



# **FHA Multifamily Risk Mitigation Strategy**

Midwestern, Southwestern  
HUD Lender Associations  
November 8-9, 2010



# Agenda

9 – 11am

Mortgage Credit

11- noon

Q&As / discussion

Noon – 1pm

Lunch

1 – 2pm

Case Studies

2 - 3pm

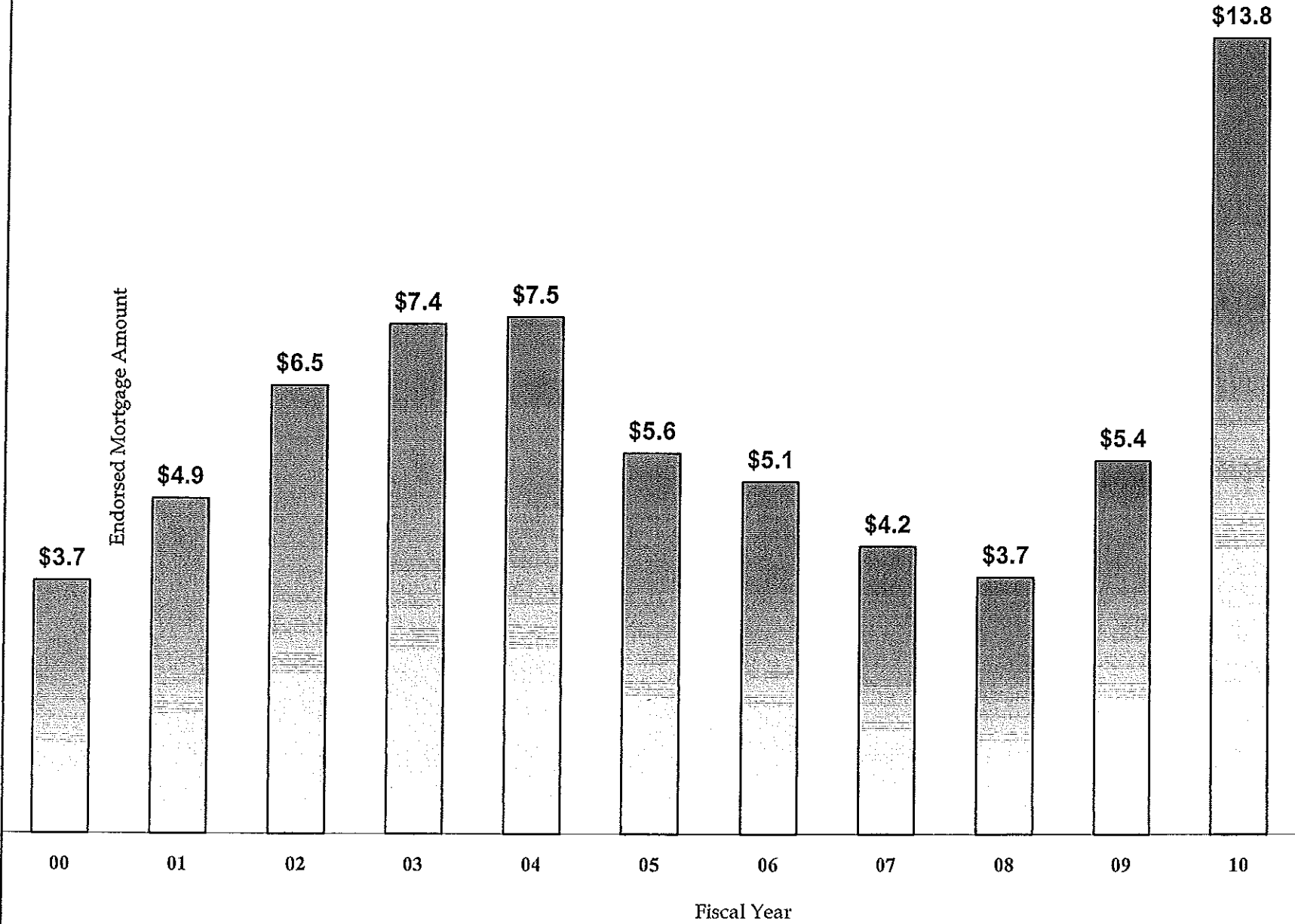
Underwriting Changes

3 – 4pm

Q&As / discussion

*Basic FHA & Risk Sharing Initial Endorsements FY 00 - FY 10*

*\$\$ in billions; excludes 242 hospitals...FY10 thru 8/24*





# FHA Multifamily Risk Mitigation

- Market Conditions Demand Response
  - Multifamily's Response:
    - Improved oversight
    - Improved processing
    - Improved credit risk management



# Scope of Mortgage Credit Review

- Capital Structure of transaction
- Cash-to-close
- Credit-worthiness / Character of the Borrower



# Principal REO Schedule Overview

- Responsibilities of lender vs. FHA staff
- Differences with 2530 clearance
- REO review is in addition to credit report, background check and other mortgage credit reviews
- The “character” issue



# Lender Deliverables

- Discussion of Organizational Structure and how Lender determined who “Principals” are for purposes of REO Schedules
  - Who are the decision makers?
  - Who are the monied partners?
- REO Schedules for each Principal
  - May require back and forth with Principals to assure appropriately completed
  - Indicate time period for which information is provided (e.g, Information is as of June 30, 2010 and represents six months of annualized operations)



# Lender's Analysis of REO Schedule

- Lender needs to provide analysis of the information found on the developer's REO Schedule
- Identify projects of concern
- Determine if owner values are reasonably valid
- Identify maturing debt and make conclusions as to refinance feasibility
- Identify loans "under water"
- Determine overall health of the portfolio
- Compare REO schedule to principal's financial statements
- Make affirmative recommendation to HUD on credit worthiness of principal



# Be Sure NOI and Debt Service provided by Borrower are accurate

- NOI should be most recent available and is before payments for debt service
- Debt service payment should NOT include escrows for taxes, insurance, etc., but should include MIP if the loan is HUD-insured



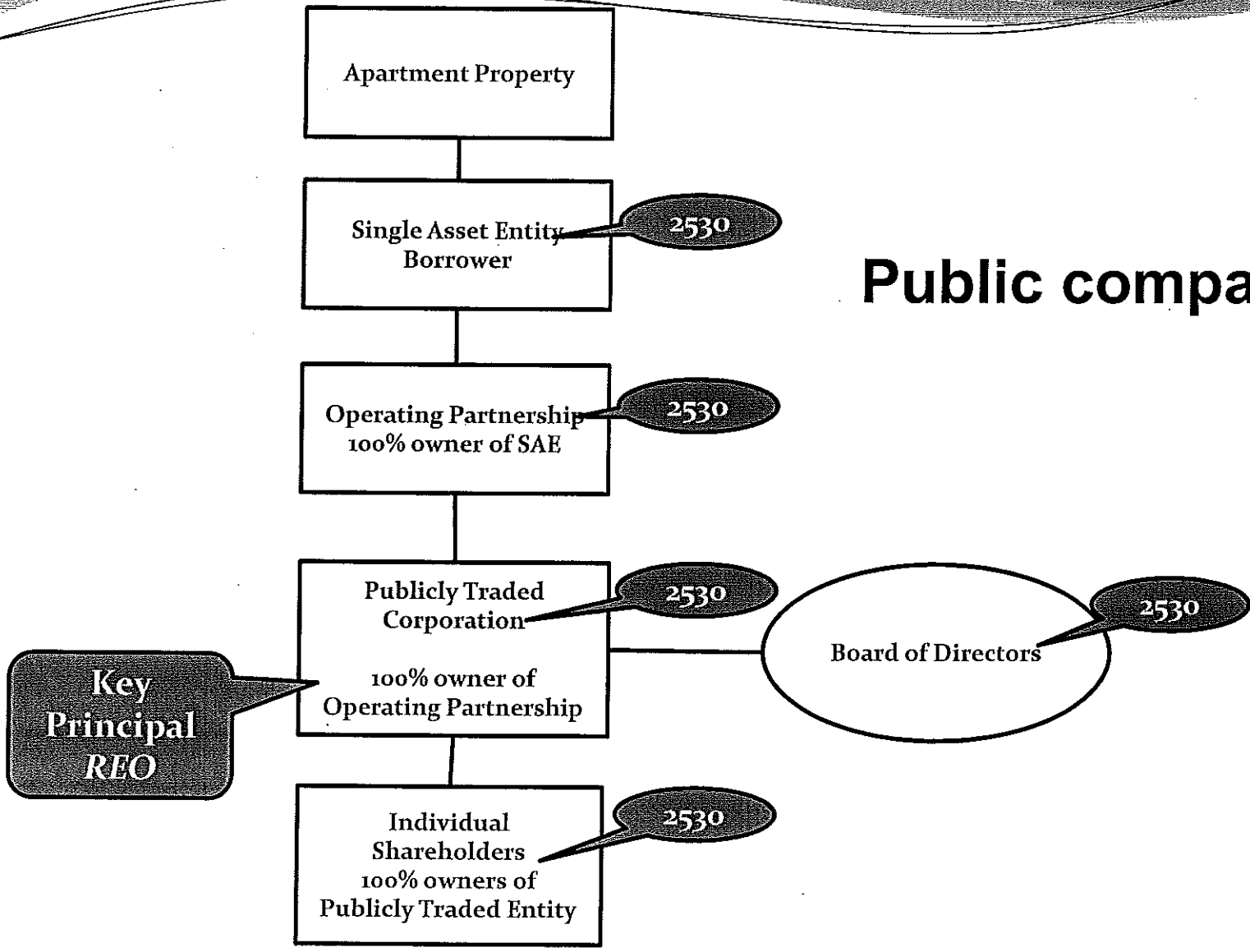
# Lender Deliverables

- Lender Mathematical Analysis of REO Schedule
  - Lender analysis of portfolio valuations
  - Lender analysis of ability to refinance ballooning transaction
  - Lender analysis of portfolio cash flow to Principal
- Lender Written Analysis of Portfolio
  - Recommend inclusion of brief write-up on each transaction depending on volume of deals on REO schedule
  - On assets that require explanation, provide DETAILED written analysis of the project, the Borrower's expectations as to how it will be handled, and why Lender believes that outcome is acceptable
  - Discuss overall portfolio results and relate it to the financial statements



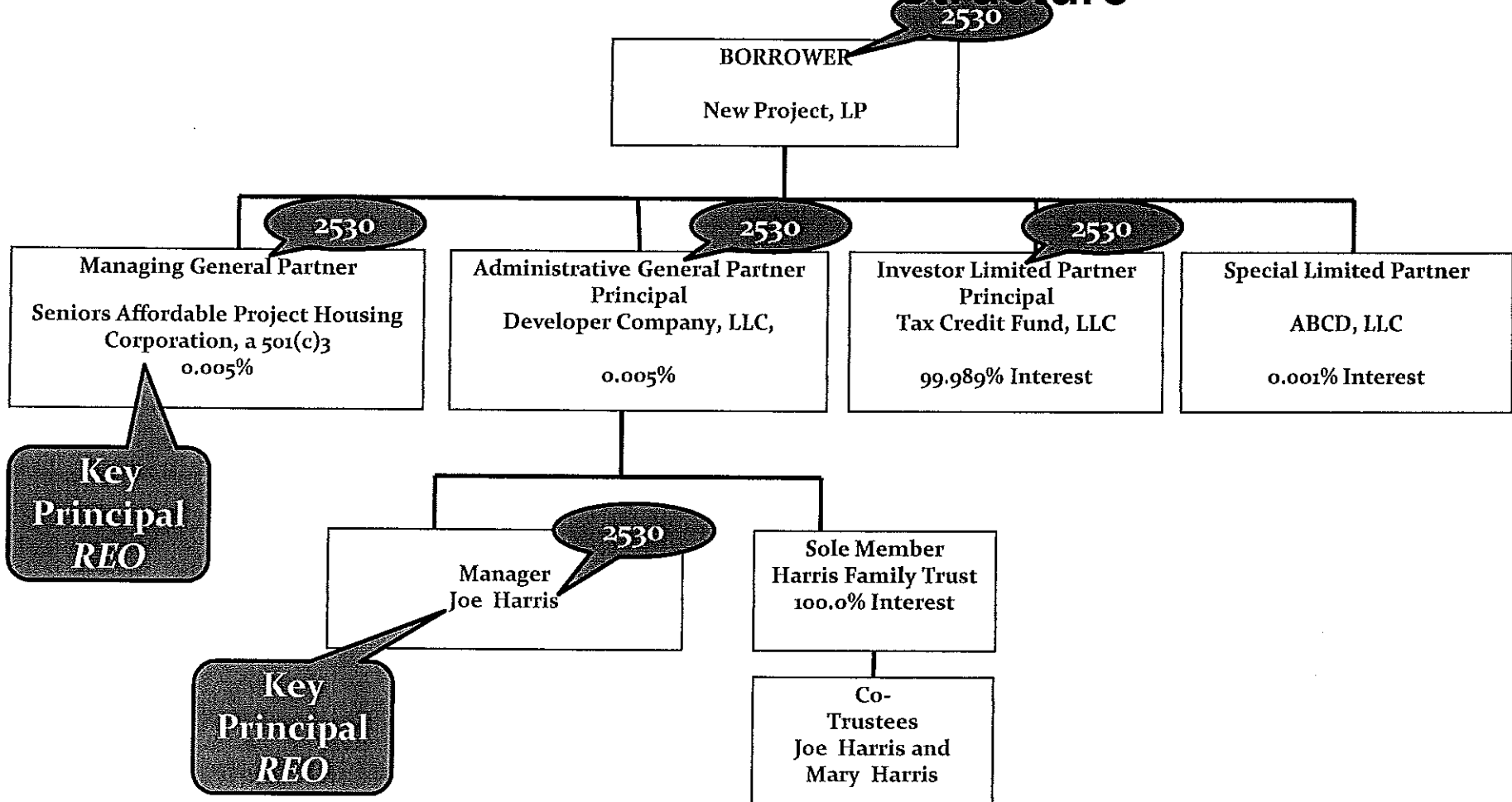
# Lender Deliverables

- Lender's Recommendation
  - Discuss both character and financial strength of each Principal
  - May be complementary information that results in a positive recommendation, such as one Principal with financial strength combined with a decision maker who is less strong financially but has excellent experience in the real estate type contemplated.
  - It is much easier to mitigate financial weakness with additional Principals than it is to mitigate character weakness.
  - Weak credit is NOT offset by more conservative loan underwriting



**Public company**

# LIHTC Borrower Structure





# Agenda

1 - 2pm

Case Studies - Character

2 – 3pm

Underwriting Changes

3 – 4pm

Q&As / discussion



# Case Studies

- Yes
- No
- Maybe – what mitigants / conditions?
  
- (Case 2 was deleted)



# Case 1

- Well capitalized sponsor – 80% 223(f) loan with no cash out
- Family business – 2 brothers – own/manage a total of 25 properties
- Their portfolio includes 10 FHA insured properties they own/manage in the region – never any mgt findings or concerns
- A trust for estate planning purposes
- Both principals have FICO scores in the high 700 range, no defaults, judgments, etc.



# Case 3

- New Construction deal in a market near major military base. 36 months of process, ready to submit Firm.
- Sponsor = the decision maker – 50%, the money – 40%, and GC – 10%.
- 30 days prior to submission of the firm, the decision maker's credit (early 2009) falls off a cliff – defaults / foreclosures, FICO score plummets



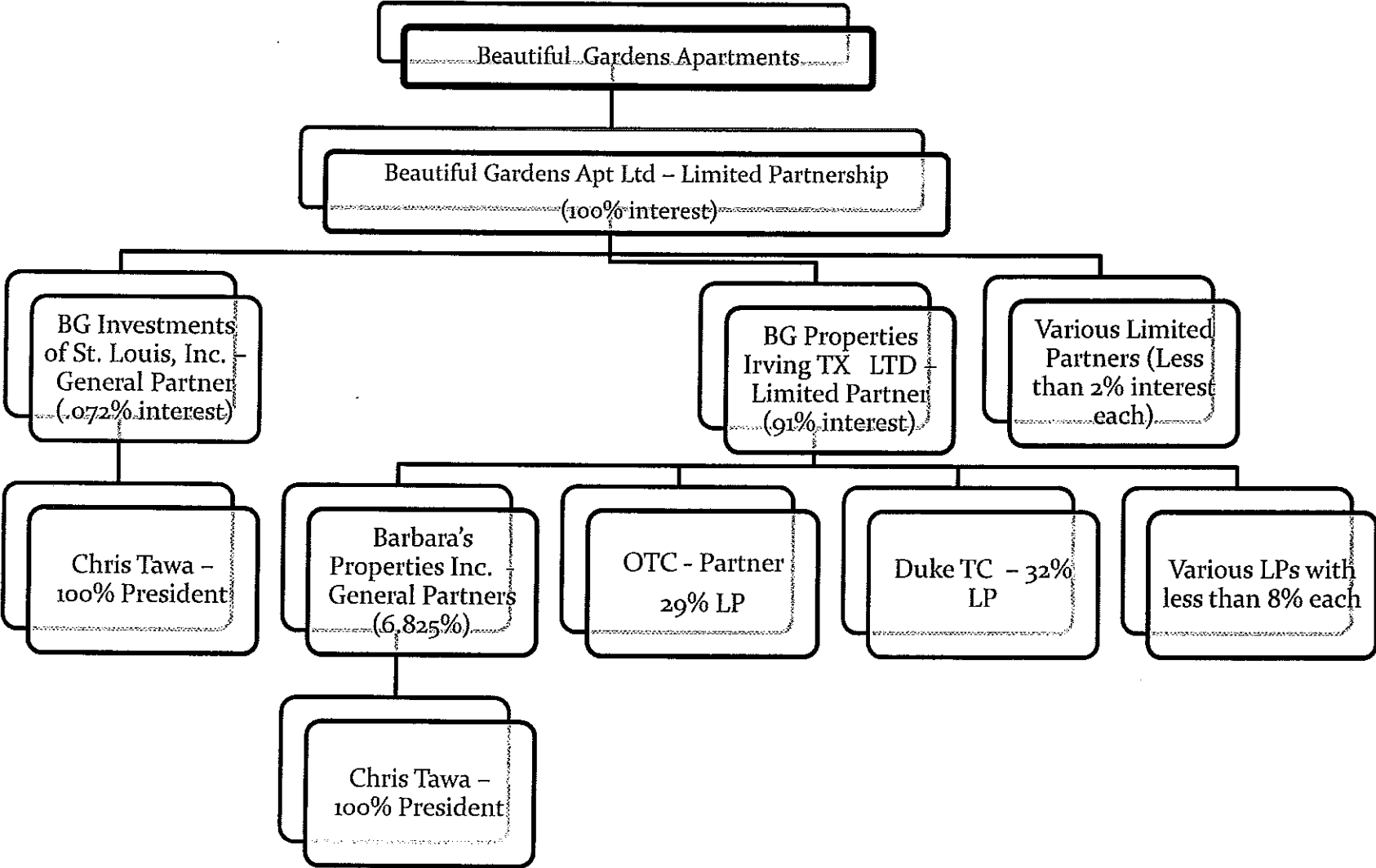
# Case 4

- Experienced, small scope Borrower, owns/manages 4 properties, good liquidity/net worth, no credit or financial capacity concerns in last 20 years.
- Discloses he is a convicted Felon, mortgage fraud – 25 years ago he pled guilty and went to jail (served 18 months of a 4 year sentence) for mis-representation in single family loan origination / brokerage business.

# Case 5

- Strong financials, 80% LTV 223(f) with no cash out. Borrower has one key principal who owns 90% of the subject property, 3 limiteds own the other 10%.
- Borrower owns 2 other properties with moderate leverage and no balloons coming due. He is a foreign national, 20 years of US residency, in good standing with Immigration authorities (and has a recent letter from them documenting that status).
- Key principal has clean credit. Didn't disclose he is a convicted Felon (came out in the OFAC check). Explained didn't understand this info was relevant or requested, provided letter and explanation.
- Explanation: Got out of prison 9 years ago, served 12 months for money laundering – a distant relative had money to invest and our principal was a Real Estate broker and arranged purchase of a small rental property. It turns out the relative's money was proceeds from criminal activity and he got caught.
- Second conviction of a misdemeanor 2 years ago. States it was an entrapment situation and he was just kidding.

# Case Study 6a - Org Chart





# Case 6

- The lender is questioning the level of review on OTC Partner and Duke TC. The lender claims they are passive investors however they control 61% of the 91% interest of the limited partner.
- When would and wouldn't an REO schedule be required?



# Underwriting

- New Construction / Sub Rehab
- Refi's – 223(f), 223(a)(7)
- Q&A's



# Processing Improvements

- Concept meetings on all D4s and on many fs
- Two stage processing for market rate, one stage for affordable
- Partial electronic submission
- Standardized narrative for D4 and f
- Standardized application file contents
- MAP processing for A7s



## General Issues – New Constr. / Sub Rehab

- Definition of “Affordable”
- Application fees
- Concept meeting
- Preapp requirements expanded



## Section III.D. – Section 221(d)(4) – NC/SR

- Market study and appraisal conducted by separate firms
- No market study for 90%+ Section 8 RA
- Occupancy standard
- Reduced # of units by shortening absorption period




## Section III.D. – Section 221(d)(4) – NC/SR

- Delayed cash out from excess land or building equity
- Retainage % changes
- Contingency/Working Capital
- Marketing / leasing plan and budget
- Relocation plan if SR with tenants in place



## Section III.D. – Section 221(d) (4) – NC/SR

- FF&E – reasonable costs are mortgagable
- R4R – higher of \$250 or formula
- PCNA – required every 10 years



## NC/SR 221 (d)(4) IOD

Operating deficit escrow is the greater of:

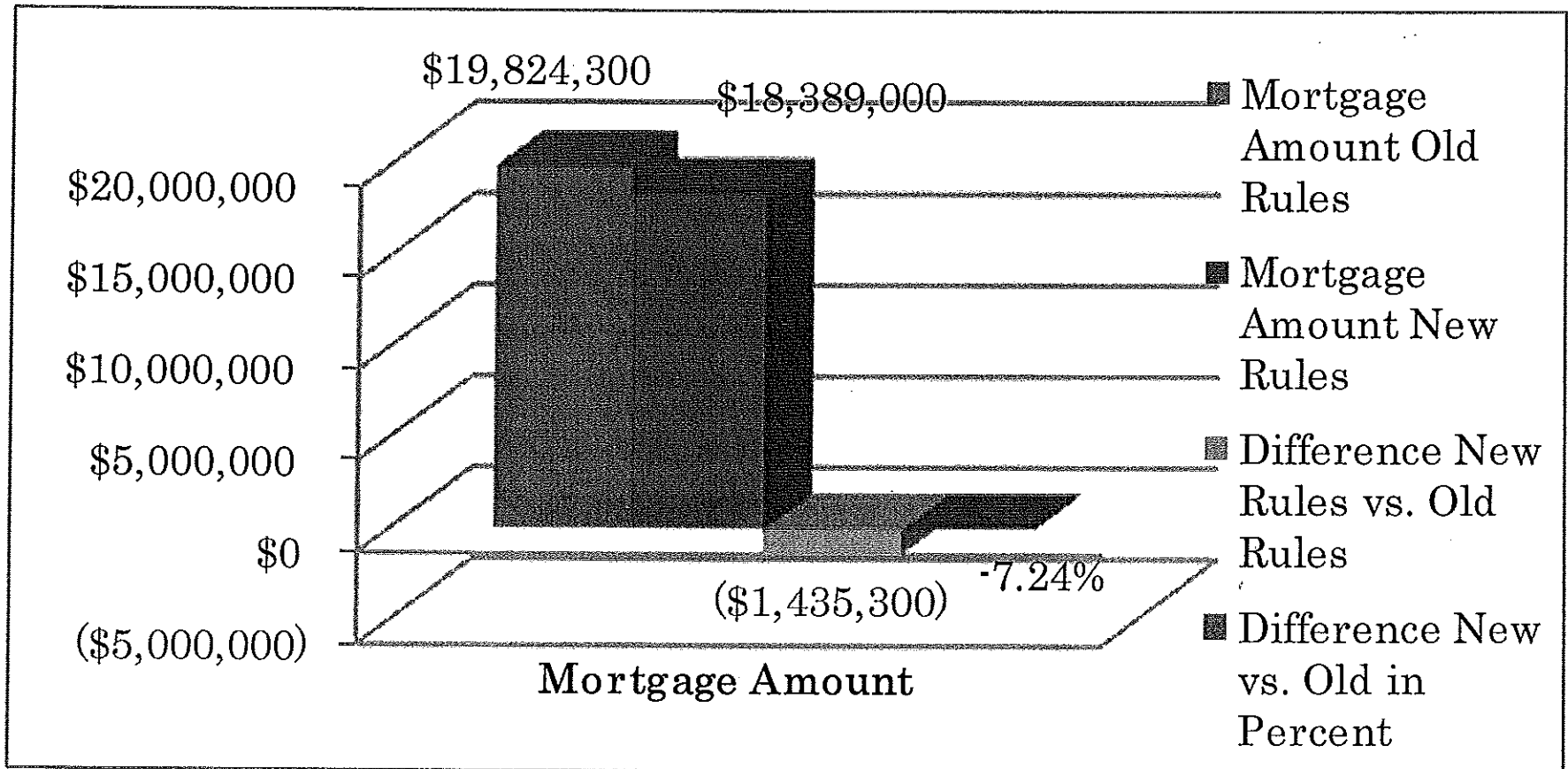
- Underwriting estimate/appraisal
- 4 months principal, interest and MIP [or 6 months if high rise]
- 3% of mortgage

# NC/SR 221(d)(4)

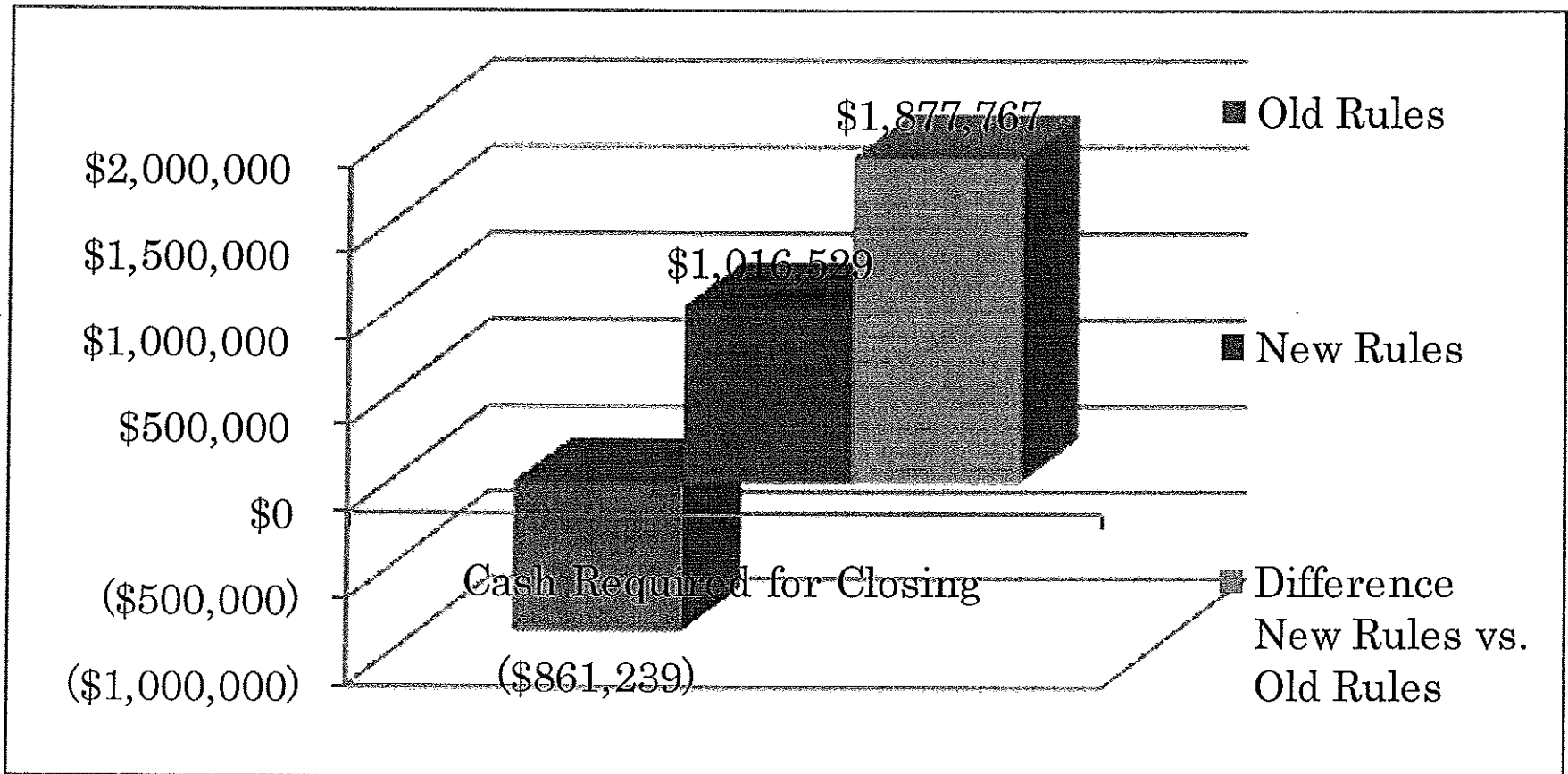
- Underwriting changes
  - Issues affecting loan sizing or project parameters

Underwriting Criterion	Old Standard	New Standard
Debt service coverage ratios	1.11	1.11/1.15/1.20
Loan-to-cost ratios	90%	90/87/83.3%
Maximum underwritten physical occupancy	95%	95/93%
Number of units	Estimated 24 month absorption	Estimated 18 month absorption

# 221(d)(4) - Mortgage Amount Before & After



# 221(d)(4) - Cash Required to Close Before & After





## Refinancing Changes – Section 223(a)(7)

- “MAP”
- Priority on time frames
- PCNA – required every 10 years



## Refinancing Changes – Section 223(a)(7)

- NO CHANGE to Loan Ratios or other program provisions
- No REO or other Credit-worthiness analysis
- No Valuation, site visit, or other MAP type analysis
- Streamlined Loan Committee presentation

## 223(f) Underwriting Changes – Loan Sizing Ratios

Loan to Value/Cost

Deal Type	Old	New
202 Refi	90%	90%
=>90% Rental Assistance	85%	87%
Affordable	85%	85%
Market Rate	85%	83.3%



# 223(f) Program Changes

- Occupancy Standards
  - Physical: > 85%, average for 6 consecutive months
  - Underwritten at  $\leq 93\%$ 
    - Except  $\leq 95\%$  when
      - $\geq 90\%$  rental assistance, or
      - 100% of rents restricted to  $< 80\%$  market
  - Stable  $\Rightarrow$  6 months



# 223(f) Program Changes

- Confirm Market & Occupancy
  - Certified Rent Roll <30 days of closing
  - Lender on site unit inspection & lease audit
  - Market study in volatile/declining markets



# 223(f) Program Changes

- Cash Holdbacks
  - 50% of refi cash out held until all critical and non-critical repairs are completed
- Reserves
  - R4R minimum: \$250/unit
  - New PCNA & revised R4R every 10 years

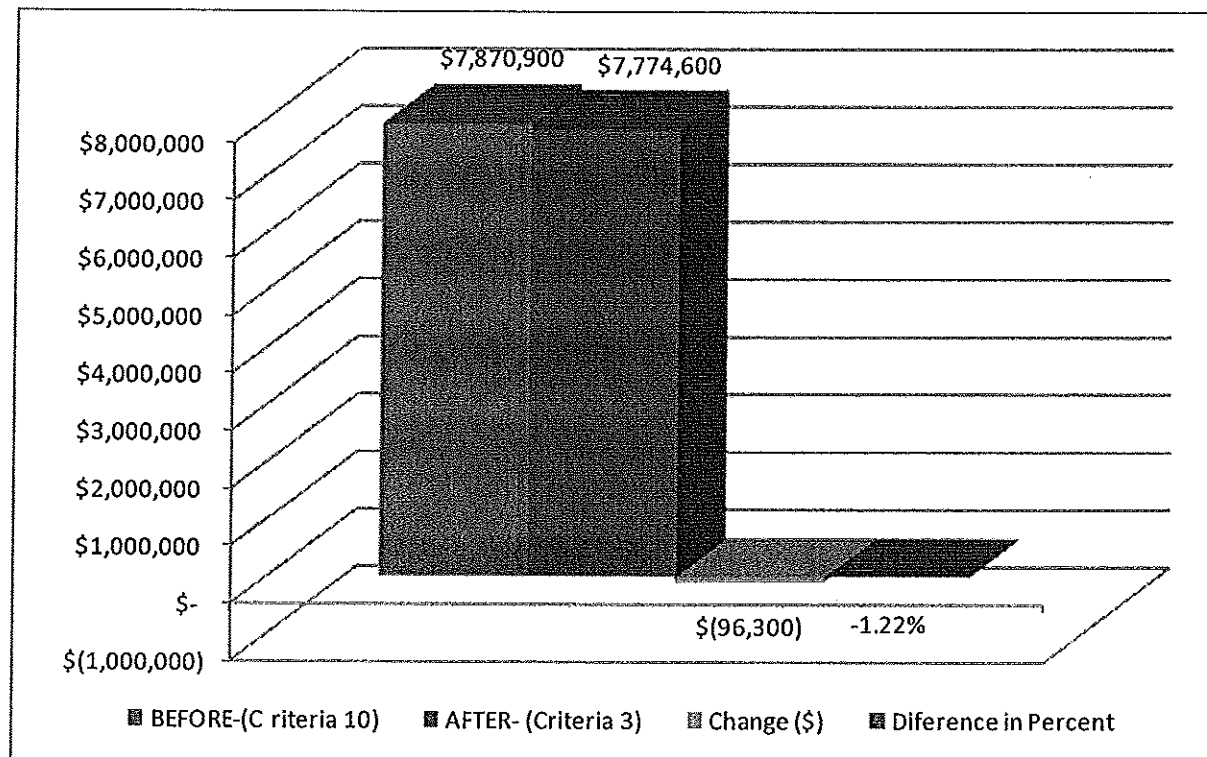


# 223(f) Program Changes

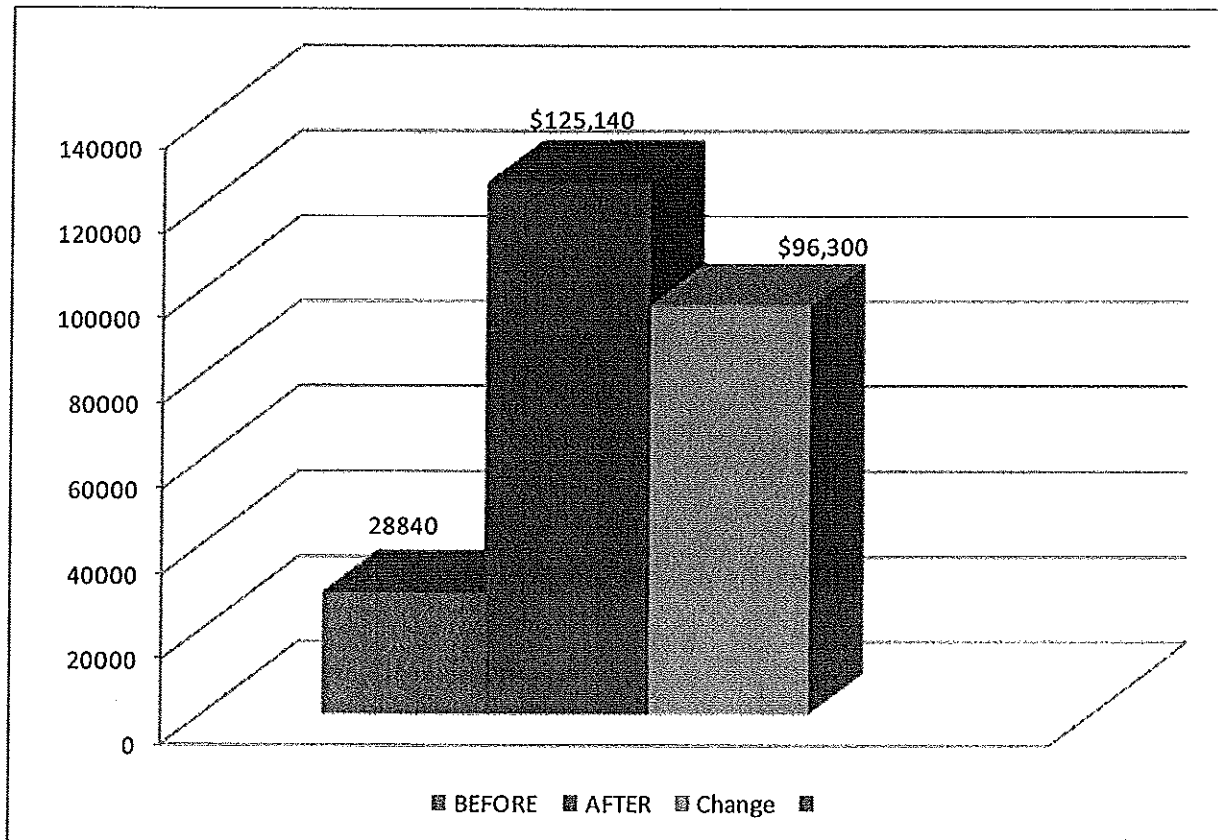
## Property credit analysis

- 3 years financials, last year CPA reviewed (waivable for acquisitions)
- 3 years mortgagor tax returns
- All expense payables cleared

# 223(f) Refi: Impact of Ratio Changes Loan Size



# 223(f) Refi: Impact of Ratio Changes Borrower Cash at Closing





# Process

- Standardized Lender Narrative
- HUD Review
- Loan Committee
- Issuance of Invite / Firm



# Process

- Loan Committee
  - National
  - Hub
- 17 Held as of 10/31/10
- 16 Approved