Before the Buzzer: Encore Multifamily broke ground this year on the 200-unit Encore at Alsbury in Burleson, Texas, locking a 5.25 percent rate and 88 percent LTC on a 221(d)(4) loan.

APARTMENT FINANCE TODAY • September/October 2010
Mortgage Lending | FHA

A Long Time Coming

Changes to leverage and debt service are just the tip of the iceberg when it comes to FHA's newly unveiled sweeping reforms.

BY Jerry Ascierto

WHEN THE FEDERAL Housing Administration (FHA) changes its multifamily programs—some of which have remained untouched for 40 years—the agency doesn't fool around.

As expected, in July, the FHA tweaked underwriting standards for its new construction and refinancing programs, making it tougher for market-rate deals to pencil out. But the agency also unveiled a clearinghouse of other risk-management efforts that will require more documentation from borrowers, more analysis from lenders, and ultimately more steps in the process of securing a loan.

"The changes are going to have the intended consequence of making it harder, and slightly less palatable, for those looking to develop market-rate housing to use HUD," says Nick Gesue, a director at Columbus, Ohio-based FHA lender Lancaster Pollard. The changes are designed to clear out the FHA's congested pipeline of market rate deals, to better sort the wheat from the chaff. By delegating additional responsibility to lenders, the agency hopes to make the process more efficient. But with so many changes unveiled at once, many in the industry fear that the new requirements may have the opposite effect.

"It's short-term pain for long-term gain. There will be a real learning curve for the lenders and for HUD staff, but is it a six-month or three-year learning curve?" asks Phil Melton, who leads the FHA division of Charlotte, N.C.-based Grandbridge Real Estate Capital. "That will make a huge difference as to whether the FHA continues to be a big player, or whether they will become a lender of last resort again."

It's not yet clear how all of these enacted and proposed changes will affect borrowers, though intuitively, the process seems more restrictive and time consuming than in the

past. The bottom line is that the agency was understaffed before these changes, and if efficiencies are to be realized, the FHA has to step up internally. “They need more and better staff,” says Doug Moritz, associate vice president of multifamily at the Washington, D.C.-based Mortgage Bankers Association (MBA).

Here’s an overview of the top changes to the FHA’s multifamily programs—and the extra hurdles you can expect.

1. Extra Steps

Two of the biggest changes include a “new concept planning meeting” between lender and HUD staff (which was already enacted in July), and a proposed new loan committee within HUD that the agency hopes to enact by the end of the year.

For the new concept planning meetings, lenders will have to meet with FHA staff to do an early review of larger market rate 221(d)(4) deals before submitting a pre-application. Basically, lenders must assemble a long list of documentation, which will then be reviewed by HUD.

The new concept planning meeting “will put extra burden on HUD staff who are already burdened, and that’s a concern,” Gesue says. “This is almost like a pre-pre-app—you may have to spend a month going back and forth on this initial concept meeting.”

The FHA also hopes to roll out an internal loan committee that would align field offices with headquarters to review particularly complex transactions.

The big question is whether the agency has the staff to accommodate these changes. While the FHA has a hiring goal for its single-family side, the agency has been under a casual hiring freeze for its multifamily divisions over the past 18 months.

2. Mortgage Credit Review

A new mortgage credit review process is also in place, and all company principals will now be heavily scrutinized. Lenders will perform financial reviews on all of a borrowing entity’s principals, analyzing their creditworthiness and schedule of maturing loans, and ultimately delivering a financing plan for any projected shortfalls.

FHA lenders concede that this will likely add to the overall deal cycle time, especially for larger organizations with many principals, or smaller organizations with very experienced principals. What’s more, the FHA expanded its definition of a principal. Now, each member of a company’s board is considered a principal and, as a result, the accompanying credit reviews will take a little longer now.

3. Changes to 221, 223 Loans

Occupancy standards for 223(f) loans are now a little tougher. Market-rate deals can only be underwritten to a 93 percent occupancy ceiling, down from the previous 95 percent, even if that apartment building has been 99 percent occupied for years.

The FHA will now also require 223(f) borrowers to have three years of their tax returns and property financial statements reviewed by a CPA. In the past, a borrower could just print out their data and certify it.

Another new requirement mandates a separate market study—beyond the study in the appraisal—for 223(f) deals in volatile or declining markets. This requirement raises questions as to who determines the need for the study, what exactly makes a market "volatile," and who has the final say.

Also, for new construction or substantial rehab deals, the FHA now requires a tighter absorption period. In the past, 221(d)(4) developments had two years to meet their occupancy goals—now just 18 months. Lenders feel this could hurt deals in solid secondary markets where lease-ups may proceed at a slower pace than the biggest metros.

4. License to Loan

The FHA is working on additional multifamily changes that it hopes to enact by the end of the year. The biggest proposal surrounds heightened standards for FHA lenders and underwriters.

Currently, any FHA lender can make any FHA loan—new construction, refinancing, market-rate, affordable. But under a proposed change, the FHA would create tiered licenses—some lenders will be able to do new construction deals, for instance, and some will not.

The FHA would assess each lender's recent history to determine the level of license. But many argue that the time frame— the past three years—does not provide a representative sample given the state of the multifamily market during that period.

The MBA recently conducted a study with four of its FHA lenders to see how many people in those organizations would be qualified to make all FHA loans. The results were troubling: Of 41 employees among four different companies, only two were qualified to make all types of FHA loans.