¶ 15-2; see also MAP Guide §8.15
- ✓ 4470.1 REV-2, Chapter 12 "Promissory Notes"; Form HUD 92223
- ✓ Form HUD-92466, "Regulatory Agreement" §§6 (a) and (b) restricting encumbrances, i.e., recordings beyond the insured first mortgage
- ✓ Memo dated May 15, 1986, "Instructions for Processing a Multifamily Insured Project with a Grant/Loan" (now §8.11 of MAP Guide)
- ✓ Memo from Thomas Demery dated July 21, 1988, "HUD-Insured Project Mortgage Loan Transactions with Special Side Features"
- ✓ Programmatic LTV or LTC leverage limits and traditional equity stake requirements in various Handbooks

Hub Policy:

For NC and SR *essentially the same conceptual limits* expressed in §§8.10 and 8.15 of the MAP Guide will be observed. However, because the traditional equity stake position is slightly smaller, the limit for total leverage (of first and secondary positions) will be 95% where private investors not listed as project principals are a cash requirement source (for these purposes, principals are those for whom Form HUD 2530 previous participation clearance has been submitted), regardless of mortgagor-type. Exceptions may be granted for up to 100% of Total Project Cost where public sources with appurtenant affordability restrictions are also involved.

Similarly, only 50% of anticipated Net Operating Income available to service secondary debt/equity positions, after deduction of estimated total operating expenses including replacement reserves allowance, and first mortgage debt service, may be pledged as collateral, and support

repayment, of the applicable required secondary note. Also, all applicable instruments must indicate that such repayment source will be amended to include only 50% of any available surplus cash or residual receipts after the date of Final Endorsement, and must be approved by HUD, as this approval authority is provided for and described in the Regulatory Agreement (see ¶s12-2E, 12-4B3, and 12-4D2 in HUD Handbook 4470.1 REV-2).

Additional requirements stated in § III of Thomas Demery's July 21, 1988 memo (copies available upon request) may also be applied at the discretion of the Hub. For example, any "call provisions" contained in the secondary instruments may not be effective earlier than the 10th anniversary of initial endorsement.

For Mortgage Credit processing or review purposes, any cash requirement reflected must be met by itemized Sources, including any public or private investor sources that are not the mortgagor entity or its principals. Any proposed secondary debt or equity position, whether secured by the project or not (sometimes guaranteed by project principals in their personal capacity, which can affect the principal's financial strength relating to the project) *must* be fully disclosed to, and approved by, HUD within the Firm Application materials, and must be updated as revised by the lender from that date until Final Endorsement.