AGM Financial Services, Inc.

Financing Communities with FHA

FHA 221(d)4 Financing

Affordable Multifamily New Construction

For affordable multifamily new construction, think FHA.

FHA-insured financing for multifamily new construction offers borrowers several advantages, including:

- **Better Underwriting**
- **Rates Fixed at Construction Closing**
- **No Hurdle to get to the Permanent Loan**
- **All in a Single Construction/Permanent Loan**

FHA-insured loans for most affordable new construction are generally sized to the lesser of:

- **1.15 Debt Service Coverage**
- **87% Loan-To-Cost**

It is important to note that, in practice, most affordable projects have much lower leverage and higher coverage, driven by the need for gap financing and LIHTC investor requirements.

FHA-insured loans for new construction have a **40-year term** and are fully amortizing. There is no loan-to-value test on new construction.

To qualify for affordable underwriting (and MIP, *see below*) affordable project must comply with the requirements of the Low Income Housing Tax Credit (LIHTC) program, including unit set-asides (20% at 50% of AMI or 40% at 60% of AMI), a minimum 15-year compliance period, and a regulatory agreement recorded by a governmental body.

Other Loan Terms

Interest rates on FHA-insured loans are **fixed** just before closing. Rates remain fixed at that same rate through construction and for the life of the loan. An FHA-insured loan for new construction is a single loan with **up to 24 months** for construction (consistent with the term of your construction contract) and **a full 40-year term** after construction. As a single loan, there is no conversion or “hurdle” to the permanent loan (that is, no occupancy or debt service coverage tests). An audit of project costs is required, but that is almost always required for affordable projects in any event.

FHA-insured loans are fully **non-recourse,** subject to certain “carve-outs” such as fraud, theft of funds, or unapproved transfers of ownership interests. These carve-outs do not change the non-recourse nature of the loan but do require that a key individual accept personal liability for these “bad boy” acts.

FHA-insured loans are **fully assumable and prepayable** at any time, though subject to declining prepayment penalties, typically for the first ten years of the loan term. Most loans stay in place for the initial 15-year LIHTC compliance period, so prepayment penalties don’t often come into play, except when rates fall significantly. Prepayment penalties can be customized to fit your plans and your rate expectations, usually with a modest adjustment to the interest rate.

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Process

The process for obtaining an FHA-insured loan for new construction has three steps – concept meeting, pre-app, and firm application.

The **concept meeting** is your chance to present your project directly to HUD staff. AGM will prepare a concept package outlining the project as you understand it at this early stage, typically including a preliminary *pro forma*, a preliminary *market study*, an existing Phase 1 environmental study, and background on the development team. Renderings, sketch site plans, and any schematic plans are helpful but not necessary at this early stage.

The goal of the concept meeting is an encouragement letter from HUD, opening the way to the pre-app stage and often identifying any issues or concerns from HUD staff. Other than the cost of the market study, there is no cost for the concept meeting and no fee to HUD or AGM.

Most affordable projects move more quickly through the loan process, skipping the **pre-app** stage and going straight to an application for a firm commitment.

The **firm application** includes an updated appraisal, an updated market study, a mortgage credit analysis completed by AGM, 80% plans and specifications, and independent reviews of the plans and costs. The application fee to HUD at this stage is an additional 0.15% of the mortgage amount. By the time we are ready to submit the firm application, the deal and the development team are largely set, with a general contractor, firm construction pricing (including Davis Bacon wages), and a qualified management agent all in place.

Timing

Generally, the entire process, from AGM's initial loan sizing to closing, takes nine to twelve months, including three to four months, to complete plans to 80% and to get firm construction pricing based on those plans.

For projects financed with tax-exempt bonds and 4% LIHTC credits, the FHA process is typically not a limiting factor, as the process at the state level for allocating, underwriting, and closing tax-exempt bonds is almost always longer than the FHA process.

MIP

In exchange for providing mortgage insurance (and making your loan nonrecourse), FHA charges a fee in the form of a Mortgage Insurance Premium, or MIP. FHA offers its lowest MIP rate for affordable projects subject to LIHTC and tax-exempt bond regulatory agreements at 0.25% of the outstanding mortgage balance. MIP premiums for the construction period are paid upfront at closing. After construction, one-twelfth of the annual MIP is paid with your monthly mortgage payment.

Fees

Fees associated with an FHA-insured loan for new construction include:

- A HUD application fee equal to 0.3% of the mortgage.
- A HUD inspection fee equal to 0.5% of the mortgage.
- A financing fee to AGM is paid at closing.
- Miscellaneous debt placement and lender legal fees.
- Typical third-party costs such as appraisal, market study, environmental reports, and plan and cost review.

Escrows

At closing, borrowers must fund certain escrows that are available to the project during construction and lease-up. These include:

- 2% Working Capital for lease-up and early operations.
- 2% Additional Working Capital as construction contingency.
- Operating Deficit Escrow, generally 3% of the mortgage amount to cover operating shortfalls in the first year after completion.

Secondary financing is allowed with an FHA-insured loan with certain restrictions. Secondary debt secured by the property is allowed only from public – federal, state, or local – sources, must have a term at least as long as the FHA-insured senior loan, and can be repaid only from surplus cash. Secondary debt from private sources must be unsecured and is similarly repayable only from surplus cash.

Founded in 1990, AGM is a leading FHA lender and GNMA seller/servicer. Family-owned with over 30 years of experience, the firm has closed over $10 billion in FHA-insured multifamily project loans nationwide. We underwrite, fund, and service all of our loans. Developers and owners can count on AGM to be accessible, transparent, consistent, and ready to lend.

We welcome the opportunity to discuss how AGM can help you close your next deal.

Myles Perkins, President & Owner
443-573-2054 | mperkins@agmfinancial.com

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MARKET RATE & AFFORDABLE

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