

#### VALUATION REVIEW

# Low Income Housing Tax Credit Pilot Program

**Tom Goade** 





#### VALUATION AND REVIEW

- <u>Question:</u> Does the HUD appraiser complete a review of the project appraisal submitted with the application?
- <u>Answer:</u> No, the review of the appraisal is delegated to the Tax Credit Pilot approved lender while the Designated Underwriter, (DU), will complete the HUD review.
- Note: The DU may request that the HUD appraiser review the appraisal if there are discrepancies between the 3<sup>rd</sup> party appraisal, RCS study and the underwriting and a significant decrease, 10%+, projection in the operating expenses.



#### **ASSISTED HOUSING PROJECTS**

#### Challenges:

- Correlation between 3<sup>rd</sup> party appraisal report of income and operating expenses and Performance Based Contract Administrator, (PBCA).
- Except for rental assistance projects, all Pilot projects must confirm that rents are at least 10% below market for each unit type
- Timing of MAP application and Section 8 contract renewal
- Made sure that underwriting of income and expenses is consistent with the HAP contract request before submitting the application.



#### MAP COMPLIANT APPRAISAL

• The pilot program requires an appraisal in accordance with Section 7.17 of the MAP Guide.

The property must be evaluated under two scenarios:

a) the "hypothetical market value" of the property without regard to any Section 8 project based subsidies, rent restrictions or LITHC, and b) a debt service analysis that considers all Section 8 project based subsidies and other low income rent restrictions must be performed.

Two independent Section C rent schedules must be prepared, one for a hypothetical market rent estimate and one that recognizes all rent restrictions and subsidies



#### CRITERIA 3

#### Market Value

The appraiser must ignore the Section 8 contract rents, tax exempt bond or LIHTC restricted rents when determining market value and the income to be capitalized for a determination of market value for the purposes of determining Section K, Form HUD-92264, and Criteria 3 Form HUD-92264-A Value. To be consistent, the appraiser must use a market capitalization rate and must assume market rents in the income approach to value. Note that the comparable sales approach to value must be completed without regard to Section 8 or LIHTC awards.



#### CRITERIA 5 DEBT SERVICE ANALYSIS

#### Debt Service Analysis:

In calculating net operating income to be used for Criteria 5

Debt Service, rent restrictions must be observed. For the Criteria 5 debt service analysis, the Line 6, Form HUD-92264-T rents must be used. This applies to projects receiving LIHTCs that may use either tax exempt bond or market-rate financing.



#### CRITERIA 5: (DON'T FORGET THE HUD-92264-T)

The LIHTC rent must be recorded but is not used as a limiting criterion, the total income to the project is the LIHTC rent combined with the Section 8 rent. The level of rental income to the project will be the Project Based Section 8 rent.

If: 2 Bedroom Section 8 Contract Rent: \$850/Month

And: 2 Bedroom LIHTC Rent limit: \$350/Month

#### **Then**

Resident's Rent Obligation to Project: \$350/Month

Section 8 Payment to Project: \$500/Month

Total Income to Project \$850/Month





#### ENVIRONMENTAL

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HQ Office of Housing

Environmental Specialist





- The environmental review will be conducted by the Hub environmental reviewer (usually an appraiser)
- All TC Pilot projects will follow the usual environmental review procedures for 223(f) projects as per Chapter 9 of the MAP Guide, except for a few twists to help streamline the process

- The Phase I ESA as augmented by the vapor encroachment screen must contain no environmental issues that would require a Phase II ESA or a Remediation Plan (no RECs or VECs), and the HUD environmental reviewer must concur with this determination
  - Carefully review the Phase I
- A site visit by the environmental reviewer will not be required if both of the following conditions are met:
  - The Phase I ESA as augmented by the vapor encroachment screen demonstrates that the property does not have Recognized Environmental Conditions or Vapor Encroachment Conditions (RECs/VECs) and the HUD environmental reviewer concurs with this determination; <u>and</u>
  - The site is in conformity with the environmental laws and regulations listed in the Sample Field Notes Checklist (SFNC) and discussed in Section 9.5 of the MAP Guide, and the HUD environmental reviewer does not identify any issues or concerns that require field investigation

- Lenders will initiate consultation under Section 106 of the Historic Preservation Act with State Historic Preservation Officers (SHPOs)
  - HUD will remain legally responsible for all findings and determinations
  - SHPOs have 30 days to respond to the Lender's consultation letter
    - If the SHPO does not respond, Lender must provide a certified statement that a letter was sent and 30 days elapsed without a response
    - HUD reviewer must check to make sure the Lender's letter was adequate for the SHPO to respond
  - HUD will participate in consultation if there is an adverse effect, there is a disagreement, there is an objection, or there is potential for foreclosure or anticipatory demolition
    - See the HUD Memo to SHPOs in Appendix F of the Guide
  - Several TC Pilot Guide appendix documents give guidance
    - Sample consultation letters
    - Section 106 process checklist
    - Section 106 Info Sheet
- Lenders <u>cannot</u> initiation consultation with Tribal Historic Preservation Officers –
   HUD must initiate Tribal consultation





#### THE TWISTS (CONTINUED)

- FHA has determined that permanent financing processed under Section 223(f) of the Low Income Housing Tax Credit Pilot Program for properties that were recently constructed and occupied, with no associated additional rehabilitation or new construction, has "No Potential to Cause Effects", as described in 36 CFR 800.3(a)(1), and thus have no further obligations under Section 106 or 36 CFR Part 800
  - Qualifications:
    - Section 223(f)
    - Recently constructed or occupied
    - No rehabilitation or new construction
  - Example: "3-YearWaiver Projects" carried out under the Pilot Program that do not involve building rehabilitation or new construction
  - If applicable, include the "no potential to cause effects in 223(f) projects" memo in the environmental file





#### USEFUL DOCUMENTS

- TC Pilot Processing Guide
- Sample SHPO consultation letters
  - Sharepoint, Shared Documents folder
- Section 106 Checklist
  - Sharepoint, Shared Documents folder
- Section 106 Information Sheet
  - Sharepoint, Shared Documents folder
- HUD memo to SHPOs
  - Sharepoint, Shared Documents folder, "Appendix F SHPO letters"
  - You may want to get a copy of the memo that went to your SHPO
- No potential to cause effects in 223(f) projects Memo
  - Sharepoint, Shared Documents folder



#### U.S. DEPARTMENT OF HOUSING & URBAN DEVELOPMENT

### LIHTC Pilot Program

Mortgage Credit Review

Dan Sullivan comments
11-27-12





## WHAT IS THE UNDERWRITER RESPONSIBLE FOR IN CONDUCTING THE MORTGAGE CREDIT REVIEW?

- Evaluating the Character and Creditworthiness of the Borrower and Development team
- Capital Structure of the deal debt vs. equity within program limits and risk tolerance, Defining Escrow requirements
- 3. Cash Sources and Uses make sure they balance and there is cash available





## WHAT IS THE UNDERWRITER RESPONSIBLE FOR IN CONDUCTING THE MORTGAGE CREDIT REVIEW?

- 4. Compliance Filling out the forms, Firm

  Commitment, making sure the signature is wet on the 2530 and 2013-SUPP
- 5. Construction draw Processing and tracking
- 6. Cost Certification process





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#### MAP Guide 8.3.D.2.

For purposes of evaluating creditworthiness and acceptable counterparty risk of principals, the Underwriter must identify those individual(s) and entities, which if they encountered significant financial or legal problems, could undermine the success of the subject property.





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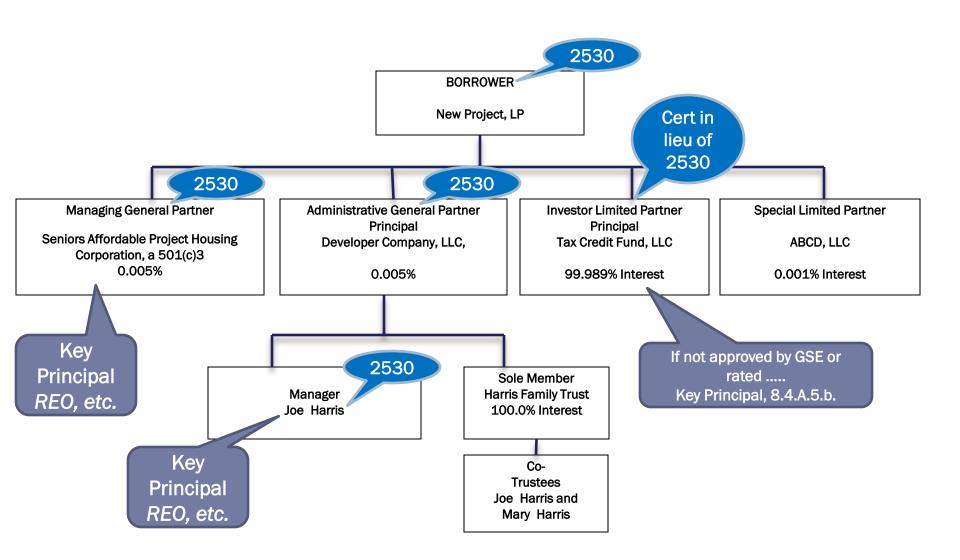
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#### **LIHTC Borrower Structure**





#### MAP GUIDE, SECTION 8.4.A.5.b.

b. If a tax credit syndicator is identified, the Lender's Underwriter will also need to provide a brief overview and analyses of the entity. Typically a tax credit syndicator is an investor intermediary with only a limited ongoing obligation to LIHTC rental properties. Accordingly an REO schedule is not required for tax credit syndicators or investors. However, the syndicator's liquidity, track record, asset management and monitoring capability and ability to perform on its commitment to provide equity to the borrower after Initial Endorsement is a material issue for mortgage credit analysis of the tax credit investor/LP. If the Syndicator is not affiliated with the General Partner, they are considered Passive for purposes of 2530 /Previous Participation clearance.



#### CERTIFICATION IN LIEU OF A 2530

- Applies to any entity that has limited liability either LLC, Corporate investor, LP, or ???
- Applies to investors and affiliates investing in tax credit projects (and Syndicators if not a GP) – not just the entity making the application for tax credits
- Special Limited Partner pre-approval ?





#### CAPITAL STRUCTURE OF THE DEAL

#### Subordination Agreements

- Points of negotiation, HUD HQs OGC approval
- > Surviving use restrictions e.g. covenants running with the land
- > Performing seconds, balloon debt
- > the Golden Rule
- Repair escrow administration





## FHA LOW INCOME HOUSING TAX CREDIT PILOT PROGRAM

## ARCHITECTURE/ENGINEERING & COST (AEC) UNDERWRITING AND REPAIR ESCROWS

**DAVID WILDERMAN** 



#### Introduction

- Most standard 223f exhibits remain
- Reviews performed by DU, not HUD Architect
- Expenditure of up to \$40,000 per unit will be allowed.
   Repairs above \$15,000/unit require licensed architect management
- Fair Housing review and specialty reports may be referred to HUD architect
- Construction period may be extended beyond the standard 12 months of the 223f program





#### PROJECT CAPITAL NEEDS ASSESSMENT (PCNA)

- Property condition, recent repairs and costs, repairs
   Statement of Work and/or plans and specs
- Completed by licensed architect or as described in MAP Guide 5.1.A.2
- ADA and Fair Housing Act analysis required
- ML 2012-12 requirements remain unchanged

#### **REHABILITATION LIMITS**

- Rehab costs limited to \$40,000/unit and "replacement" of no more than 1 "system"
- "Systems" = 5 primary building components:
  - Building envelope
  - Structural system
  - Plumbing
  - Electrical
  - HVAC
- "Replacement" = replacement of more than 50% of any system, based on cost





#### TREATMENT OF COSTS

- Rehab costs include builder's general conditions, overhead, & profit, and other hard costs
- Rehab costs are mortgageable up to 223f limits (\$6,500 X local HCF)
- 85% & 87% LTVs allow for mortgage proceeds, up to 15% of depreciable costs, to pay for developers' fees.
- Mortgages limited to 80% value can use proceeds for any purpose
- Wheelbarrow sorts costs as mortgageable vs. non



#### EXHIBITS RELATED TO THE GENERAL CONTRACTOR

- Repairs above \$15,000 per unit require a licensed architect's oversight
- Architect's recommendation as to whether a GC is necessary
- Exhibits required:
  - IOI disclosure & 50-75% rule disclosure
  - Detailed Cost Estimate, Form HUD-92326
  - GC Resume with focus on MF experience
  - Schedule of other Work in Progress
  - 2530/92013 SUPP



#### OTHER REQUIREMENTS

- Plans and Specifications (if required)
- Relocation Plan, including a detailed construction progress schedule
- Owner-Architect Agreement on AIA Document B108 & HUD Amendment
- Property Insurance Schedule, Form HUD-92329
- LBP and Asbestos test reports (pre-1978), and specialty reports not covered by Environmental Report



- Pilot will require some of the controls of 221d4 sub rehab program
- GC or an independent inspection firm hired by the syndicator required at architect's discretion
- Lender obtains written certification that work has been completed as shown on the HUD 92464.
- Lender ensures no liens have been filed against property

- Lender disburses upon receipt of certifications and date down endorsement – copies to Mortgage Credit and A/E
- HUD inspections at normal 223(f) intervals (35%, 65% and 100% completion)
- Lender approves and disburses fund requests
- HUD inspection and signoff required before final disbursement

- 100% of the Total Cost of Repairs is to be Escrowed at Closing
- Additional 20% of Total Cost or Repairs is Required as Completion Assurance, but this Amount may be Partially Deferred at the Discretion of the Pilot Hub



#### What makes a successful AEC analysis?

#### The closed deal stays closed!

- The work is completed
- The work is within cost
- The long term physical integrity of the project has been ensured



- For questions regarding the Pilot, please contact:
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Thank you

