

## **PRIMING THE PUMP: PROGRAMS TO ENCOURAGE LENDERS TO LEND**

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Despite the difficulty potential borrowers are facing when it comes to obtaining financing for their real estate projects these days, one area where some lenders are willing to lend is with respect to the acquisition, refinancing, rehabilitation and/or construction of multifamily rental housing projects such as apartment buildings. This willingness to lend is due in part to various programs, such as those described in more detail below, which provide lenders with greater security in the event of a borrower default.

### **I. The Federal Housing Administration**

The Federal Housing Administration (the “FHA”), as part of the Department of Housing and Urban Development’s (“HUD”) Office of Housing, provides mortgage insurance on loans provided by certain FHA-approved lenders. This is important because of the extra layer of protection which mortgage insurance provides to lenders in the event that a borrower defaults under its loan. If a borrower defaults on an FHA-insured loan, the FHA will pay a mortgage insurance claim to the lender. As a result of the protection offered to lenders by mortgage insurance, borrowers under FHA-insured loans are usually required to provide very little cash investment (as compared to conventional loans) at closing (<http://www.hud.gov/offices/hsg/fhahistory.cfm>). The primary multifamily FHA mortgage insurance programs are with respect to (i) financing of new construction or substantial rehabilitation of multifamily housing projects pursuant to the Section 221(d)(3) and/or Section 221(d)(4) Program and (ii) refinancing or financing the purchase of existing multifamily housing projects pursuant to the Section 207 and/or Section 223(f) Program ([http://portal.hud.gov/portal/page/portal/FHA\\_Home/lenders/multifamily\\_programs](http://portal.hud.gov/portal/page/portal/FHA_Home/lenders/multifamily_programs)).

#### **A. Section 221(d)(3)/221(d)(4) Program: New construction and rehabilitation**

Mortgage insurance obtained through the Section 221(d)(3) and 221(d)(4) Program is used for financing the construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income families, elderly and the handicapped. Financing of projects owned by private non-profit organizations is eligible for mortgage insurance under the Section 221(d)(3) Program (12 U.S.C.A. sec. 1715l(d)(3)) and financing of projects owned by for-profit business is eligible for mortgage insurance under the Section 221(d)(4) Program (12 U.S.C.A. sec. 1715l(d)(4)). To be eligible for mortgage insurance, financing must be used for the construction or rehabilitation of detached, semi-detached, row, walkup or elevator-style rental or cooperative housing (<http://www.hud.gov/offices/hsg/mfh/progdesc/rentcoophsg221d3n4.cfm>). Under the Section 221(d)(3) Program, loans to non-profit organizations are eligible to receive mortgage insurance

up to a maximum amount of one hundred percent (100%) of the replacement cost estimate for the project (as determined by HUD) whereas under the Section 221(d)(4) Program, qualifying for-profit organizations are eligible to receive mortgage insurance up to a maximum amount of ninety percent (90%) of the replacement cost estimate for the project (as determined by HUD) (12 U.S.C.A. sec. 1715l(d)(3) and 12 U.S.C.A. sec. 1715l(d)(4)).

B. Section 207/223(f): Purchase or refinance of existing multifamily rental housing

Mortgage insurance provided under the Section 207 and 223(f) Program can be obtained for the acquisition or refinancing of existing multifamily rental housing. At one time, mortgage insurance obtained through Section 207 was used in connection with the financing of new construction and substantial rehabilitation of multifamily housing projects; however this is no longer the case and instead, the Section 221(d)(3) and Section 221(d)(4) Programs discussed in Paragraph A above are the appropriate programs for obtaining such mortgage insurance. During the fiscal year ending in 2008, no mortgages were insured through the Section 207 Program (<http://www.hud.gov/offices/hsg/mfh/progdesc/renthsg207.cfm>).

For financing of a multifamily property to be eligible for mortgage insurance under the Section 223(f) Program, the property being financed must contain at least five (5) residential units with complete kitchens and baths and construction or substantial rehabilitation of the property (if any) must have been completed at least three (3) years prior to the date of applying for the loan for which mortgage insurance is sought (<http://www.hud.gov/offices/hsg/mfh/progdesc/purchrefi223f.cfm>). Non-critical repairs are allowed during the term of the loan under this program however, substantial rehabilitation is not allowed during the term of the loan under either the Section 207 or the 223(f) Program (<http://www.hud.gov/offices/hsg/mfh/progdesc/purchrefi223f.cfm>). As a result, developers and lenders tend to obtain financing and apply for mortgage insurance, respectively, under the Section 221(d)(4) Program mentioned above. (<http://www.hud.gov/offices/hsg/mfh/progdesc/renthsg207.cfm>)

II. Government National Mortgage Association

The Government National Mortgage Association (“Ginnie Mae”) is a government sponsored enterprise within HUD. Ginnie Mae guarantees the payment of principal and interest on certain mortgage-backed securities. Mortgage-backed securities are groups of mortgages called “pools” which serve as collateral for the issuance of securities on the secondary market. Ginnie Mae has strict requirements as to the mortgages which may comprise such pools and participate in the Ginnie Mae program including, without limitation, requirements that a mortgage pool must consist of similar types of mortgages (e.g. all multifamily or all single family), and that all mortgage loans within a pool must bear the same interest rates and must also

be insured by a federal loan insurance program such as the FHA's mortgage insurance programs mentioned above (<http://www.ginniemae.gov/about/about.asp?subTitle=About>). As a result of the Ginnie Mae program, participating lenders are able to obtain a better price for their mortgages when placing them on the secondary market because of the Ginnie Mae guarantees and, as a result of such favorable pricing, are able to use the profits to make more loans for the benefit of low and moderate – income families.

### III. Federal Home Loan Mortgage Association

The Federal Home Loan Mortgage Association ("Freddie Mac"), a federally chartered corporation, also provides financing for multifamily housing projects. Specifically, Freddie Mac purchases existing mortgages on multifamily housing projects from lenders which are part of "Freddie Mac's Program Plus Network" and either retains the mortgages in its own portfolio or packages them into securities which are then sold to investors on the secondary market. Unlike Ginnie Mae, Freddie Mac does not guarantee the payment of principal and interest on government-insured mortgages.

In order to be eligible to be a part of Freddie Mac's Program Plus Network, a lender must first meet certain minimum standards including, without limitation, requirements that the lender (1) have a minimum adjusted net worth of Two Million Dollars (\$2,000,000); (2) maintain minimum liquid assets of Two Hundred Thousand Dollars (\$200,000); (3) have a minimum servicing volume of either (i) Two Hundred Million Dollars (\$200,000,000) worth of mortgages secured by income properties (including Fifty Million Dollars (\$50,000,000) worth of mortgages secured by multifamily properties) or (ii) One Hundred Million Dollars (\$100,000,000) worth of mortgages secured by multifamily properties; and (4) have a minimum of One Hundred Fifty (150) mortgages secured by income properties and/or multifamily properties (<http://www.freddiemac.com/multifamily/sellhowto.htm>). If a lender meets those minimum requirements, it can submit an application request form, which can be found on the Freddie Mac website at <http://www.freddiemac.com>. If one of Freddie Mac's regional directors of loan production determines that there is a "market need" for such lender, the regional director will then contact the lender (<http://www.freddiemac.com/multifamily/sellhowto.htm>).

Freddie Mac's Program Plus Network lenders offer a variety of financing (including fixed-rate mortgage programs and adjustable-rate mortgage programs). Eligible borrowers under Freddie Mac's conventional mortgage program include general and limited partnerships, corporations, trusts, joint ventures, limited liability companies or individuals. The loans that are eligible under its conventional mortgage program include acquisition, refinancing, and acquisition rehabilitation loans. The conventional mortgage program typically allows a 30 year maximum amortization period and usually requires replacement reserves, and real estate tax and property insurance escrows. The standard loan application fee is the greater of Two Thousand

Dollars (\$2,000) or 0.1% of the loan amount. Under the conventional mortgage program, the minimum occupancy requirement is generally 90% for ninety (90) days prior to closing and loans are usually non-recourse (subject to certain standard carve-outs such as for fraud) ([http://www.freddiemac.com/multifamily/termsheet\\_genreqcmo.html](http://www.freddiemac.com/multifamily/termsheet_genreqcmo.html)).

In addition, Freddie Mac offers two different rate lock options for borrowers financing multifamily housing projects to lock in their interest rate and establish a mortgage amount after initial underwriting review but prior to the time that the Freddie Mac Program Plus Network lender submits its final underwriting package to Freddie Mac for approval. “Early Rate – Lock” allows a borrower to lock the interest rate up to four (4) months prior to the purchase of the mortgage by Freddie Mac and “Extended Early Rate-Lock” allows a borrower to lock the interest rate between five and twelve months prior to the purchase of the mortgage by Freddie Mac (<http://www.freddiemac.com/multifamily/pdf/ataglance-cmo.pdf>).

In 2008, Freddie Mac settled \$18,800,000,000 through its various commercial loan programs for various multifamily housing projects ([http://www.freddiemac.com/news/archives/multifamily/2009/20090209\\_multifamily.html](http://www.freddiemac.com/news/archives/multifamily/2009/20090209_multifamily.html)).

#### IV. Federal National Mortgage Association

The Federal National Mortgage Association (“Fannie Mae”) is also a federally chartered, government sponsored enterprise. Fannie Mae provides financing for market rate and/or affordable multifamily housing. Similar to Freddie Mac, Fannie Mae provides such financing through certain approved lenders and does not guarantee government-issued mortgages but instead guarantees payment of principal and interest on mortgages which it purchases from its approved lenders. Fannie Mae approved lenders are referred to as Delegated Underwriting and Servicing (“DUS”) lenders.

Fannie Mae offers a variety of loan programs (including fixed-rate mortgages and adjustable-rate mortgages) (<https://www.efanniemae.com/mf/finsolutions/pdf/dus.pdf>). Provided such entity is creditworthy, any single-asset entity organized in the United States (with all U.S. principals) is eligible to be a borrower under Fannie Mae’s standard DUS mortgage program. Loans that are eligible under its standard DUS mortgage program include acquisition, or refinancing of multifamily housing properties. The multifamily housing properties must have a minimum of five units. Loans made pursuant to the standard DUS mortgage program offerings include (but are not limited to) loans with a 30-year maximum amortization period and replacement reserves, real estate tax escrows and property insurance escrows are usually required -- particularly for higher leverage transactions. Loans in amounts greater than One Million Five Hundred Thousand Dollars (\$1,500,000) are usually non-recourse (subject to certain standard carve-outs). Fannie Mae also offers an extended rate lock which allows a borrower to lock in an

interest rate forty-five (45) days to one year prior to loan closing (<https://www.efanniemae.com/mf/finsolutions/products/pdf/standarddus.pdf>).

On July 20, 2009, Fannie Mae announced that it (in coordination with its lenders and housing partners) provided \$1,100,000,000 in small loans (loans of up to \$3,000,000 or \$5,000,000 for certain high cost areas) for the multifamily rental housing market during the first half of 2009 (<http://www.fanniemae.com/newsreleases/2009/4757.jhtml?p=Media&s=News+Releases>).

These are just a few of the programs out there providing financing options with respect to multifamily rental housing projects. For more in-depth information about the specific products and services available, you should contact your lender directly to find out if it is part of the various approved networks of lenders providing services under the programs offered by the FHA, Ginnie Mae, Freddie Mac, or Fannie Mae.

If you have any questions about these loan programs, please contact Sheelagh Allston at (410) 895-1207 or [sallston@rosenbergmartin.com](mailto:sallston@rosenbergmartin.com). If you need any assistance with any of your other real estate needs, please contact an attorney in our real estate group:

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