U.S. Department of Housing and Urban Development

Minneapolis Field Office
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Minneapolis, Minnesota 55402-4012
http://www.hud.gov/local/min/minhome.html

MEMORANDUM FOR: Minnesota MF Hub Lenders

SUBJECT: Underwriting Issues- Circular 03-01

Date: February 28, 2003

On December 19, 2002 we issued a brief circular covering current underwriting issues and concerns. We have renumbered that circular "02-01" and now issue Circular 03-01. Circular 03-01 pertains only to Minnesota projects at this time, and covers a broad range of programs areas and topics.

1. Management Certification (Form HUD 9839a, b and c): In our April 17, 2001 letter that some of you may have received, we referenced a per unit per month (PUPM) management fee cap for projects that are insured under Section 221(d)(3)'s and proposals containing Section 8. Unfortunately, this portion of the letter was in error. There is no distinction on allowable management fees between our programs - our directives state that the fee must be reasonable.

HUD has determined that a PUPM management fee of $45 or less is reasonable. The management fee is shown on page 4 of HUD Form 9839B. We will review on a case-by-case basis any situations where you believe that a higher PUPM amount is reasonable.

Please note that, even with Section 232 health care projects, FHA/HUD only insures the real estate facilities and major moveable equipment involved, but no intangible assets, and thus, only property management fees relating to the tangible physical assets qualify and are scrutinized under this category/ line item limitation.

2. Section 213(i) Refinances:

Based on a few concerns that emerged as a result of the volume of recent Section 213 (i) applications, and given the dearth of written, prescriptive underwriting requirements, we have decided to articulate a few requirements that apply only to Section 213(i) proposals in Minnesota that are refinancing a HUD Insured mortgage:

A. Application fees must accompany applications. Such fees may be reimbursed at closing if included and approved within the loan request.

B. Regardless of estimated monthly savings, any mortgage request that exceeds the originally insured mortgage must:

   1) be accompanied with an updated appraisal reflecting value in excess of the newly proposed loan amount, and
   2) result in total financing fees of no more than .5% of the new loan amount (for both origination and placement, unless sufficient justification for a higher transaction fee is provided by the lender).

C. Generally, replacement reserve shortfalls may not be included in new loans where such inclusion causes the new loan amount to exceed the originally insured mortgage. However, if upon inspection FHA determines that there are critical or non-critical work write up repairs, then it reserves the right to require the inclusion of replacement reserve shortfalls, so long as there continues to be estimated monthly debt service savings pursuant to refinance.

3. Refinancing of Section 241(f) mortgages pursuant to Section 223(a)(7):
We recently received email from HUD Headquarters instructing us not to accept any more applications for refinancing Section 241(f) mortgages using Section 223(a)(7) until they issue further direction. There is a question regarding our legal authority to insure such mortgages since Section 241(f) has been repealed. We will keep you posted on Headquarters' determinations and direction.

4. Section 232 Proposals: Based on the current interest rate environment and given our recent experience with this type of product, our preferred financing structure and amendments to previous processing procedure are as follows:

A. Non-Profit Developers Fees may be included in Replacement Cost, but may not be used like BSPRA as a cash requirement offset. In other words, project economics and reconciled value from all three approaches will inform whether it is prudent for lenders to include profit within the replacement cost development budget for a given project.

B. There is currently imposed a 3.5% cap on financing fees based on market rate taxable MBS's, rather than the higher ceiling associated with tax-exempt bond issuance (5.5% for rates not much different than market). Once the market has corrected itself and tax-exempt issuance again justifies the added transaction costs within the loan through "below-market" (i.e., below-taxable) rates, then we will consider raising the cap on tax-exempt bond structured deals.

C. We now require that all ALF projects submitted as 100% private pay facilities provide two rental schedules, and the NOI available for debt service be predicated upon the lower of the two. The private pay schedule should be based on the applicable unsubsidized market rates achievable. However, since virtually no ALF has been developed, to our knowledge, that does not take advantage of Elderly Waiver (public) sources for at least some proportion of their residents during stabilized operations, it is necessary to submit a second rent schedule for the anticipated mix of public- and private-sourced residents.

   We anticipate that no less than 10% of total units should be analyzed in accordance with the applicable county's current rate schedule at one of the lower acuity levels, on average, for the "reserved" units under contract with the county, say at the "B"-"D" level of acuity, unless the staffing and OER reflect the more intensive operations being underwritten. Please note that some seasoned ALFs now contain SNF-like proportions of public-sourced occupancy (60%-70%), although for a more independent (formerly "intermediate care") resident. The lender's judgment on the appropriate mix should be based on a careful analysis of the depth of the private pay market indicated by the market study, and the degree to which the county's reimbursement schedule provides near-market (private) rates for public-sourced residents.

In order to avoid processing delays, questions relating to this circular's application to specific projects should be directed to either Tim Gruenes (612-370-3051 x 2252) or Del Relopez (x2274).