SMALL BUILDING RISK SHARING INITIATIVE

SUMMARY of COMMENTS RECEIVED to INITIAL NOTICE and HUD's RESPONSES

1. Lender Eligibility

Comment: Several commenters recommended that HUD allow other types of lenders to participate, in addition to certified CDFIs, nonprofit, public, or quasi-public loan funds with affordable housing purposes, or consortia/joint ventures including two or more profit-motivated private lenders and either a CDFI or other mission driven organization described above. Comments included the following:

a. That any FHA/MAP lender be allowed to participate independently, and that the criteria for acceptance into the program might include the lenders' activity in the targeted market.

b. That HUD adopt policies that streamline the program's financing of projects located in remote or exurban areas, to ensure that the Initiative "complements" Section 538 Loan Guarantee Program of the U.S. Department of Agriculture (USDA) Rural Development Program[1], and automatically accept into the Initiative all lenders who are already qualified under the Section 538 program.

c. That HUD allow small property lenders to utilize an existing relationship they may have with an FHA lender or local mortgage broker, or a retained counsel, to help manage relevant activities, and that relevant multifamily lending experience be an acceptable substitute for FHA mortgage experience.

d. That HUD automatically approve HFAs participating in the Section 542(c) program in good standing as Qualified Participating Entities (QPEs) in the Initiative; that HUD ensure that HFAs not currently participating in the Section 542(c) are eligible and facilitate their

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[1] See http://www.rurdev.usda.gov/ca/pdf%20files%20and%20documents/538_Overview.pdf.

participation; and that HUD modify or exempt HFAs from requirements that may prohibit some HFAs from participating or make it more difficult for them to participate

HUD Response: HUD recognizes that any set of qualifications will benefit some potential applicants and eliminate others from the program. However given the complexity of the program and the specificity of the market to be served, some standards are essential and no lenders will be approved simply by virtue of some other standing, such as being an FHA lender, a USDA 538 lender, or an HFA. It is important to note here that HFAs were considered eligible from the start, either as public or quasi-public loan funds or as members of joint ventures.

Secondly, in response to these comments and other factors, HUD has determined that because the participation of FHA MAP lenders in the Initiative would likely expand its impact significantly, FHA MAP lenders will be invited to participate. However, their participation will be deferred by 6 months from the initiation of the program, so that CDFIs and other nonprofit, public, or quasi-public organizations can start first and provide HUD with an opportunity to fine tune the program before having to manage larger numbers of participants.

2. Consortium Requirements

Comment: Section IV.A.3 of the Initial Notice states that a QPE could be "…a joint venture or similar formal arrangement between two or more for-profit private lenders and either a CDFI or nonprofit…" A commenter recommended changing that requirement to "…at least one for-profit private lender and…" Other commenters recommended that HUD "allow consortia of any composition so long as they are controlled by nonprofit or public lenders."

Another commenter asked how the QPE would be expected to split the retained portion of the risk among partners in the joint venture, and asked whether it would be up to the CDFI and the FHA-approved lender(s) to divide that risk accordingly, or have the FHA require one of the entities to retain all of the risk.

HUD Response: HUD's decision to admit FHA MAP lenders into the program is largely expected to eliminate interest in consortia and joint ventures. Furthermore the complexity of comments addressing consortia convinced HUD that the admission of consortia would complicate program operations extensively and unnecessarily. However, a newly formed organization could be created. The new entity will have to meet all the requirements of the Initiative including qualifying as an approved FHA non-supervised mortgagee.

3. Rural Set-Aside

Comment: Commenters asked that HUD establish a set-aside for rural properties because applications from rural areas may not reflect economies of scale, may be less sophisticated, or may be less innovative than urban proposals. Commenters stated that set-asides have proven valuable to ensure that rural areas receive a fair share of financing from the Community Development Block Grant program, the HOME Investment Partnerships program in many states, the Affordable Housing Programs of several Federal Home Loan Banks, and others. The commenters stated that for these same reasons, and because small rental properties are a major part of the rural affordable housing stock, a rural set-aside should be established in the risk sharing program, and recommended that 25 percent of all units financed through this Initiative be located in rural areas as defined by USDA.

HUD Response: The program resources are not constrained by numbers of units, so the proposed goal is not workable or necessary. However the preservation of small scale rural and small town housing is considered critical and HUD encourages rural states' HFAs and other eligible rural organizations to participate. Caps on individual lenders' activity will be established and monitored to limit exposure during the first year. If satisfactory this limit may be adjusted or eliminated.

4. Applicant/Lender Requirements

Many commenters expressed the concern that participating lender qualifications were too onerous. A few commended HUD's expression of willingness to accept alternate "proof" of the proposed requirements since some CDFIs could not meet the specific tests imposed but were nonetheless effective organizations. Most commenters, however, urged HUD to retain flexibility in this area. A few also commended HUD "… for using existing standards to qualify participating entities rather than creating yet another set of requirements. " The commenters stated that relying on the standards set by FHFA for CDFIs to join the Federal Home Loan Bank system is a logical starting point. Others commented more specifically, as described below.

Comment: Several commenters stated that applicants should not have to be or become FHA lenders. One added that a demonstrated relationship with an FHA lender should suffice. Another stated it was unclear whether the "officer must be employed by the CDFI or, in the case of a joint venture the position can reside within the FHA-approved lender." Finally, in the cases of a consortium it was recommended that the CDFI partner should not have to become the FHA lender.

HUD Response: All QPEs must be or become FHA lenders in order to access FHA's systems and achieve the legal authority required for pay downs and other transactions. Mission Based Lenders must be FHA, but not MAP Lenders, while Private Lenders must be FHA MAP Lenders. Certain MAP Guide references with respect to Environmental Reviews remain relevant however to both Mission Based and Private Lenders. The approximately 90-day FHA lender application process can be accomplished simultaneously with the approval as an Initiative participant, and it may provide QPEs with additional lending credentials and opportunities.

Comment: One commenter stated that Section IV.B.2 of the Initial Notice stated that a QPE must meet certain minimum financial capacity standards similar to those promulgated by the Federal Housing Finance Agency in 2010 as conditions for CDFIs to become members of the

FHLB System. That commenter also requested clarity on whether the associated CDFI will have to be a member of the FHLB system, which could be a significant impediment to participation. The commenter stated that if that is the intention behind this requirement, removing it is recommended. Another commenter recommended that CDFIs that are FHLB members should automatically be certified as having the financial capacity to qualify, as well as CDFIs that have met the FHLB standards and been approved for FHLB membership, but are not yet members.

HUD Response: The Initial Notice stated that less application documentation is required for CDFIs with FHLB membership, (See Sections IV.B.4.a. and b. of the Initial Notice). CDFIs that have been approved to become members but have not done so are not under any ongoing review by the FHLB; and may not have the access to loan funds that the members will, and therefore will need to provide the alternative, more detailed documentation.

Comment: One commenter stated that the Section IV.A.2.d requirement that at least 33 percent of the participating entity's resources be dedicated to the development and/or management of affordable housing seems unnecessary in light of other requirements for mission orientation and financial capacity. Most of the entities that qualify under the other provisions of the program will easily exceed that standard, but there could be unintended consequences for larger and diversified CDFIs. This requirement does not seem like a necessity for the program.

Another commenter stated that the Initial Notice required a QPE to have at least 33 percent of its resources dedicated to "the Development and/or management of Affordable Housing" (Section IV.A.2.d of the Initial Notice). QPEs are lenders, not developers or managers, so this requirement should refer to "*lending for" development* and/or management of affordable housing.

HUD Response: Extensive housing related experience and a substantial commitment specifically to affordable housing finance is critical for knowledgeable and effective

participation. However, this particular measure of housing finance knowledge and experience will be changed to no less than 20 percent or 20 of the applicant's multifamily housing loans. In addition the experience and commitment is no longer to be measured by "budget and staffing" but will instead be measured by the percentage and/or number of the lender's total loans that are for multifamily affordable housing purposes, within the past two years.

Comment: About 13 commenters stated that Lenders' staff in charge of the program should not have to have 3 years of FHA lending experience, because similar experience in multifamily lending or reliance on relationships with other FHA lenders or retained counsel should suffice. The commenters stated that alternatively an individual staff member with a successful lending track record should suffice.

One commenter stated it was unclear whether an officer must be employed by the CDFI or, in the case of a joint venture, the position can reside within the FHA-approved lender. If the officer must be employed by the CDFI, the commenter recommended changing the requirement to "at least 3 years of experience in multifamily mortgage operations" because many CDFIs do not work directly with the FHA today.

Another commenter proposed that if FHA experience remains mandatory; then applicants should be able to obtain that experience with consultants. The commenter stated that the prohibition against concurrent outside or self- employment should be removed and HUD should allow small property lenders to utilize an existing relationship they may have with an FHA lender or local mortgage broker, or a retained counsel, to help manage relevant activities. Consideration could also be given to staff experience with a government-sponsored enterprise (GSE).

HUD Response: HUD agrees that alternative experience may substitute for FHA experience, so long as it is substantial and is fully described, and so long as the applicant

organization becomes an FHA lender. However "relationships" with MAP lenders, consultants or counsel would not be acceptable. Further the QPE's manager or other senior executive staff member would have to be the one with the FHA lending or equivalent experience.

Comment: A few stated that they did not think that the "average income in excess of average annual expenditures" requirement should be imposed since the CDFIs' markets have contracted recently, but that, instead a longer look back should be considered, as should a CDFI's ability to raise capital, since otherwise many will not qualify.

HUD Response: This standard was changed so that applicants can provide the relevant data for all of the past 5 years, and compute the average from the best 3 years of the previous 5. However financial solvency must also be demonstrated and this is not an unreasonable requirement: several FHLBs require member CDFIs to meet a stiffer standard, demonstrating three years of consecutive positive earnings to ensure financial stability and solvency.

Comment: One commenter stated that lenders should not have to meet the 20 percent net asset ratio test, but should be able to demonstrate other ways in which they meet similar objectives in reducing their exposure to liability, such as a loan loss history, unrestricted cash balances, and projects' loan to value ratios. The commenter stated that HUD could limit participation in the program to specific amounts rather than an all-or-nothing participation. For instance, a $10 million loan limit for small CDFIs ($5 million HUD exposure) would be very useful while still protecting HUD.

Another commenter supported the Initial Notice's language stating that alternative methods for demonstrating soundness of operations were welcomed. A third recommended that "… the net asset ratio apply only to those assets for which the QPE is liable." Another stated: where an applicant fails to meet the 20 percent net asset ratio requirement, HUD should develop a

process to “pre- flight” an applicant’s belief that it operates in a “sound financial condition” prior to submitting a full application.

HUD Response: Minimum financial capacity standards were changed. Applicants must either have a 20 percent net asset ratio and a minimum net worth of $7.5 million, or a CAMELS composite rating of 1 or 2 and a minimum net worth of $7.5 million. If the net worth requirement is not met, applicants will establish a dedicated reserve in a financial institution acceptable to HUD. Complete Application Requirements are posted on the Web at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/progdesc/progsec542b. According to the Federal Housing Finance Board’s Final Rule (Federal Register Volume 75, Number 2 of January 5, 2010), past studies indicate CDFIs generally have net asset ratios in excess of 40 percent, so the 20 percent standard in not especially arduous and CDFIs must achieve it for other purposes anyway.

Comment: Similarly to the proposed calculation of the net asset ratio above, commenters stated that the minimum 30 percent loan loss reserve calculation should be applied only to those loans for which the QPE retains liability.

HUD Response: The loan loss reserve test remains as is. HUD will consider additional information demonstrating why an applicant’s ratio, if less than 30 percent reflects a sound financial condition. This requirement is standard for FHLB members. It is only half the requirement applicable to depository institution applicants, but generally CDFI loans have performed well and so a lesser standard is appropriate.

Comment: Commenters stated that HUD should confirm that the QPE is not expected to pledge any collateral or assign the underlying loans or cash flow in order to participate in the Risk Sharing Program. The proposed rules do not explicitly address this issue.

HUD Response: Legal matters such as this will be addressed in the RSA that HUD and the QPE will enter into. However no collateral pledges, assignments of cash flow or other such commitments are required other than maintaining the standards and other requirements used to select participants for the program.

Comment: One commenter stated that "… the proposal's presumption that all mission-based lenders will all have operating manuals on a variety of matters is inaccurate, although they do follow their operating procedures."

HUD Response: HUD presumes that otherwise qualifying lenders will be able to produce written documentation of their standard business practices. Operating procedures must be written in order to convey them to HUD and to demonstrate that standard procedures are in place and are accessible to staff, although a single manual containing all of them will not be necessary.

Comment: One commenter noted that the servicing and asset management capacity of lender applicants should be a consideration. For a risk sharing program some minimal, standardized level of reporting would be appropriate for participants.

HUD Response: This is an important point, and application questions with respect to these areas have been added to the Program Details posted on the Web at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/progdesc/progsec542b. A written plan for managing or assigning responsibility will be required.

Comment: Commenters stated that the Initial Notice would require that any applicant must include a 15-page narrative that provides information regarding an applicant's organization history, multifamily portfolio information, staff capacity, and portfolio information among other issues to address the minimum financial capacity standards. The commenters stated that it is unclear if this requirement is mandated for all lender applicants or just those applicants that are

not members of the FHLB system. A lender correspondent requested an exemption from the narrative if a member of a joint venture was an existing MAP lender. Another commenter suggested that instead of a lengthy narrative, could not the last HUD lender review be used to provide the basis for applicant underwriting and servicing capabilities?

HUD Response: This requirement applies to all applicants, many of whom will not yet have lender reviews from the Multifamily Asset and Counterparty Oversight Division (MACOD), formerly the Lender Quality Monitoring Division (LQMD). Applicants with MACOD reviews may be included in the application but they are no substitute for summaries of the information noted above.

Comment: Commenters stated that the narrative requirement asks for very detailed information going back 10 years about an organization's multifamily loan portfolio, information dating back 10 years on other properties in the applicant's portfolio, and a detailed staff assessment for asset management purposes. Commenters stated that these requirements are rather onerous on a small CDFI and do not reflect their capacity as a lender accurately nor reflect the realities of day-to-day operations. Commenters stated that HUD should simplify these requirements to ensure that HUD is accessing necessary and appropriate data to identify lenders that will minimize exposure to FHA.

HUD Response: HUD's expectation is that a qualified applicant should have accessible and complete historical data with respect to its lending operations.

Comment: One commenter, a national network of CDFIs, stated a different viewpoint, indicating that all of the financial performance standards in the Notice were needed and appropriate: The commenter stated that it "applauds" the inclusion of several CDFI-related provisions in this proposal that were covered in HUD stakeholder discussions. The commenter stated that most notably it believes that the eligibility criteria for CDFIs and other mission driven entities found

in Section IV-A of the Initial Notice are important to ensure proper deployment of these resources, and that likewise the Minimum Financial Capacity Standards found in Section IV-B (2) of the Initial Notice appropriately take into account the unique nature of CDFIs and provide an appropriate standard for the industry."

HUD Response: HUD's objective is to establish standards that will support a successful program, while allowing room for organizational variation. Modifications noted above and an expressed willingness to allow substitute measures of various organizational structures should allow HUD to achieve these goals.

Comment: One commenter stated that HUD should also establish criteria for assessing the applicants' ability and experience with respect to loan servicing, asset management, workout procedures etc.

HUD Response: Loan Management and Workout Procedures are required to be addressed in the Final Application Requirements posted on the Web at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/progdesc/progsec542b

5. Project Types: Rehabilitation vs. New Construction

Comment: Commenters stated that new construction should be allowed along with rehabilitation projects. Several of the commenters emphasized the necessity for new construction in rural areas especially where pent up demand exists for the elderly, people with disabilities, or low to moderate income families, while another emphasized its need in states such as California where there is pressing demand for additional housing as well as preservation. One commenter also encouraged the inclusion of substantial rehab loans.

HUD Response: The Initiative is designed as a preservation program to serve currently underserved markets, to establish and test risk sharing arrangements with new categories of lenders, and to target a new, specific type of housing and ownership. It is not considered practicable or

useful to add the complexity of new construction projects, at least until the Initiative's operations are tested and refined. However, everything short of new construction, including substantial rehabilitation, will be allowed under the program. Construction draws are allowed under the program to facilitate significant relocations.

6. Project Types: Scattered Site Projects

Comment: Commenters stated that Section IV.D.2 of the Initial Notice provides that eligible projects must consist of 5 to 49 rental dwelling units (including cooperative dwelling units) on one site with specific provisions for noncontiguous parcels of land within a single area. One commenter recommended removing the "on one site" provision of the rule to allow QPEs to bundle several similar small properties into a single loan, thus controlling transaction costs and increasing efficiency. Another commenter also supported the multiple site provisions.

HUD Response: Allowing scattered sites increases the efficiency of origination, but also incurs greater risk. Scattered site prospects can be considered but they must have at least 5 units per site and they must demonstrably constitute one marketable and manageable real estate development.

7. Project Types: Include Acquisitions

Comment: Commenters stated that wherever the Initial Notice lists eligible and ineligible uses of funds, HUD should allow acquisition as an eligible use for projects being acquired by nonprofit or public entities or partnerships controlled by such entities, to accommodate situations in which "Mom and Pop" owners wish to liquidate their real estate.

HUD Response: This recommendation has been incorporated into the Program Details posted on the Web at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/progdesc/progsec542b as acquisition has always been an intended use of funds.

8. Project Types: Clarify Refinancing Possibilities

Comment: Commenters asked that HUD clarify what loans can be refinanced. Commenters stated that the Initial Notice stated that financing of existing properties without substantial rehabilitation is permitted (Section IV.D.2.d of the Initial Notice). The commenters stated that the only details provided, however, are for "a *QPE- financed* loan to be refinanced" (emphasis added). The commenters stated that HUD's Final Notice should either provide details for refinance of a loan that was not QPE-financed, or make clear that this paragraph applies to all refinance situations regardless of the source of the original loan.

HUD Response: HUD's intent is not to limit refinancing to existing, QPE-financed loans: The intent is to accommodate broadly defined refinancing opportunities, with or without rehabilitation under the Program. This intent is further described in Application Requirements and Program Details posted on the Web at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/progdesc/progsec542b.

9. Project Types: Emphasize Project Size over Loan Limit

Comment: Emphasize project size rather than loan amount. The Notice's introduction states that this Initiative is intended to apply to properties of 5-49 units *or* to loans of $3,000,000 or less. To focus on the program goal the Notice should have a stated preference for loans to projects with fewer than 50 units.

HUD Response: Loan amounts have been increased from $3 million for all eligible properties, to $5 million in certain high cost areas, as designated in HUD's "Annual Base City High Cost Areas" Mortgagee Letter. Eligible projects must consist of at least 5 rental dwelling units, but are no longer restricted to a maximum of 49 units. With loans limited for all properties, regardless of unit count, to $3,000,000 (or $5,000,000 in high cost areas), the Initiative will effectively be targeted to smaller multifamily properties, as HUD intends.

10. Building Owner Requirements

Comment: Commenters stated that HUD's financial reporting requirements of the borrower were far too demanding. The commenters specifically identified the requirements to: a) maintain complete project books and financial records; and b) provide the QPE with a cost certification at completion as well as annual audited financial statements and certifications, etc.

One commenter stated that the requirement for annual audited financials should be maintained, but waived for less sophisticated borrowers. Several commenters also addressed the costliness of third party reports, and one commenter stated that these requirements would prevent many potentially good borrowers from applying. Other commenters suggested that the landlords should not have to secure the costly services of architects, engineers, market analysts, general contractors, etc., as the Initial Notice suggested, since small building owners would more likely use their own employees for such tasks.

HUD Response: The capacity of a borrower to maintain books and financial records should be a fundamental consideration of any lender, though HUD agrees that audited financials may be waived for a borrower who demonstrates the capability to manage his books and/or whose business activity level falls below certain standards. Cost certifications are a means of establishing that the intended work was completed, and other third party reports or the hiring of architects, engineers, etc. are necessary for complex rehabilitations. However the QPE may waive these reports and the use of certain professionals when it can be justified by the nature of the project.

11. Underwriting Criteria: General

Comment: One commenter recommended some degree of standardization of the underwriting under this Initiative. The commenter stated that standardized lending parameters and strong oversight would contribute to the success of the program, and without standardized

parameters (including among HUD offices), it will be more difficult for HUD to monitor performance under the program.

HUD Response: The proposed arrangement in which HUD approves the lender and the lender uses its own, but pre-approved lending criteria, is a fundamental element of the Risk Sharing Program. However, certain fundamental FHA loan standards in Program Details will apply.

12. Loan Terms: Maturity Dates

Comment: Several commenters stated that the loan terms are too restrictive. A commenter stated that extended maturity dates common in FHA lending are expected to hinder secondary market investment, necessary for many loans. Another commenter stated that major hurdle identified in the Initial Notice was the requirement of a complete amortization of the loan within the loan term. The commenter stated that requiring full amortization of risk-share loans, with, for example, 35-year mortgages on 35-year amortization schedules would make such loans much less attractive to potential investors. The commenter stated that investors would be more willing to purchase 10-, 15-, and 20-year mortgages, that this flexibility is especially important if these mortgages cannot be securitized through Ginnie Mae, and that there is a precedent in the current 542(b) program that allows Fannie Mae and Freddie Mac to offer loans of 15 years or more. The commenter recommended establishing a minimum loan term of at least 10 years and amortization that could extend up to 25-35 years.

Another commenter recommended establishing a minimum term of 10 years, and allowing terms up to 20 years, with amortization periods of 35 years. This commenter stated that the balloon payment structure is even more important when the mortgages cannot be secured through Fannie Mae, also noting that Fannie Mae and Freddie Mac are allowed to offer terms of 15 years or more under 542(b).

Another commenter stated that the full amortization requirement "… is inconsistent with the existing authority under Section 542(b), which allows for balloon mortgages with 15 year terms and 30 year amortizations (as presently implemented by Fannie Mae under its Standard FHA Risk-Sharing Execution)." This commenter stated that while balloon mortgages can increase the risk profile of loans because of the need to refinance the loan in order to be paid off at maturity, this risk can be appropriately mitigated through underwriting. The commenter stated that it would be prudent to require a minimum loan term of 10 years, and to require lenders to mitigate any balloon risk through their written underwriting standards, and offered as an example, that a lender could require any loans that have a balance due at maturity to amortize on no more than a 30 year schedule, or that alternatively, lenders could also establish debt service coverage (DSC) and loan-to-value (LTV) ratios that correspond to different terms/amortizations.

Another commenter stated that until Congress enacts the statutory change to allow Ginnie Mae to securitize loans on small buildings made under Section 542(b), the requirement of "complete amortization over the term of the mortgage" may limit CDFI participation in this Initiative. The commenter stated that, as HUD noted in the Background section of the Initial Notice, CDFIs do not typically have access to long-term capital, short of the new capital available under the CDFI Bond Guarantee Program. The commenter stated that without the Ginnie Mae securitization, HUD should allow flexibility for partially amortizing mortgages (e.g. 5/30 mortgages) to allow CDFIs to better utilize the program by selling those loans after a shorter term to create the liquidity that Ginnie Mae securitization would if enacted. The commenter stated that otherwise, CDFIs may only make a small number loans under this Initiative based on the financial feasibility and willingness to hold 30-year loans.

HUD Response: HUD agrees that shorter terms are needed, and loan terms under the program are now changed to allow for balloon payments at the end of the year 15 or thereafter, with

an amortization term of no more than 30 years. Alternatively the loans may amortize fully over a term of up to 40 years.

13. Loan Terms: Lien Subordination

Comment: Commenters asked HUD to allow subordination of Risk Sharing loans to USDA Sections 515 or 514 loans, for improvements and upgrades.

HUD Response: FHA insured loans must remain in first lien position, except for use agreements that may in some cases hold a superior, non-monetary lien position. Furthermore, USDA Section 514 or 515 loans can be subordinated to new FHA insured first mortgages.

14. Loan Terms: Loan Size Limit

Comment: Commenters stated that the $3 million cap is reasonable in most housing markets, but it leaves out several smaller multifamily buildings in high-cost markets, and, as an example, stated that it is not uncommon for a 50-unit, Class B apartment building in Brooklyn or the Bronx to require a $4-5 million mortgage to be purchased or recapitalized. The commenters stated that for this reason, Fannie Mae's Small Loan Lenders program extends its loan limit to $5 million in certain high-cost markets. The commenters recommended that the FHA enact a similar exception for its Risk-Sharing Program.

HUD Response: HUD agrees that the $3 million limit, while appropriate for most of the Initiative's activity, should be increased to accommodate projects in certain high cost areas. Accordingly the Initiative will be adjusted to loans of up to $5 million, but only in areas designated as high cost areas in HUD's "Annual Base City High Cost Areas" Mortgagee Letter. (Note: This is not meant to include provisions in the Mortgagee Letters that allow further adjustments on a project by project basis.)

15. Loan Terms: Lender Fee Limits, MIP and 50 Percent Risk Sharing

Comment: Commenters stated that without more information on fees allowed to QPEs, and MIPs, it is hard to determine if the 50/50 risk sharing arrangement is feasible for QPEs. The commenters stated assuming that the mortgage insurance premium is consistent with the example in the Request for Comments, and that other rules are generally consistent with the FHA MAP program (i.e. loan fees are capped at 3.5 percent or 5.5 percent with tax-exempt bond financing), we believe that a 50-50 risk-share may be too burdensome to the QPE. The commenters stated that loans through the Fannie Mae Delegated Underwriting and Servicing (DUS) program, which requires its licensed lenders to cover the first 5 percent of losses plus a share of any further losses, with a cap at 20 percent of the original loan amount.[5] In exchange for retaining this risk, lenders are given significant flexibility over underwriting and pricing. For larger multifamily projects, we also have the option of executing eligible loans through FHAMAP, which does not require lenders to retain any of the risk.

Given the terms offered by Fannie Mae and other execution options, it is unclear what financial incentive the QPE would have to execute small multifamily loans through the proposed Risk Sharing Program. Specifically, why would the QPE agree to retain 50 percent of the risk when it can retain significantly less through an alternate execution?

For this reason, assuming competitive fees, we recommend altering the risk-sharing agreement so that the QPE is responsible for the first 5 percent of losses plus a share of any further losses, with a cap at 10 percent of the original loan amount. This would put the lender's overall risk exposure on par with the Fannie Mae DUS program.

HUD Response: HUD's MIP, as established by the Commissioner, is published in the Federal Register. HUD does not limit additional MIP amounts charged by the lender, nor does it limit other fees charged by the lender under the Risk Sharing Program. Thus lenders costs should be recoverable. It is assumed that the QPE will establish a fee structure that will support

its organization and not make loans so unreasonably costly that they eliminate borrowers. The entire Risk Sharing Program is premised on a balancing of risk assumption and HUD oversight. With a small share of the risk allocated to the QPE, such as the 10 percent proposed above, HUD would need to assume a high level of due diligence review for every deal proposed, and the QPE would have to adopt FHA's more stringent lending criteria. This approach would defeat the purpose of the Initiative, by eliminating the flexibility the QPEs would otherwise have in dealing with properties and borrowers involved in this segment of the market.

16. Affordability

Comment: Several comments responded to the use restriction, at 20 percent of the units set aside for tenants earning no more than 50 percent of median income, or 40 percent of the units for tenants earning no more than 60 percent of median income, but comments were contradictory. Some commenters indicated that the rule was too restrictive, while others considered it not restrictive enough and still others thought it was appropriate so long as specific units did not have to be designated. In the first category of commenters who thought the rule was too restrictive, one stated that the properties using the program may have tenants and rents that would qualify, but the only ones guaranteed to have them would be tax credit projects that already have many funding sources available. Thus it was thought to defeat the purpose of the Initiative. One commenter recommended retaining the Risk Sharing Program's original statutory requirements. In general however, HUD's use agreement requirement was widely supported.

Several commenters raised the question of whether or not the owner had to designate particular units as permanently affordable and they stated that this was seen as a potentially serious problem that was not addressed in the Initial Notice.

Another commenter suggested that for properties where income verification and use restrictions already exist, HUD should ensure that owners are not overburdened by duplicative or

overlapping requirements and eligibility screenings. Other commenters addressed the proposed practice of certifying tenants only when they moved in, without annual recertifications. One commenter asked whether or not the unit would remain affordable if the initially certified tenant moved out. Another commenter supported the proposed requirements with two caveats: (1) the Final Notice should clearly apply the same criteria to new tenants at the time they move in, and (2) it should specify how many years the title restrictions should last. The commenter suggested 20 years, unless the owner can prove there is no longer a market for this affordable housing.

One commenter recommended that projects with low-income housing tax credit (LIHTC) or project-based Section 8 vouchers should automatically be deemed to meet the program's affordability requirements, and that the CDFI Bond Guarantee program requirements should be applied to those without subsidies. The commenter stated that these requirements restrict use of the program to projects in "Underserved Rural Areas" or "Low-Income Areas" defined as neighborhoods where the median income does not exceed 80 percent of Area Median Income (AMI).

Another commenter stated that there was an absence of clarity with respect to the affordability requirements. The commenter stated that the Initial Notice could be interpreted to allow owners to charge tenants rents that exceed the LIHTC program's rent caps. The commenter stated that the Final Notice should specifically require the LIHTC rent caps of either 30 percent of 50 percent AMI, or 30 percent of 60 percent AMI. This commenter further stated that in order to sustain the intent of preserving housing for lower income households, the Final Notice should explicitly state that turnover residents must also be income eligible over some affordability period. The commenter further stated that the Initial Notice made no reference to a reasonable affordability period, and suggested that the minimum 15-year period of the LIHTC program provides one option. The commenter stated that another model might be the HOME

program's variable affordability periods based on the amount of assistance per unit: 15 years if more than $40,000 per unit; 10 years if between $15,000 and $40,000 per unit; and, 5 years if less than $15,000 per unit."

A commenter stated that until the affordability requirements are modified through legislative amendments, HUD is encouraged to work with lenders to find ways to help small property owners meet the income certification requirements. Another commenter indicated that there may be resistance to the income certification and affordability requirements, stating that the target tenants are already low income. The commenter stated that the owners are used to running credit checks on new tenants so the income certification should not be so burdensome, and they should be aware of tenants' eligibility anyway. The commenter stated that while tenants may resist providing income information the benefit of the improvements to the property makes a good case to offset these concerns.

HUD Response**:** From the extent and nature of the comments, HUD recognizes that it did not provide enough detail in the Initial Notice with respect to affordability requirements. Accordingly HUD has provided much more detail in Program Details posted on the Web at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/progdesc/progsec542b to better express its intent. However it is important to note here that the affordability set asides of either 20 percent of the units for households earning no more than 50 percent of median income, or 40 percent earning no more than 60 percent of median income are the statutory standard for the Risk Sharing Program, so these set asides are not negotiable. In addition to tenant income eligibility, the rents of the units set aside must not exceed the maximum LIHTC and Risk Sharing Program rent limits, of 30 percent of 50 percent of AMI, or 30 percent of 60 percent of AMI, depending on the set-aside elected by the owner.