AGM Financial Services, Inc.

*Financing Communities with FHA*

## FHA 221(d)4 Financing

# Market Rate Multifamily New Construction

## For ground-up new construction, think FHA.

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

- **Fixed Rates**
- **No Recourse**
- **Higher Leverage**
- **Longer amortization**
- **Single construction/permanent loan**
- **No limits on rents, tenants, or returns**

**FHA loans up to $125 million are generally sized to the lesser of two amounts based on one of the following criteria:**

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

### Debt Service Coverage

The amount of debt a project can support based on its projected net operating income (rental and other income less operating expenses and reserves) and the loan's interest rate and term. FHA-insured loans for new construction have a 40-year term and are fully amortizing.

### Loan-to-Cost

The loan amount is based on 85% of FHA-recognized costs, including construction costs, land value, and most soft costs, along with an allowance for developer fees and builder profit.

The tests for loans greater than $125 million are 1.30 debt service coverage and 75% loan-to-cost.

There is a third test based on *statutory limits* - programmatic maximums adjusted for local market conditions. Statutory limits generally come into play only in high-cost markets or for high-cost projects. There is no loan-to-value test on new construction.

### Other Loan Terms

Interest rates on FHA-insured loans are fixed just before closing and 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), though an audit of project development costs is required.

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. The typical prepayment penalty structure includes a 10% penalty in year 1, then declining 1% per year until year 10, when the loan is prepayable without penalty. Prepayment penalties can be customized to fit your long-term plans for the property, 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.

The **pre-app** includes an updated market study and Phase 1 environmental study, an appraisal, and a very limited set of schematic drawings, including a site plan, a building plan, an elevation, and a typical wall section. At this stage, the application fee to HUD is 0.15% of the mortgage amount. The goal of the pre-app is an *invitation to apply for a firm commitment* to mortgage insurance.

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.

### 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. For projects designed to achieve one of several green building certifications, the annual mortgage insurance premium is 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.
Green building certifications recognized by HUD include the National Green Building Standard and various LEED and Energy Star certifications.

### 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.**

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