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HUD-insured loans are a boon to apartment construction, rehab

One of the missions of the U.S. Department of Housing and Urban Development is to create strong, sustainable, inclusive communities and quality affordable homes for all. One of the ways in which HUD accomplishes its mission is to ensure mortgages made by private lending institutions help finance construction and rehabilitation of multifamily rental housing for families and seniors. Given the current freeze in capital markets, HUD's lending programs once again are facilitating the financing of apartment projects by making capital available for multifamily rental housing through attractive and innovative lending programs.

HUD's multifamily lending program can trace its roots to the collapse of the American banking and housing industries during the Great Depression. In response to that collapse, Congress passed the National Housing Act of 1934 and created the Federal Housing Administration, which became a part of HUD in 1964. Since 1934, FHA and HUD have insured approximately 47,000 multifamily project mortgages and have approximately 13,000 insured multifamily projects in their portfolio. HUD has continued this tradition in the wide variety of innovative programs that HUD now offers.

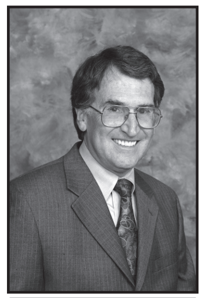
While many of these programs are familiar ones, multifamily developers are attracted to construction and permanent loans amortized over a 40-year term with an interest rate that the developer can lock in at the time of loan endorsement. Moreover, in response to concerns over the red tape and other delays associated with its processing of these loans, HUD implemented Multifamily Accelerated Processing to expedite and simplify loan processing. Because of the availability of capital and expedited loan processing, many private developers who were otherwise reluctant

Charles P. Leder
Managing shareholder, Berenbaum, Weinshienk & Eason PC, Denver

to use HUD financing are now finding it an attractive alternative.

Developers seeking financing for new construction or substantially rehabilitated multifamily rental housing frequently utilize HUD's Section 221(d)(4) program for affordable or senior (without services) housing. For housing to be "affordable" under Section 221(d)(4), the project must be subject to a recorded regulatory agreement with a term of at least 15 years. To take advantage of tax credits, at least 20 percent of the units must be rented to residents with income at 50 percent of HUD's adjusted median income or 40 percent of the units at 60 percent of AMI. Financing under Section 221(d)(4) typically requires working capital and operating deficit escrows. HUD determines the maximum loan amount based upon debt service coverage and loan-to-value ratios.

HUD's 221(d)(4) program also is available for new market-rate housing with no restrictions on rents or tenant qualifications. Mixed-use projects also are eligible for this program. The favorable interest rates and 40-year amortization period as well as the ability to close on the permanent financing as part of the construction loan are major advantages of this HUD-insured loan program for new apartment and mixed-use housing projects. Nonrecourse and fully assumable (upon HUD's approval of the buyer) terms make these loans quite attractive for borrowers.



James L. Kurtz-Phelan
Attorney, Berenbaum, Weinshienk & Eason PC, Denver

Another popular HUD program is insurance of Section 223(f) mortgages. This financing is for existing multifamily and senior rental properties. To be eligible, the project must be at least three years from initial occupancy. The program does not have a maximum loan amount, although there are statutory limits based on the value of the project. HUD determines the loan amount based upon debt service coverage and loan-to-value ratios and risk perceived by HUD based upon the age of the project. If a project has been well maintained, the repair obligation and replacement reserve requirements will be manageable.

Lawyers for the lender and the borrower are expected to act as quarterbacks in bringing the deal to the closing table. Once the FHA-approved private lender has completed its underwriting, lender's counsel sends out a "welcome letter" to borrower's counsel setting forth all of the documentation requirements. The list is lengthy, as are the closing requirements for most commercial loans, but HUD requires a number of additional documents not found in a commercial loan. Another major difference is that HUD requires all documentation to be precisely in accordance with its requirements. Unlike many commercial lenders, HUD allows very little room for document negotiation and any substantive revisions may be subject to the approval by HUD's national office.

To facilitate the expeditious processing and closing of a HUD loan, a borrower's lawyer must review all documents – from zoning and utility availability letters to architect agreements, construction contracts, surety bonds and letters of credit – for compliance with HUD requirements and coordinate their delivery to lender's counsel. Given the volume of loan applications landing on the desks of HUD attorneys in the various regions, adhering to HUD's requirements and ensuring that submittal packages are complete can make the difference in being able to close the loan in a timely manner. For a construction loan, using a contractor that is experienced in HUD construction requirements and contracts is extremely helpful.

One drawback to the HUD-insured loan program is the length of time it takes to get from application to closing. According to one HUD lender, HUD has been inundated with applications and, although refinances can be quicker, a new construction loan can take up to six to nine months to process and close. However, the wait can be worthwhile. For example, we recently represented two borrowers that closed HUD-insured loans – one a refinance, the other a new construction loan. Both loans carried interest rates below 5 percent. The lower interest rate coupled with a 40-year loan term made the new construction project financially feasible and enabled the refinanced project to generate positive cash flow.

These advantages can more than offset the long lead time required. A sophisticated borrower who starts the process well ahead of construction or refinancing deadlines can benefit from the programs. Continuing a long tradition, HUD's multifamily loan programs have been a major boost to the apartment market during the recent downturn and will continue to support new housing projects in the future.▲