Ask Eddie

Ed Hicks

I am considering parsing off a section of my existing Land Lease Community (mobile home park), for the installation and financing of homes+sites as single family detached units and operating it as apartment units using HUD code homes, but have heard there have been some major changes to the FHA guaranteed loan program which provides for the financing. What are the changes, and how could they affect a loan? James C., Asheville, NC

The document you are referring to was issued by the HUD staff in July 2010 and is entitled "HUD Multifamily Risk Mitigation" Mortgage Letter 2010- 21. You may retrieve it at:
http://www. nmhc. org/Content/ServeFile. cfm?FileID=8246

A little known provision of the program doesn't require site built units, but if the homesites are appropriately zoned for manufactured housing, newly constructed HUD code homes may be used as the dwelling unit. This approach is particularly attractive for those developers who are interested in financing out the home plus the homesite for a strictly rental unit, as if in a single family detached apartment project, or in the case of the use of duplex modular units. It also applies to modular "stacked" factory built apartment projects.

Note: there is still no provision in the loan program for release of individual units or homesites, as they would be in a sub-division or cooperative. The loan must be paid off in its entirety in no less than 10 years, unless an earlier payoff has been negotiated at Initial Endorsement with the lender, usually with some pre-payment penalties.

It was written to mitigate some significant project losses under market conditions where there have been some significant market declines in occupancies, operating income, and resulting loan losses.

Previous Debt Service Coverage Ratios (DSCR) for the FHA221(d)4 program and some other multi- family loan guarantee programs noteably the (221(d)3, and the 221(f) programs, were 1. 11 to 1 (90% of value) based on Net Operating Income from unit rental operations for rental assistance, affordable, and market rate units, on loans not to exceed the statutory limits as modified by the local High Cost Percentage (HCP).

Changes in these programs were to limit the DSCR based on the rental rates, so that for 100% assisted programs (such as Section 8) projects which were under a contract for at least 15 years the ratio remained at 1. 11 to 1 of Net Operating Income (NOI), for affordable housing rental projects the DSCR was reduced to 1. 15 to 1, for market rate rental units it was reduced to 1. 18 to 1, and for market rate refinance projects the new DSCR is now 1. 20 to 1. The loan term and amortization periods for the 221 programs remain at 40 years.

HUD now requires the Sponsor (borrower) to submit documentation on rehab projects show a stable occupancy level at least 6 months before submission to Firm Commitment (second loan closing after the audit period), and when the amortization period commences.

The absorption period for new development has been reduced from 24 months to 18 months, and any "cash out" of land equity based on market value, if any, will be withheld and 10% of all construction (not land or payoff of existing debt will be retained until Final Endorsement. The operating deficit escrows will be the greater of 3. 0% of the mortgage amount or 4 months principal, interest, and mip before any of the units may be occupied. "Breakeven" occupancy is now considered to be at a DSCR of 1. 0 on (NOI).

The lenders are now to review two important additional documents, one regarding the existing mortgage debt which must include information on all installment debts, notes, contracts, and mortgages, (e. g. FHA , conventional). Current balances must match the current balance sheet. All capital leases if any must also be shown on the balance sheet, if any. Accounts receivable and accounts payable are not required to be shown.

And the second document provides information to the lender on the borrower (Sponsor) Real Estate Owned including but not limited to: property address and description, ownership role and percentage ownership, current physical occupancy, annual net cash flow or net operating income for the property before debt service payments, the current fair market value of the property and the date of such valuation, existing unpaid principal balance of all mortgages secured by the property and the maturity dates including all liens on the propery, the interest rate on the first mortgage and subsequent mortgages listed, the date of Note, or the date the interest rate was last set for variable rate loan(s)., the sum of the existing unpaid principal balance amounts and lien amounts of all mortgages secured by the property and a calculation of the current equity by the borrower in each property.

Although it may seem a little intimidating to a community owner when considering dealing with a FHA loan guarantee program, most of the work is done by the lender under the Multi- family Accelerated Processing (MAP) program, which greatly can reduce the burden of paperwork. In many cases, it may work to a m/h land lease community owner's advantage by turning vacant homesites into revenue producing rental units using this little known program.

Note: according to MHI, this mitigation letter does not apply to the FHA207m loan guarantee program for development, rehab and refinance of m/h land lease communities, but only applies to those projects which may be using HUD code or modular housing sub-rehab or new development of multi family housing using the FHA221(d)4 program.

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