



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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

February 17, 2011

MORTGAGEE LETTER 2011-13

TO: All FHA-Approved Multifamily Mortgagees

SUBJECT: Revision of Mortgagee Letter ML 10-30, Extension of Temporary Authority for Multifamily Hubs to Process Waiver Requests Pertaining to the Three-Year Rule for Section 223(f)¹

Purpose

The extended temporary authority established by Mortgagee Letter ML 10-30 published on September 2, 2010, and scheduled to expire on February 28, 2011, allows Multifamily Hubs to process waiver requests pertaining to the Three-Year Rule for Section 223(f) applications. The Department is revising certain provisions of the Mortgagee Letter and related Housing Notice H 10-19 that relate to the guidance issued on Risk Mitigation in Mortgagee Letter 2010-21 and related Housing Notice H 2010-11. The temporary authority is being extended for a period of one year from the date of publication of this Mortgagee Letter. Please be advised that the Department does not intend to extend the authority beyond this date.

This Mortgagee Letter sets forth the Department's policy, initially established on February 6, 2009, to grant temporary authority to Multifamily Hub Directors to waive the Three-Year Rule for Section 223(f) applications, for the purpose of providing liquidity to recently constructed or substantially rehabilitated, self-sustaining properties that are unable to secure permanent long-term financing due to the freeze in the capital markets which hampers the ability to transfer ownership. This Mortgagee Letter will benefit applications that meet all of the qualifications of the Section 223(f) program, except for the fact that the property was originally constructed or substantially rehabilitated less than three years prior to the date of application for Firm Commitment. Eligibility for recently constructed property applications must have a Certificate of Occupancy (CO) dated no later than the date of the application. This Mortgagee Letter does not apply to projects that are three or more years old that have had only minor and/or cosmetic repairs less than three years ago, since these projects would qualify for processing under our existing Section 223(f) requirements.

¹ "The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0029 and 2502-0001. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number."

Background

Within the past two years, a number of fully operating, self-sustaining properties recently constructed or substantially rehabilitated projects were unable to secure permanent long-term financing due to the freeze in the capital markets. The Department recognized the need to continue to provide liquidity to the market place. In order to do so, waiver authority of the Section 223(f) eligibility restriction to properties that have been completed or substantially rehabilitated for three years prior to the date of the application was granted is required. At the conclusion of FY 2010, 29 projects with nearly 6,000 units benefited from the Department's action.

Historically, the Section 223(f) program requirements have been temporarily modified to better meet program goals when economic conditions greatly decreased the availability of credit. When the Section 223(f) Handbook was originally published, it set forth a Special Eligibility program that was applicable to recently completed projects, whose construction was started before June 30, 1974, and completed before the end of 1975. This special program was implemented to address liquidity shortages prevailing in Multifamily Real Estate Financing at that time that prevented otherwise sound projects from obtaining permanent financing. The capital market credit freeze that occurred in the past two years, similarly constrained the availability of permanent financing. This Mortgagee Letter provides relief similar to that provided in 1974, but also includes additional requirements to ensure that the properties are viable, self-sustaining and will not jeopardize the long-term financial stability of the Section 223(f) program. The Department has determined that capital markets are improving, diminishing the need for waiver authority. However, the Department acknowledges that there are still a number of projects in the pipeline that have demonstrated a legitimate need for a waiver of the Three-Year Rule, and has decided to extend the authority for one final 12 month period.

Waiver Authority

As of the date of this Mortgagee Letter, Hub Directors will have temporary authority to waive the Three-Year Rule for the Section 223(f) program subject to the conditions and processing instructions below. This authority applies to both refinances and acquisitions. The requirements of this Mortgagee Letter may not be waived by Hub Directors unless otherwise noted.

Compliance with Risk Mitigation – Mortgagee Letter ML 2010-21

All of the requirements for Section 223(f) Three-Year Rule waiver approval enunciated in Mortgagee Letter 10-30 remain unchanged and are republished in this Mortgagee Letter except that the following conditions have been modified or revised to comply with the Department's guidance contained in ML 10-21, HUD Multifamily Risk Mitigation:

- Condition #8, “Occupancy” has been revised to comply with the Department’s guidance on Risk Mitigation that was specifically directed towards projects utilizing the waiver authority granted by this Notice.
- Condition #13, which required a separate market study has been revised to give HUD field offices discretion without coming to HUD Headquarters for a waiver.

All other applicable requirements of the Risk Mitigation ML and Notice must be followed.

This Mortgagee Letter supersedes and replaces ML 10-30.

Conditions

1. This waiver authority applies only to conventionally financed apartment projects and qualifying condominium buildings that operate as rental projects, that were originally constructed or substantially rehabilitated less than three years prior to the date of application for Firm Commitment, and in cases of new construction have a CO for the entire project dated no later than the date of the application. For projects that were constructed in phases and have more than one CO, refer to the date of the most recent CO. Only apartment projects and qualifying condominium buildings are eligible under this waiver authority. Any project that falls under the Section 232 program is ineligible.
2. Any prepayment restriction associated with the new Section 223(f) financing must be discussed with the applicant. This should be accomplished prior to or immediately upon receipt of the application.
3. The final mortgage amount shall only be sufficient to pay off existing indebtedness, and may not include an equity payment to the Owner. Existing indebtedness is defined as project debt that is over one year old. Recently incurred debt (less than one year) is ineligible. Evidence that the debt is project related must be submitted with the application.

NOTE- This condition is not applicable to acquisitions.

4. All other applicable program requirements for the Section 223(f) program must be met, including compliance with applicable Civil Rights Laws, including the nondiscrimination and affirmatively furthering Fair Housing provisions of the Fair Housing Act, and applicable accessibility requirement for persons with disabilities (see 24 CFR 5.105(a) for a listing of Federal Civil Rights requirements).

The mortgagee or mortgagor must not be presently a defendant in any outstanding lawsuits brought by the Federal Government, or have any outstanding delinquent debts owed to the Federal Government and not have any outstanding civil rights lawsuits brought by the Department of Justice, charges initiated by FHEO, or administrative actions or lawsuits brought by substantially equivalent state or local

fair housing agencies, that have not been resolved to the satisfaction of DOJ, HUD, or respective state or local fair housing agency at the time of waiver.

5. The applicant must submit documentation evidencing that an effort to obtain permanent conventional financing have been unsuccessful or that current offers of conventional financing has been cancelled. This documentation should include rejection letters from prospective Lenders or cancellation letters from Lenders that had previously committed financing. Acceptable documentation may also include a certification signed by both the Borrower and the FHA Lender that credit is not available at reasonable rates and terms without the commitment of the FHA Insurance.
6. Current Loan, Past Due Payables and Project Liabilities. The applicant must submit evidence that all interest and/or debt service payments have been made on time since the beginning of the current loan. Satisfying this criterion is necessary to demonstrate the creditworthiness of the current owner.
7. The submission of financial statements for the project is required. A Certified Public Accountant (CPA) or Independent Public Accountant (IPA) should audit the latest year's financial statements, however, if audited statements are not available an Owner-certified statement for the latest year, or period of operation, may be accepted. This policy is only applicable to applications submitted under the temporary authority provided by this Notice. The Lender must state why audited statements are not available. Any Owner-certified financial statement or Owner-certified balance sheet and operating statement or CPA or IPA audited financial statements must contain at a minimum the Criminal Warning and Certification information contained on Form HUD-92417. A substitute statement must contain the following certification and criminal warning:

"I HEREBY CERTIFY that the foregoing figures and statements contained herein submitted by me as agent of the Mortgagor [Owner] for the purpose of obtaining mortgage insurance under the National Housing Act are true and give a correct showing of _____'s (Name of Mortgagor or Owner) financial position as of _____(date of financial statement). Signed this _____ day of _____, 20___. Signature of authorized agent with name printed or typed under signature _____.

Warning – HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802).

8. Occupancy. Projects must meet both a Sustaining Occupancy requirement and a Certified Rent Roll requirement prior to Endorsement. These requirements apply to both newly constructed and substantially rehabilitated projects.
 - a. Sustaining Occupancy is defined as having sufficient income to pay all operating expenses, monthly debt service, escrow and reserve for replacement

requirements for three consecutive months. Applications including those for qualifying condominium buildings, may be submitted prior to the project achieving Sustaining Occupancy under these conditions:

- i. The project must achieve Sustaining Occupancy for a period of three consecutive months immediately prior to the date of Endorsement.
 - ii. Fund a Debt Service Reserve of four months of Principal, Interest and MIP. This will be released once the project has maintained break-even occupancy for six consecutive months after Initial Final Endorsement. HUD Mortgage Credit Staff will consult with Asset Management staff prior to approving the release.
 - iii. Exception. Projects that have sustained an average minimum 85% physical occupancy for 6 months prior to application submission and maintain this level through application processing, with confirmation by a certified rent roll submitted within 30 days of Endorsement will not be required to fund a Debt Service Reserve.
 - b. In these cases, achievement of Sustaining Occupancy must be included as a Firm Commitment condition. Commitments containing this condition may not be extended if the condition is not satisfied within the original Commitment term.
 - c. In addition, the Certified Rent Roll level of occupancy must be 85% for all units in the entire project, including all phases, for a period of six months prior to application submission and maintain this level three consecutive months immediately prior to Endorsement. Rent concessions, other discounts and short term leases (less than 12 months) that are offered by a landlord to induce a prospective tenant to enter into a lease must be taken into consideration when evaluating the credibility of the occupancy requirement. The market analysis contained in the Appraisal report, or market study, if required, should include a discussion of any rent concessions and lease terms in relation to concessions employed by competing projects and must justify any processing occupancy rate that exceeds the Certified Rent Roll Occupancy level.
9. All construction or substantial rehabilitation, including accessibility requirements, must have been completed prior to submission of an application for Firm Commitment. Construction completion must be evidenced by a CO by the applicable local authority. It is recognized that some substantial rehabilitation cases are completed while the project is occupied and that CO may not be applicable. Other evidence of the completion of work are acceptable (i.e. local inspections or certifications) at the discretion of the processing office.

10. No waiver of the requirement for submission of “as-built” plans shall be permitted. For substantial rehabilitation, plans or other construction documents that are relative to the type of work completed should be submitted.
11. As per outstanding requirements, a current Phase I Environmental Assessment must be submitted. It should reference any prior Environmental Assessments and these older reports should be submitted if available. Environmental processing must be completed in accordance with the current requirements.
12. In accordance with the Uniform Standards of Professional Appraisal Practice, the Appraisal report should discuss any current listings of the subject and any offers made and/or accepted to purchase, lease or option the project. Also, since these projects are recently constructed or rehabilitated, depreciation will be minimal or significantly reduced, contributing to the reliability of the Cost Approach. Processing offices are reminded that this approach is required and should be considered in the reconciliation process.
13. Market Studies and the Appraisal Market Analysis. Copies of any market studies and updates that were made in conjunction with obtaining the current loan must be submitted. Although a separate market study is not mandatory under Section 223(f), Hub directors have discretion and are strongly encouraged to require a separate market study where there is concern about the stability of the market. A separate market study is required for proposals that have not achieved an average minimum 85% physical occupancy for six months prior to application submission and maintained it during application processing. Market studies must be required where there is evidence of a volatile or declining market or in cases where the market is just recently beginning to re-bound. Lenders should consider that they may be required to obtain such a study to support the underwriting conclusions of market demand for the subject property over the loan term, and are encouraged to include this as a topic for a concept meeting prior to application.

Whether or not a separate market study is required, a thorough market analysis must be included in the appraisal report. It must address the current market conditions of the subject property, including a discussion of long term demands for rental housing based on but not limited to local demographics, employment, schools, shopping, transportation and other neighborhood amenities.

14. Inspections/Repairs. All of the existing requirements related to project inspection, repair escrows, and protection against latent defects associated with the new Section 223(f) financing are applicable to cases processed under this waiver authority. In addition, the following requirements apply:
 - a. Any latent defects that became apparent during the warranty period provided under the project’s original construction contract, whether repaired or not, must be disclosed at the time of application.

- b. The Project Capital Needs Assessment shall assess the adequacy of the repairs performed to address any latent defects and determine whether any additional repairs are required to correct the defects, and shall establish a cost to complete the repairs.
- c. All repairs required under this category, whether critical or non-critical, must be performed prior to closing and may not be included in the mortgage.

Escrow requirements for all other non-critical repairs are to be determined in accordance with the current instructions.

- 15. Acquisitions. Although Condition #3 regarding existing indebtedness does not apply for acquisitions, special attention should be given in situations where the seller of the property is able to realize a profit beyond simply paying off project debt. The appraiser, MAP underwriter and HUD review appraiser must address prior sale information for both the subject and comparables for at least the prior five year period. There must also be market evidence in the form of comparable sales that demonstrate that newly constructed projects in the subject's market area can be sold for a profit. Whether or not the transaction is a refinance or an acquisition, an accurate appraisal with a thorough review is very important in preventing undue risk to the Department due to current market conditions.

Hub Submission Requirements to Headquarters

Current requirements mandate that waivers granted at the Hub level must be submitted electronically to the Office of Multifamily Housing Development. This information should be provided at the time the decision is made to grant the waiver. It is important that this information is provided timely for all approved waivers in order for Headquarters to evaluate the effectiveness of this policy. If there are any questions regarding the actions taken on this waiver request, please contact Joseph A. Sealey, Director of the Technical Support Division at (202) 402-2559, Headquarters' Office of Multifamily Development. Persons with hearing or speech impairments may access this number via TDD/TTY by calling 1-877-TDD-2HUD (1-877-833-2483).

/s/

David H. Stevens
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Federal Housing Commissioner