

Decoding HUD's new rules

Recent policy changes in HUD financing will impact the multifamily market. Over the last several years, getting conventional lenders such as banks, private investors or commercial-backed securities to commit to a multi-family development has been challenging.

Many developers have turned to other means to acquire funds for viable projects, including programs available through the U.S. Department of Housing and Urban Development (HUD).

HUD's Federal Housing Administration (FHA) Section 221 (d)(4), a program that insures mortgage loans to facilitate new construction or substantial rehabilitation of multi-family or co-op housing, has been of particular interest to developers and many have obtained financing through the program. FHA Section 221 (d)(4) has a 40-year non-recourse term, which means developers are not required to sign a personal guarantee for the project. HUD also only requires about 17 percent equity on a project it approves, whereas a bank would require between 25 to 40 percent equity. The loans are insured through the Ginnie Mae Insurance Program, which makes the security an AAA-rated instrument.

The bad news, however, is that due to increased interest in the program and a desire to mitigate risk given the current economic conditions, HUD has implemented a series of policy changes that affect both developers and lenders and will increase the timing of the application process, at least for the foreseeable future.



IN THIS SECTION



APPLYING FOR FINANCING

As a Florida-based contractor specializing in multifamily, our company is currently working on several HUD projects in the Southeastern United States, with an additional project set to begin in early 2011. Our clients obtained financing for our projects before the changes took effect, but we spoke with local lenders about what to expect as a result of the new policy. Here is some advice and tips for applying for HUD financing in today's market.

In 2008, HUD insured mortgages for 88 FHA Section 221 (d) (4) projects with nearly 14,000 units for a total of \$1 billion. In 2009, the numbers increased slightly with HUD insuring 90 projects for a total of \$1.3 billion. HUD tweaked the program this September and implemented changes to better strengthen the financial position of its insurance fund, which is in essence designed to eliminate the weaker applicants. Overall, the changes mean more documentation for borrowers, more analysis from lenders and additional steps in the process of securing a loan.

Completing an application from start to finish used to take six to nine months, but under current conditions, it can easily take a year. HUD's "fast-track" process, known as the Multi-Family Accelerated Program (MAP), was intended to reduce invitation response time to 50 days and the firm commitment HUD review time to 50 days. However, the new requirements will add one or two levels of review to the wait time, depending on the size of the loan and the project.

There is a backlog of projects submitted before the changes went into effect causing delays. However, the new policy both tightens up the parameters of projects and looks more closely at lending partners.

If you wish to secure HUD financing, the first step is to do your research. Make sure the chosen geographic area can sustain your project. If you're confident that the area is in need of development, make sure to choose a knowledgeable team with which to work. Select a team that is familiar with HUD, including architects, planners, civil engineers and consultants, because all HUD projects require specific forms and strict guidelines your team will

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Thalle Construction Co.

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need to complete and follow.

Once your team is secure and the project is solidly defined, the second step to securing FHA mortgage insurance for a HUD loan is to complete the pre-application process. There are regional HUD offices that take applications from approved lenders, who serve as a liaison between the developer and the HUD office on every project. To find a lender, go to the local HUD office and get a recommendation or call on people you know for a reference. Once you've found your preferred lender, develop a relationship with them since they are familiar with the regional office and can give you an early indicator whether or not the project has a chance for financing before the process begins.

With the lender selected, the application process works two fold: first, you submit a pre-application, which will be underwritten by the lender and reviewed by HUD. They will either approve it and invite you to apply for a firm commitment for mortgage insurance or decline your application. Once your application is submitted,

it will be reviewed to determine if the proposed loan is an acceptable risk. According to the HUD website, the reviewers will consider several variables, including the market need, zoning, architectural merits, capabilities of the borrower, availability of community resources and other items. If your project meets the program's requirements, the local HUD office will issue a commitment to the lender for mortgage insurance on the project.

TIGHTER REQUIREMENTS

Developers should be aware that HUD has tightened its requirements for market studies to reflect what is happening today and it is no longer considering projections as viable reasons for development. HUD has become more conservative in order to minimize risk. We have seen companies get approval by cutting the size of their project in half, so take that into consideration when planning a development. Also, new units must be absorbed in 18 months; otherwise HUD will likely require the development to be phased.

Developing, applying and securing HUD financing may be a lengthy and trying process, but policy changes should eventually benefit those developers who take the time to formulate the right project.

— James Pyle

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