FHA HOUSING TAX CREDIT PILOT PROGRAM
FREQUENTLY ASKED QUESTIONS #2

JULY 10th, 2012

Section 8 Contract Renewals

Q. It was my understanding that HUD was not allowing Option 4 contract renewals for longer than 5 years, but I thought it was also one of HUD's goals to encourage owners with expiring contracts to renew for 20 years regardless of whether Option 4 or Option 2 was to be used. What is the Tax Credit Pilot policy?

A. A 20 year contract can be obtained for an Option 4 renewal project, as well as for any other renewal Option. The caveat is that the Option 4 renewal entails meeting the "lesser of current rents x OCAF or budget-based rents" test. That test being met, then rather than renewing the existing contract the owner can terminate the existing contract and enter into a new 20 year contract.

Treatment of Development Fees

Q. If we have a LIHTC Pilot eligible project requiring a 3 year waiver, will HUD permit the unpaid deferred developer fee to be treated as a legitimate refinancing transaction cost, subject to the limitations of Criterion 10 (i.e. the greater of 80% LTV or 100% of Transaction Costs)?

A. For all Pilot projects, development fees 1) in total amounts approved by Tax Credit Allocation Agencies (but not to exceed 15%), and 2) scheduled for payment in amounts and at times agreed upon with the syndicator, will be treated as mortgageable costs consistent with current practice. That is, that in the case of FHA insured loans limited to 80% of value, the LTV limit provides a safe harbor and limits risk, so proceeds may be used for any purpose including payment of development fees. However when LTV is increased to the Criterion 10 limits - 87% for Section 8 projects and 85% for other LIHTC projects - payment of development fees with FHA mortgage proceeds is allowed for up to 15% of the costs approved by the Allocating Agency, to the extent supported by the mortgage, and consistent with all other Allocating Agency rules and the partnership or LLC operating agreement. Finally it is important to note that no distinction is made by HUD between development fees paid with equity or debt sources drawn down prior to completion, and <u>deferred</u> development fees to be paid from operations after completion. When funding permits and according to LTV limits and the eligible basis definition above, either may be treated as mortgageable costs.

Rent Restriction (10% Test / Below Market Requirement)

Q. The requirement for rents in projects that do not have project based Section 8 contracts to be set at least 10% below market rents is resulting in the ineligibility of many projects that might otherwise qualify: Is there any flexibility in this area?

A. The reason for this "10% test" was to ensure that the Pilot would in fact provide affordability vis-à-vis market rents and thus mitigate market risk. However the test was too narrowly understood as a comparison of market rents with the Tax Credit ceiling rents rather than the actual, attainable Tax Credit rents (i.e. the rents that the project is able to achieve prior to the Pilot transaction.) This inadvertently restricted eligibility beyond the intent of the language. The threshold eligibility requirement is that the actual rents being achieved must be at least 10% below market, although Tax Credit ceiling rents may be higher.

The following examples provide further clarification. Example 1 illustrates that when the Tax Credit ceiling rent exceeds market rents, and the attainable rents are not at least 10% below market, the project is ineligible. Example 2 demonstrates that even when ceiling rents and attainable rents are well below market, the project will remain ineligible because both the ceiling and attainable rents are less than 10% below market. Example 3, a variation on Example 2, shows eligibility may be achieved under similar conditions, when attainable Rents are only slightly lower than ceiling rents but do meet the 10% test. Finally, Example 4 shows a slightly different eligible scenario, in which ceiling rents exceed market but attainable rents are 10% below market. Both examples 3 and 4 illustrate the benefit of the interpretation described above: The Tax Credit ceiling rent does not have to be 10% below market for eligibility as long as lower attainable rents are 10% below market. Under the earlier, more conservative interpretation, the project would have been ineligible because ceiling rents are not 10% less than market.

EXAMPLE	1. Attainable LIHTC Rents At Market/ Ceiling Rents Above Market	2. Attainable LIHTC Rents and Ceiling Rents Less than 10% below Market	3. Attainable LIHTC Rents 10% Below Market/ Ceiling Rents Below Market	4. LIHTC Ceiling Rents Above Market/ Attainable Rents 10% Below Market
Market Rents	$630	$1,230	$1,230	$1,400
LIHTC Ceiling Rents	$880	$1,160	$1,160	1,450
LIHTC Attainable Rents	$630	$1,160	$1,100	$1,260
Project Outcome	Ineligible	Ineligible	Eligible	Eligible

Note: This test is only to determine eligibility for the Pilot Program: Rents for underwriting of unassisted projects are to be set at the lesser of Tax Credit ceiling rents and the market rents obtained through the market study included in the appraisal.

Tenant Relocation

Q. The 2 week time period allowed for temporary relocation of tenants is not adequate for the more extensive rehabs, even when limited to the $40,000 per unit maximum used for the Tax Credit Pilot.

A. This limit has been reconsidered and extended to 30 days.

Cap Rates Used in Underwriting

Q. HUD has been asked to consider adjusting the cap rates used in underwriting Pilot projects: Is this under consideration?

A: HUD does not intend to adjust the acceptable approach to deriving valuation cap rates for Pilot projects that are not assisted. However, for assisted projects (i.e. those in which greater than 90% of the units have a Project Based Section 8 contract) underwritten and processed as part of the Tax Credit Pilot, the capitalization rate may be derived using a band of investment, and the Section 8 contract and any favorable financing specific to the application may be factored into the rate analysis.

Note: HUD is authorizing this approach only for assisted projects under the Pilot (and 202 projects as originally authorized), and is not considering expansion of this approach to non-Pilot transactions.

Funding of Repair Escrow at Closing

Q. Is there any flexibility with respect to full funding of the Repair Escrow at closing? We are concerned that it will create higher equity infusions up front, and reduce the investors' return.

A. No, 100% of the repair escrow must be funded at closing. However, there is flexibility with respect to the funding of the additional 20% of cost that is generally required for completion assurance. HUD will allow for deferrals of this amount on a case by case basis.

Eligibility of RAD Projects

Q. Has HUD addressed the question of allowing RAD projects into the Pilot Program? If so, what adjustments have to be made?

A. The final Notice on the Rental Assistance Demonstration (RAD) is to be issued shortly. HUD also plans to issue further guidance on details for the underwriting of RAD transactions with FHA insurance at a later date. In the meantime we expect that coordination of the Tax Credit Pilot Program and RAD will be workable. One potential RAD project is being considered for the Pilot now. Although additional issues may need to be resolved as the project moves forward, HUD has agreed that as long as at least 90% of a project's units are assisted, the 15-year Project Based

Vouchers (PBV) or a 20-year Project Based Rental Assistance (PBRA) HAP Contract provided through RAD meet the intent of the project based assistance (i.e. a 20-Year Project Based HAP Contract) required for the Tax Credit Pilot. The rent-setting mechanism for RAD conversions will be as described in the RAD Notice and the rent-setting and Section 8 contract renewal sections of ML 2012-1, which launched the Pilot, will not apply for RAD projects.

Tenant Age Restriction for Tax Credit Pilot Projects

Q. In California the Tax Credit Allocation Committee (CTCAC) uses 55 as the age-restriction for projects and projects enter into a 55-year Regulatory Agreement. Would HUD permit the continuation of the 55-year age-restriction for Tax Credit Projects in the Pilot, even though the 223(f) limits age restrictions to 62 years of age?

A. No, this provision cannot be waived. Age restricted 223(f) projects may be limited to tenancy by heads of household aged 62 or older, but discrimination against non-elderly family members is prohibited. Accordingly unless the state agency can amend its age restriction to match HUD's, these deals are not eligible for FHA mortgage insurance whether they are Pilot Program projects or not.