FHA Section 542(c) Risk-Sharing Program for Multifamily Housing Program Rules

Purpose

Kentucky Housing Corporation (KHC) has partnered with HOPE of Kentucky, LLC, and the Community Reinvestment Fund, USA (CRF) (collectively the "Participating Lenders") to leverage KHC's permanent loan resources to assist qualified projects in obtaining FHA Risk-Sharing loans.

To foster the production of affordable multifamily housing, KHC will offer FHA Risk-Sharing loans to projects that are applying for Low-Income Housing Tax Credits ("Housing Credit"). FHA Risk-Sharing loans will be made available on a case-by-case basis, depending on the availability of funds.

In the event of inconsistencies between the requirements listed in this FHA Section 542(c) Risk-Sharing Program for Multifamily Housing Program Rules, together with Appendixes A and B attached thereto (collectively, the "Program Rules") and KHC's Multifamily Finance Guidelines, the requirements contained within these Program Rules will prevail.

Loan Requirements

Qualified projects must:

- Meet the affordability requirements of the Housing Credit program and the FHA Risk-Sharing program. This requirement will be evidenced by a recorded Land Use Restriction Agreement.
- Comply with KHC's and the FHA Risk-Sharing Underwriting and Development Policies contained in HUD Handbook No. 4590.01 Rev-1, as may be revised from time to time, and KHC's Multifamily Finance Guidelines.

Eligible Projects and Applicants

- Applicants may be either nonprofit or for-profit entities, and must show evidence of competency, capacity, and experience.
- Projects can be new construction, adaptive reuse or substantial rehabilitation (minimum of $20,000 per unit, as defined in KHC's Qualified Allocation Plan). Project location and site are important considerations. KHC expects quality work and the use of quality materials.
- KHC prohibits involuntary relocation of tenants solely for the purpose of meeting loan eligibility requirements. If tenants must be relocated on a temporary basis to complete the proposed work, a written relocation plan must be approved, with details of relocation responsibilities and tenant compensation.

APPENDIX A
Underwriting Criteria: FHA Risk-Sharing Loans

The following underwriting criteria are applicable when assessing FHA Risk-Sharing loan applications. FHA Risk-Sharing loans are available on a case-by-case basis, depending on the interest of credit worthy borrowers participating in the Housing Credit program and the availability of funds from KHC and the Participating Lenders.

Type of Loan:

Permanent financing for multifamily affordable housing projects supported by 9 percent Low-Income Housing Tax Credits (Housing Credits). First mortgage with Federal Housing Administration Section 542(c), Risk-Sharing insurance.

Eligible Projects:

Affordable housing projects that have received a reservation or allocation of Housing Credits. Projects must have 5 or more units.

Eligible Borrowers:

Project owners must be organized as a single-asset partnership, limited liability company or corporation and must have commitments or letters of intent from each investor expected to contribute equity to the project in exchange for an ownership interest conveying the tax credits, losses, or other tax benefits that the project generates.

Each principal (as defined in HUD Handbook No. 4590.01 Rev-1) with 25 percent or more ownership interest in the project must disclose all past participation in HUD-FHA programs (except single family home mortgages) and the nature of their proposed project. Principals must disclose their previous participation by completing the HUD 2530 form (PDF version) or through the APPS. Both can be accessed through HUD's Web site, www.hud.gov.

Preliminary Request:

Applicants for Risk-Sharing loans must submit a preliminary request to KHC with a detailed project description and completed KHC underwriting model to multifamilylending@kyhousing.org. KHC will notify applicants if they are approved to proceed to full application. Applicants must have already submitted the development team for capacity review via the online application system prior to submitting the preliminary request for Risk-Sharing funds.

Firm Commitment:	KHC will issue a letter of intent upon approval of the initial application and a firm commitment letter upon verification of award of Housing Credits.
Security:	Permanent loan must be secured by a first mortgage lien on the real property being financed.
Loan Amounts:	Maximum of $2,000,000.
Loan Interest Rate:	Rates will be based on current market conditions and the term of the loan. Current rates are published on the Multifamily Finance page of KHC's Web site, www.kyhousing.org. Interest rates may only be locked after the issuance of the conditional commitment and after an award of Housing Credits has been received. Rates must be locked prior to final underwriting and issuance of the final Housing Credit reservation letter.
Amortization and Loan Term:	Maximum 40-year term amortization, minimum term is 15 years. Note that nine to twelve months before maturity, a FIRREA appraisal will be required from the borrower.
Forward Commitment Term:	Maximum of 30 months from lock-in date.
Loan-to-Value (LTV) Ratio:	The LTV ratio shall not exceed 90 percent for insured, 9 percent Housing Credit projects based on a MAI-certified appraisal in accordance with the FIRREA Act of 1989. The LTV calculation must include all hard debt within its loan amount component. The appraisal can be no more than 30 months old at the time the loan closes, if not within the original commitment period. An appraisal update may be required prior to closing if there is a substantive change in market conditions perceived by KHC or the investor.
Commitment Fee:	A commitment fee of three percent (3%) of the loan amount will be due from the borrower upon acceptance of the preliminary commitment issued after Housing Credits have been awarded.
Maximum Risk-Sharing Fees:	The maximum amount of financing fees that can be paid from the Risk-Sharing loan is 3.5% of the loan amount. Any fee costs above this threshold must be paid from other sources.

Upfront MIP:

An upfront Mortgage Insurance Premium ("MIP") equal to one-half percent (0.5%) of the loan amount will be due at loan closing.

Monthly MIP:

A monthly MIP of one-half percent (0.5%) is required for loans under this program and will automatically be calculated in the underwriting model.

Extension Fee:

Extensions are available based on review and approval. Extensions of 1 to 6 months may be granted for a correlating fee, and are subject to interest rate adjustment based on current market conditions. For further detail on extension request process requirements and fees, see Appendix B or contact KHC.

Non-Delivery Fee:

If the borrower is unable to convert to a permanent mortgage loan for any reason prior to the expiration of the forward commitment period, the loan is subject to a non-delivery fee. This fee is calculated as the greater of:

- An amount equal to the present value of the difference of the forward interest rate and current KHC or Participating Lenders minimum acceptable rate over the life of the loan; **-OR-**
- Three percent (3%) of the committed loan amount.

Borrowers must provide a personal guarantee to KHC for payment of the non-delivery fee.

Property Stabilization:

The permanent loan will close upon project completion evidenced by the issuance of certificates of occupancy for all units and the project achieving 90 percent occupancy for 90 consecutive days. Multi-stage projects are subject to 90 percent occupancy for the previous 180 days. Additionally, the property must have a minimum debt service coverage ratio based on annualized financials of at least 1.25 for insured 9 percent Housing Credit properties.

Closing Fee:

KHC will circulate KHC's closing agenda prior to loan closing. The borrower shall be responsible for hiring its own attorney and be responsible for paying all legal costs (including providing a title policy) of the transaction, including a $5,000 closing fee of KHC's or its designee's legal counsel.

KHC will issue a firm commitment letter upon final approval that upon acceptance, will lead to final due diligence (primarily real estate and organizational document review) and drafting of loan documents.

Loan Resizing:

Following commitment acceptance, loans that increase or decrease less than five percent (5%) from the original committed loan size will not be subject to a resizing fee. For further details on loan resizing requests in excess of five percent (5%), see Appendix B or contact KHC.

Prepayment Penalty:

Lockout or yield maintenance for a minimum of 15 years, and thereafter prepayment is allowed for a fee equal to 1 percent of the outstanding loan balance. However, no prepayment premium shall be due for prepayment occurring within 180 days prior to the scheduled maturity date of the mortgage loan.

Federal Davis-Bacon Act:

The Federal Davis-Bacon Act wage rate requirements apply to new construction and substantial rehabilitation projects of 12 or more units when the Risk-Sharing Program is used for construction financing. Davis-Bacon requirements do not apply when the Risk-Sharing funds are utilized solely for permanent take-out. The Davis-Bacon Act requires that workers receive no less than the prevailing wages being paid for similar work in the locality. Prevailing wages are computed by the Department of Labor and are issued in the form of a Federal Wage Determination. The Wage Determination lists each classification of workers who will work on the project and the rates that must be paid to each classification.

Projects must comply with Davis-Bacon if it is a condition of other federal assistance in the development.

Underwriting Requirements:

Management Expertise – The project Owner, Developer, Property Management Company and Tax Credit Investor must have adequate experience to successfully support and manage the project during the term of the loan.

Environmental Review – An environmental review performed in accordance with the National Environmental Policy Act of 1969 and related laws and authorities and 24 Code of Federal Regulations (CFR) Part 58. KHC will conduct this review.

Debt Service Coverage – Minimum debt service coverage ratio of 1.25 in year 1 is required for insured 9 percent Housing Credit projects based on annualized financial statements. The gross rental income, Gross Potential Rent (GPR), shall be underwritten as the lower of actual rent per unit or the Housing Credit maximum allowable rent. In addition, vacancy will be underwritten at a minimum of 7 percent for insured 9 percent Housing Credit projects. If the property's local submarket is less than 85 percent occupancy, an additional 2 percent vacancy will be added to the underwritten vacancy calculation.

Reserve for Replacement (R4R) – The greater of $275 per unit for new construction or $325 per unit for rehabilitation (or higher if required by equity investor). The R4R shall be held as a reserve by KHC for capital repairs and must be paid monthly. KHC may require an initial deposit to be made to the reserve account as determined by the PCNA and estimated future repairs.

Operating Deficit Reserve (ODR) – Prior to funding, an amount equal to 6 months debt service and 6 months of projected operating expenses (or higher if required by equity investor) must be deposited in a separate ODR account to be to be held by KHC. See KHC's Multifamily Finance Guidelines for additional requirements for ODR.

Site Inspection – A site inspection will be required prior to permanent loan closing. In addition, at the end of year 10, a Property Condition Analysis will be ordered at the expense of the property owner. The analysis can be paid from replacement reserves if adequate funds are available in the account.

Servicing:

KHC will be responsible for billing, collecting, and servicing of loan disbursements and loan payments.

Compliance:

Risk-Sharing requires all projects to be audited annually in conformance with the HUD Consolidated Audit Guide. Audits for each year must be submitted to KHC no later than 90 days after the borrower's fiscal year end.

All Risk-Sharing loan documents will be subject to a regulatory agreement which, among other things, states, "Owners shall not without prior written approval…assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs." Reasonable operating expenses and necessary repairs, for the purpose of this section, include reasonable expenses necessary to operate and repair the physical project, including normal properly management fees. However, it would not include related party fees that are not critical to keep the project operating on a daily basis. Examples would include partnership management fees, asset management fees, incentive management fees and etc. Any such fees that would result in an assignment, transfer, disposal of, or encumbrance of any personal property of the project prior to determining the money is available through the normal surplus cash calculation, would first need to receive specific written approval from KHC.

Projects must adhere to all KHC compliance monitoring procedures.

If **HOME funds** were utilized in the project, records must be retained for five years after the project completion date.

Affordability Period:

The affordability period shall be equal to the term of the original first mortgage loan.

A deed restriction equal to the term of the loan will be recorded against the property for the affordability period.

APPENDIX B
KHC Risk-Sharing Product Details

Forward Commitment Extensions

Forward Commitment Extension Requirements:

- Once a forward commitment is in place, it is possible to request an extension of up to six months, subject to KHC and the Participating Lenders approval. The extension is subject to a fee and an interest rate adjustment.
- In order for a Forward Commitment Period to be extended, the property must be performing at close to stabilization and forecasted to be fully stabilized during the extension period.
- Submissions for consideration of extensions to existing forward commitments should include the following analysis:
  - ☐ Summary report of project status, reason for delay, verification that mortgage loan will likely close at end of extension period, and confirmation that there has been no material adverse change impacting the borrower, property, or project.
  - ☐ Evidence of extension of letter of credit, if applicable.
  - ☐ Analysis of construction loan draw schedule and equity investment schedule.
  - ☐ Analysis of current lease-up or market absorption of units, including comparison to underwritten rents and a rent roll analysis– occupancy/rent/arrearage.
  - ☐ Analysis of borrower and property manager's ability to comply with regulatory requirements, if applicable, including Low Income Housing Tax Credit compliance and any environmental regulations.
  - ☐ If an extension is requested, an updated appraisal will be required when the original appraisal is older than 24 months at the time of the extended forward commitment conversion date.

Extension Fees

Extension fees are established at the discretion of KHC and the Participating Lenders. Current fees (Forward Extension Period - Extension Fee):

- 1 month or less - 35 basis points
- 2 months - 40 basis points
- 3 months - 45 basis points
- 4 months - 50 basis points
- 5 months - 55 basis points
- 6 months - 60 basis points

Interest Rate Adjustment

- If the pre-approved interest rate is less than the current minimum acceptable rate, the borrower must either buy-down the interest rate or increase the interest rate to the current Participating Lenders minimum acceptable rate.
- If the borrower elects to buy-down the interest rate, an amount equal to the present value of the difference of the preapproved forward interest rate and current Participating Lenders minimum acceptable rate over the life of the loan must be paid prior to forward loan commitment extension.
- KHC will provide borrowers with an analysis of the interest rate adjustment options upon extension approval.

Loan Resizing

- No additional compensation will be required for a loan size increase or decrease equal to or less than 5% of the formally committed loan amount.
- For loan size increases or decreases greater than 5%, but less than 15%, a $1,200 resizing fee will be charged plus the following:
    - For increases, KHC will price the additional amount using the current Participating Lenders pricing parameters. The interest rate will become a blended rate between the original loan amount at the original interest rate and the increase in loan amount at the new interest rate.
    - For decreases, KHC will require a non-delivery fee based on the amount of the decrease as calculated in accordance with the commitment letter.
- KHC considers a loan size increase or decrease of more than 15% to be a material change that would require new underwriting. As such, KHC considers such requests as a request for a new commitment, and therefore the existing commitment is considered null and void, and subject to the non-delivery fee.

Commitment Breakage

If the borrower is unable to convert to a permanent mortgage loan for any reason prior to expiration of the forward commitment period, the commitment is considered null and void and is subject to the non-delivery fee.

Non-Delivery Fee

If the borrower fails to close, a non-delivery fee must be paid equal to the greater of the present value of the difference of the committed forward interest rate and the current Participating Lender's minimum acceptable rate over the life of the loan **or** 3% of the committed loan amount. KHC will provide the borrower with a final non-delivery fee calculation. Borrowers must provide a personal guarantee to KHC for payment of this fee.