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

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

February 28, 2014

MORTGAGEE LETTER 2014-04

TO: All Mortgagees
All Multifamily Hub Directors
All Program Center Directors
All Project Managers
All Field Office Directors

SUBJECT: Revisions to Large Loan Risk Mitigation Policies

I. Purpose

This Mortgagee Letter updates HUD's underwriting standards for large multifamily loans (Mortgagee Letter 2011-40), above $25 million and/or which support projects exceeding unit threshold. The intent is to facilitate compliance with these policies. This Mortgagee Letter simplifies and consolidates the tiered requirements for Debt Service Coverage Ratios (DSCR), Loan to Value Ratios (LTVR), and Loan to Cost Ratios (LTCR), Initial Operating Deficit (IOD), and Debt Service Reserves applicable to these Large Loans and supersedes ML 2011-40. Provisions changed from Mortgagee Letter 2011-40 are identified below in ***bold italics***. All other requirements spelled out in Mortgagee Letter 2011-40 remain in effect and are thus repeated here.

These policies do not apply to: a) loans below the loan size or unit thresholds specified in this Mortgagee Letter, b) refinancing loans processed under Section 223(a)(7), c) refinancing or substantial rehabilitation loans for properties with rental assistance contracts covering 90% or more of the property's units, or d) the insurance programs administered by the Office of Healthcare Programs.

II. **Background**

Mortgagee Letter 2011-40 and Notice H 2011-36 discussed the need for specialized underwriting standards to mitigate the increased risks to the insurance fund of losses from Large Loans on properties located in a single submarket with potentially hundreds of rental units. The revisions incorporated in this subsequent Mortgagee Letter are intended to provide greater clarity and thus enhanced understanding of the requirements on the part of both industry and HUD staff.

III. **Underwriting and Reserve Standards for Large Loans**

A. The following DSCR, LTVR and LTCR underwriting standards shall be applied incrementally as loan sizes increase:

New Construction/Sub Rehab under Sections 220, 221(d) (3), 221 (d)(4) and 231 on loans at or above $40M:

Loan size	Affordable DSC limits	Affordable LTC limits	Market DSC limits	Market LTC limits
<$40M*	1.15*	87%*	1.20*	83.3%*
$40M – ***$75M***	1.20	85%	1.25	80%
>$75M	1.25	80%	1.30	75%

*Represents current underwriting guidance. ***"Affordable housing" is defined in Mortgagee Letter 2010-21.***

Refinancing under Section 223(f) on loans at or above $50M:

Loan size	Affordable DSC limits	Affordable LTV limits without/with cash out	Market DSC limits	Market LTV limits without/with cash out
<$50M*	1.176*	85%*/80%*	1.20*	83.3%*/80%*
$50M – $75M	1.20	83.3%/75%	1.25	80%/75%
>$75M	1.25	80%/70%	1.30	75%/70%

*Represents current underwriting guidance.

For new construction/substantial rehabilitation or refinancing loans over $100M, the lender should use the ***>$75M*** underwriting standards, above, applicable to the program. Within 5 business days after the required concept meeting, the HUD staff will advise the lender as to whether the standards described here or higher standards will apply. Based on HUD's analysis of the risks and the mitigants appropriate to the particular loan application, the required minimum DSCR, LTCR ***or*** LTVRs for loans over $100M may be increased.

B. Minimum Initial Operating Deficit (IOD) and Debt Service Reserves for Large Loans

New construction/substantial rehabilitation projects with Large Loans (i.e., at or above $25M or 150 units) should have a minimum amount of Initial Operating Deficit Reserve to help assure success of these projects during their early, most vulnerable stages of rent-up. Because newly completed projects financed with Section 223(f) under a 3-year rule waiver may face similar rent-up challenges, a minimum Debt Service Reserve is likewise required for those Large Loans as well.

For Large Loans, the following minimum Reserve amounts apply to Sections 220, 221(d) (3), 221 (d) (4) and 231 Loans (as IOD's) and Section 223(f) Loans (as Debt Service Reserves for 3 year rule waiver Newly Completed Properties). If the amount determined under Section 7.14 of the MAP Guide "Calculating Operating Deficits" exceeds the amount shown below, the MAP Guide amount takes precedence.

Loan size ***or*** unit count ***(if either crosses a threshold below, the higher tier applies*)***	***Reserve amount based on minimum number of months of <u>amortizing</u> debt service, including MIP***
<$25M ***or*** <150 units	Between 4 to 6 months debt service**
$25M ***– $75M or*** 150 ***– 400 units***	9 months debt service
>***$75M or*** >400 units	12 months debt service
>$100M	12 months debt service, unless a higher amount is identified through HUD analysis of the risks and the mitigants appropriate to the particular loan application

* Examples: $20M loan for 175 units requires minimum 9 months debt service, as does $30M loan for 125 units.

**Current underwriting guidance for non-Large Loans

For new construction/substantial rehabilitation loans over ***$100***M units, lenders should use the >***$75M***/>400 unit ***minimum IOD amount above*** when underwriting the loan. Within 5 business days of the required concept meeting, the HUD staff will advise the lender as to whether the IOD amount is sufficient or a higher amount will be required, based on HUD's analysis of the risks and the mitigants appropriate to the particular loan application.

In addition, for any Section 223(f) loans (processed with or without the 3-year rule waiver) over $75M or 500 units, lenders should use the >***$75M***/>400 unit ***minimum Debt Service Reserve amount above*** when underwriting the loan. A larger funded Debt Service Reserve in an amount determined by HUD during application processing may be required based on HUD's analysis of the risks and the mitigants appropriate to the particular loan application.

Release of Initial Operating Deficit or Debt Service Reserve amounts will be in accordance with the MAP Guide or other applicable directive.

C. ***18 month Maximum Absorption Period***

The provision, stated in Mortgagee Letter 2010-21 on Risk Mitigation, which limits the absorption period for estimating market demand to 18 months, continues to apply to all projects

including those with loans exceeding $25M or units above 150. Hub Directors may waive the 18-month absorption period restriction only in cases where there is an unusually strong market which will support initial rent-up to sustaining occupancy beyond 18 months and where the borrower has clearly demonstrated successful experience with developing such projects in the recent past. Such projects may require larger Initial Operating Deficit or Debt Service Reserves than the minimum amounts calculated in accordance with paragraph III, B above.

IV. **Implementation**

The provisions contained in this Mortgagee Letter are effective immediately upon issuance and shall apply to all appropriate loan applications under Sections 220, 221(d)(3), 221 (d)(4), 231 and 223(f) for which an Invitation Letter has not yet been issued or, in the case of single-stage processed loans, a Firm Commitment has not yet been issued.

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For questions regarding this Mortgagee Letter, please contact Theodore K. Toon at (202) 402-8386, Headquarters Office of Multifamily Housing Development. Persons with hearing or speech impairments may access this number via TDD/TTY by calling 1-800-877-8339.

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