Preserving Affordable Housing through the Small Buildings Risk Share Initiative

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The FHA Risk Sharing Value Proposition

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Mission and Market Opportunity

- Need to look beyond subsidized properties to address affordable housing mission.
  - 63% of MF units affordable at 80% AMI are unsubsidized (sources: AHS; Fannie Mae; NAAHL)

- Lower-rated MF properties (CoStar 1&2 star):
  - Contain 42% of all MF units
  - Comprise 75% of all MF properties
  - Mostly (73%) have 20+ units
Mission and Market Opportunity

• Long-term, fixed-rate mortgages may appeal to long-term owners, especially to protect against interest-rate/refinancing risks
  ▪ Liquidity is scarce for small balance multifamily loans with long-term fixed rates
    – Fannie and Freddie small balance products are open only through a limited number of lenders
    – Mainstream FHA products are too costly, slow, and inflexible for small balance loans

Business Opportunity

▪ Lenders use own underwriting policies (with FHA approval) and do most processing
▪ Minimal FHA processing cuts production cost and processing time
▪ Lenders hold 50% of credit risk, allowing efficient leverage of balance sheet
▪ FFB funding
  – eliminates interest-rate risk
  – has been fast, inexpensive, and reliable for HFAs
Business Opportunity

- FFB funding allows attractive pricing and margins:
  - 35 yr term: 2.641% (10 yr Tsy + 89.1 bps)
  - 40 yr term: 2.667% (10 yr Tsy + 91.7 bps)
  Notes: fixed-rate; full amortization; 10 yr prepay lock-out; indicative as 10/7/16; excludes 12.5 bps MIP

- Lenders need:
  - Strong track record, capacity, and balance sheet
  - Sufficient volume to support production and servicing platforms

FHA Risk Sharing Programs – Small Buildings Risk Share Initiative

1. SBRS Overview
2. Application Requirements
3. SBRS Resources
SBRS Overview

Background: Section 542 of the Housing and Community Development Act of 1992 established the two pilot risk sharing programs:

1. 542(b) Qualified Participating Entity (QPE) Risk Sharing Program: current participants are Freddie Mac and Fannie Mae.

2. 542(c) Housing Finance Agency (HFA) Risk Sharing Program: currently 35 HFAs participate.

Section 235 of HUD’s FY 2001 Appropriations Act, Public Law 106-377, converted the pilot program into a permanent multifamily insurance program.

• Increase the supply and preservation of affordable small properties. Small properties face significant obstacles accessing fixed rate, long term financing.

• Attract new lenders to this underserved segment of the market with inclusion of high capacity CDFIs, or non-profit, or public or quasi-public agencies (Mission-Based Lenders);

• Effective January 2016, FHA MAP lenders were eligible to apply.
• Support affordable housing while minimizing risk to FHA Insurance Fund (under MAP loans, FHA assumes 100% of claim/insurance risk; under Risk Sharing loans, FHA assumes 50% of the claim/insurance risk)
• Utilize existing Risk Sharing program platform that allows delegated processing, decision making, and closing procedures to enhance the delivery of affordable housing in local markets
• Risk Sharing and delegation enable participating lenders to process small loans more quickly and efficiently, and with lower costs.

• Lenders share risk 50/50 with HUD.
• Projects must qualify as affordable housing, consistent with LIHTC Program requirements.
• Eligible properties have 5 or more rental dwelling units; no cap on number of units in a property.
• 2 fixed rate loan terms available: 35 year fully amortizing loan term; or 15 year balloon loan amortized over 30 years.
• Loan amounts limited to $3M in standard markets or $5M in “High Cost Areas” as designated annually by HUD.
SBRS Overview

• Lender’s first year in the program: limited to 20 loans or $50 million in closed loans; HUD to pre-review first 3 to 5 loans.
• SBRS is a preservation initiative: new construction is not permitted; rehabilitation and refinance loans only.
• Loans may be ‘insured upon completion’ or ‘insured advances’ (if using FFB, subject to FFB financing availability for insured advances).
• MIP will be published in the Federal Register; currently 12.5bps is due annually to FHA.
• All Risk Share program loans qualify as ‘Broadly Affordable’ in the MIP Notice effective 4/1/16.

• SBRS lenders may access (but are not required to use) Federal Financing Bank (FFB) financing as source of capital.
• SBRS lenders must enter into a Risk Sharing Agreement (RSA) with HUD (covering both FFB and non-FFB funding).
• ‘Onboarding’ process to use the FFB funding program: Execute program documents (Master Purchase and Sale, and Master Escrow and Custody Agreements).
• Loan pricing is comparable to a Ginnie Mae execution; FFB posts pricing daily; individual loan pricing based on market conditions on the day of funding.
• Rates for 35 year fully amortizing loans in the 542(c) program have averaged 102 bps over 10 year Treasuries, plus MIP and servicing fee.
SBRS Overview

- Lenders use their own underwriting standards; asset management and servicing policies (with quarterly reporting on loan performance using forms TBD by HUD).
- In the event of a default, HUD will pay 100% of the claim.
- Participating CDFIs may issue a 5-year debenture to HUD and have up to 5 years to repay HUD for their half of the loss.
- Lenders to be individually reviewed and qualified for their ability to manage disposition of defaulted assets, otherwise HUD will perform this function.

Key differences between SBRS and standard insurance program:

- Servicing and ownership of SBRS loans may not be sold or assigned to another lender.
- HUD’s review is limited (after initial pre-review period) to:
  - Previous participation of principals (2530 clearance)
  - Environmental review under 24 CFR part 50
  - Intergovernmental review (if applicable for jurisdiction and if loan is ‘insured advances’)
  - Subsidy Layering Review
- Lender can close loan after HUD’s Firm Approval (commitment) letter issued, then will submit closing package with Note for endorsement to HUD’s local office.
Lender Application Requirements

Two stage process: Pre-Qualification & Final Application

Applicants must meet organizational requirements for:

- **Mission Based Lenders** - Certified as a CDFI by the CDFI Fund, or Non-profit, quasi–public or public agency; or
- **Private Lenders** – FHA MAP lenders in good standing with HUD

All applicants must have:

- FHA license
- Affordable housing lending experience: 20 loans in past 2 years, or 20% of all loans (measured in $)
- Acceptable track record with HUD

Financial capacity standards for SBRS (which are higher than FHA requirements)

- Minimum $7.5M net worth and a net asset ratio of 20%; OR
  - Minimum net worth $7.5M and a CAMELS composite rating of 1 or 2, or equivalent nationally recognized rating system (i.e., AERIS/CARS)
- If the lender cannot meet these requirements, a dedicated reserve must be established with an initial amount of $500,000.

- Positive Net Income from best 3 of past 5 years;
- Minimum Operating liquidity of 1.0 for most recent 4 quarters and for 1 or both of the 2 preceding years.

Minimum financial standards may increase in the future based on the size of the lender's total SBRS portfolio.

Loan loss escrow funded from lender servicing fees under consideration by HUD.

Pre-Qualification application: submit hard copy of “Pre-Qualification Worksheet” and certifications.
Lender Application Requirements

After Lender is pre-qualified, submit Final Application no later than 90 days after notification.

Final Application materials:

- Narrative with organizational history, mission, multifamily affordable lending experience, description of its multifamily lending activities.
- Required exhibits:
  - Manual describing lenders investment, business and financial practices
  - Certifications
  - Audited financial statements for last 3 fiscal years
  - Sample Debenture form
  - Loan Portfolio List
  - Counsel List
  - List of Principal staff

Refer to "Application Requirements" for complete details.

Lender Application Requirements

NOTE: If applicant is not a MAP lender: Final Application must include evidence of submission of a complete FHA lender application as a “FHA Non-supervised Mortgagee”. This application is submitted online, and is separate from the SBRS approval process.

Details in Handbook 4060.1, Rev-2.


An FHA Lender Approval Application, Form 92001-A, can be downloaded from HUD’s website at:

SBRS Resources

Links to the SBRS program documents:

- SBRS Application Requirements
- SBRS Initiative Pre-Application Worksheet
- FHA Small Building Risk Share Initiative Final Notice
Typical CIC Multifamily Loan

- 15 unit building
- Acquisition + Rehab = $750,000
  ($50,000 per unit)
- First mortgage loan: $600,000
- Rents: $700 - $900 / month
- 90% of units affordable at 60% AMI
Access to long term capital.
- Currently we only offer 3-5 year terms. Longest investment is 10 years

Grow and diversify our portfolio
Stabilize revenue
Establish new relationships and strengthen existing ones
- Provide opportunity to be involved as a permanent lender in LIHTC deals

Provides a long term option for small transactions in which other lenders would rather not do

Majority of the work we do is for preservation, so this program fits very well

50% risk share!
Application Process

- SBRS application
  - Pre application
  - Final application
- FHA application

FHA Application

- Business Formation Documents
- Commercial Credit Report on Mortgagee
- Credit Reports of Principal Owners and Corporate Officers
- Resumes of Corporate Officers
- Resume of Officer in Charge
- State License or Registration
- Financial Reports
- Funding Program
- Fidelity Bond
- Errors and Omissions Insurance
- Quality Control Plan
Quality Control Plan
QCP

- Road map on how MLF will follow the various HUD guides- specifically Handbook 4000.1
  - 1014 pages
- 34 Sections 64 pages

QCP-Covered most aspects of MLF’s operations

- Integration with Other Agency or Investor Guides and Manuals
- Origination
- FHA Section 542(b) Initial Loan Screening
- FHA Section 542(b) Loan Processing
- Selection of Third Party Report Providers
- FHA Section 542(b) Loan Underwriting
- Potential Underwriting Risks and Mitigants
- MLF Loan Review Committee
- Application Submission and HUD Processing
- HUD Issuance of Firm Approval Letter
- Loan Closing, Titles, and Insurance
QCP-Covered most aspects of MLF’s operations

- Loan Servicing & Asset Management
- Quality Control
- Results of QC Review / MLF Follow-up Activities
- Results of QCP Review & Other Lender Reporting Requirements to HUD
- QC Reviews - Loan Servicing & Asset Management
- MLF Legal Representation
- MLF Staffing Roles, Plan, Training
- Identity of Interest
- Technology
- Accounting
- Credit Files/Document Storage

Closing Thought

Thoroughly review and understand the FHA application and requirements before filling out the SBRS pre application!