



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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

July 3, 2012

Mortgagee Letter 2012-13

TO: All FHA-Approved Multifamily Mortgages

SUBJECT: Extension of Temporary Authority for Multifamily Hubs to Process
Waiver Requests Pertaining to the Three-Year Rule for Section 223(f)
Refinancing or Acquisition of Affordable Multifamily Rental Housing¹

I. PURPOSE

The temporary authority established by Mortgagee Letter 2011-13 (Mortgagee Letter) published on February 17, 2011, expired on February 29, 2012. That Mortgagee Letter allowed Multifamily Hubs to process waiver requests pertaining to the Three-Year Rule for Section 223(f) applications. The temporary authority is being extended for a 1 year period for refinancing or acquisition of affordable multifamily rental housing but not for market-rate properties. "Affordable" for the purpose of this Mortgagee Letter means properties receiving Project-Based Section 8 through either a Housing Assistance Payment (HAP) Contract or a Project-Based Section 8 Voucher, for greater than 90% of the units, or supported by Low Income Housing Tax Credits (LIHTC) or subject to similar use restrictions, as described below.

This Mortgagee Letter will benefit applications for affordable properties that otherwise meet all requirements of the Section 223(f) program, except that the housing was originally completed or substantially rehabilitated less than 3 years prior to the date of application for Firm Commitment. Such recently completed properties must have a Certificate of Occupancy dated no later than the date of the application. This Mortgagee Letter does not apply to projects that are 3 or more years old that have had only minor and/or cosmetic repairs less than 3 years ago, since these projects would qualify for processing under regular Section 223(f) requirements without the need for a waiver.

II. BACKGROUND

This Mortgagee Letter modifies 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 projects begun before 2008, when problems in the capital markets made permanent financing to

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."

take out construction loans unavailable. Although the need for this waiver authority has largely passed for this cohort of market-rate properties, liquidity remains a challenge for recently constructed affordable housing. The purpose for extending this waiver authority is to support affordable housing developments, including those involving LIHTC or Project-based Section 8, which would otherwise find it difficult to obtain permanent financing.

III. 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 for affordable multifamily housing transactions. This authority applies to both refinances and acquisitions. The requirements of this Mortgagee Letter may not be waived by Hub Directors unless otherwise noted.

The requirement for evidence of unsuccessful attempts to secure permanent financing, stated in previous extensions of this waiver authority, is no longer included in this current extension. This Mortgagee Letter supersedes and replaces Mortgagee Letter 2011-13.

IV. CONDITIONS

1. This waiver authority applies only to conventionally financed apartment projects and qualifying condominium buildings that operate as rental projects, that were originally completed or substantially rehabilitated less than 3 years prior to the date of application for Firm Commitment, and in cases of new construction have a Certificate of Occupancy 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 Certificate of Occupancy, refer to the date of the most recent Certificate of Occupancy. Only apartment projects and qualifying condominium buildings are eligible under this waiver authority. Any project that would qualify under the Section 232 program or which does not have Project-Based Section 8 assistance for more than 90% of the units or which does not otherwise meet the “affordable” definition is ineligible.

“Affordable” is defined as: (a) projects that have a recorded qualified regulatory agreement in effect for at least 15 years after Final Endorsement, and (b) projects that meet at least the minimum LIHTC restrictions of 20% of units at 50% of the Area Median Income (AMI), or 40% of units at 60% of AMI, with economic rents (i.e., the portion paid by the tenants) on those units no greater than LIHTC rents; or (c) mixed income projects if the minimum low income unit rent and occupancy restrictions and regulatory agreement meet the above criteria. Projects need not use LIHTCs to qualify as “affordable” so long as they have, and are in compliance with, a recorded regulatory agreement monitored and enforced by a public entity imposing the minimum low income occupancy and restricted rents described above, and having a term of at least 15 years after Final Endorsement. Projects qualifying as “affordable” by virtue of having more than 90% of the units subsidized under Project-Based Section 8 must have contracts also lasting at least 15 years after Final Endorsement.

2. 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 borrower or its affiliates. Existing indebtedness is defined as project debt that is over 1 year old. Recently incurred debt (less than 1 year) is ineligible unless such debt was used for acquisition or capital improvement financing. Evidence that the debt is project related must be submitted with the application.
4. All other applicable program requirements for the Section 223(f) program must be met, including compliance with applicable Civil Rights Laws, 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 Fair Housing and Equal Opportunity (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 Department of Justice (DOJ), HUD, or respective state or local Fair Housing agency at the time of waiver.

5. The applicant must submit evidence that all interest and/or debt service payments, as well as accounts payable and other project operating expenses have been made on time since the beginning of the current loan. Among other requirements, this criterion is a necessary condition in order to demonstrate creditworthiness.
6. The submission of financial statements for the project is required. A non-identity of interest Certified Public Accountant (CPA) or Independent Public Accountant (IPA) will review the latest complete fiscal year financial statements. For refinance applications, interim or year-to-date financial statements may also require such review. Borrower-certified interim statements may also be acceptable, if the project has a history of stabilized occupancy as defined in paragraph 7a below. Examples of when interim financial statements might require CPA or IPA review include:
 - 1) period covered is all but the last month of the fiscal year;
 - 2) there is a soft market or case specific risk factors, and
 - 3) the project has just reached sustaining occupancy.

Any borrower-certified financial statement or borrower-certified balance sheet and operating statement or CPA or IPA audited or reviewed 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).”

7. Occupancy. Projects must meet both a Sustaining Occupancy requirement and a Certified Rent Roll physical occupancy 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 3 consecutive months. Applications, including those for qualifying condominium buildings, must achieve Sustaining Occupancy for a period of 3 consecutive months immediately prior to the date of Endorsement.
 - i. Unless the “Exception” below applies, a Debt Service Reserve of at least 4 months of Principal, Interest and MIP must be funded. This will be released once the project has maintained break-even occupancy for 6 consecutive months after Endorsement. HUD Mortgage Credit staff will consult with Asset Management staff prior to approving the release. This requirement may be waived by the Hub Director in the case of a non-profit borrower entity with a demonstrated record of successful development and ownership of affordable housing.

Exception: Projects that have sustained an average minimum 85% physical occupancy for 6 consecutive months prior to application submission and which maintain this level through application processing, as confirmed by a Certified Rent Roll submitted prior to 30 days of Endorsement, will not be required to fund a Debt Service Reserve.
 - ii. For transactions that have yet to reach Sustaining Occupancy, achievement of Sustaining Occupancy for 3 consecutive months must be included as a Firm Commitment condition.
 - b. The Certified Rent Roll level of physical occupancy at 85% for all units in the entire project, including all phases, must be maintained for at least 3 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 evidence. 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 it must justify any processing occupancy rate that exceeds the Certified Rent Roll Occupancy level.

8. 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 Certificate of Occupancy issued by the applicable local authority. Some substantial rehabilitation cases are completed while the project is occupied and so Certificate of Occupancy may not be applicable. Other evidence of completion of work, such as local inspections or certifications, will be acceptable at the discretion of the processing office.
9. No waiver of the requirement for submission of “as-built” plans shall be permitted. For substantial rehabilitation, plans or other construction documents which defined the scope of work completed are required.
10. 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.
11. 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. This approach is required and should be considered in the reconciliation process.
12. 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), a separate market study may be required 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 6 months prior to application submission and maintained it during application processing. A separate market study must also be required where there is evidence of a volatile or declining market or in cases where the market is just recently beginning to re-bounce. 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.

13. 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 current instructions.

14. 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 5 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.

15. Evidence that the project meets the "affordable" housing criteria must be submitted. Such evidence includes but is not limited to a copy of the Housing Assistance Payments Contract, letter from the State agency awarding the LIHTC to the project, or other documentation demonstrating that the project is subject to similar use restrictions monitored and enforced by an appropriate public entity.

For questions, and/or concerns regarding this Mortgagee Letter, please contact Robert Arbios, Director, Policy Division, at (202) 402-2913, Office of Multifamily Housing Development. Persons with hearing or speech impairments may access this number via TDD/TTY by calling 1-877-TDD-2HUD (1-877-833-2483).

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