U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

MEMORANDUM FOR: Julia R. Gordon Assistant Secretary for Housing –
FHA Commissioner, H

THROUGH: Janet M. Golrick, Acting, Chief of Staff for Housing, H

THROUGH: Vance T. Morris, Associate General Deputy Assistant Secretary
for Housing, H

ETHAN HANDELMAN
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FROM: Ethan D. Handelman, Deputy Assistant Secretary, Multifamily
Housing Programs, HT

SUBJECT: Proposed Mortgagee Letter Amending the 2020 MAP Guide concerning methods of calculating cost not attributable to dwelling use-Criterion 4 of HUD Form 92264A, determination of maximum insured mortgage amount

I. OBJECTIVE

HUD proposes to simplify its method for calculating costs-not-attributable to dwelling use for multifamily insured loan applicants where proposed loan amounts exceed the "Statutory Limits." The change reduces the time and effort by lenders and HUD staff to calculate and apply the statutory limits for insured multifamily loans with no material impact on resulting loan amounts and with no increase in risk. The change takes the form of a new Appendix A.5.10 replacing the current Multifamily Accelerated Program (MAP) Guide Appendices A.5.10 and A.5.11 with additional minor changes in related sections to conform all instructions to the new method.

II. BACKGROUND

Consideration of this simplification was initiated after publication of the 2020 MAP Guide which among many changes, extended the concept of "cost-not-attributable" to refinance applications, an expansion of the number of applications where the calculation is relevant. This earlier, 2020 MAP Guide change was intended to expand the utility of HUD's insured refinance program in high-cost metropolitan markets. The current proposed simplification is intended to improve underwriting efficiency and to support the intended improved access to HUD's refinance program in high-cost markets. But the simplification is also needed to streamline multifamily underwriting processes in light of the high business volume seen in recent years. The change also improves lenders' ability to provide customers with an accurate, early forecast of expected loan amount in cases where the statutory limits may be a limiting factor.

There is no intent to materially change the underwriting results or loan amounts resulting from costs-not-attributable. Testing indicates that use of the proposed methodology results in an average modest increase in mortgage amounts for projects where Criterion 4 is the determining limitation with no observed adverse impacts. For most insured loan applications, mortgage amount is determined by risk-based criteria such as a minimum required debt-service-coverage-ratio (DSCR) or a maximum allowed loan- to-value (or cost) ratio (LTV). But in high-cost markets, the statutory limits are relevant in a greater minority of cases and the proposed change simplifies underwriting of those cases. When a proposed mortgage is limited by Criterion 4-Statutory Limits, there is no implication of greater risk because the prevailing criterion is always the lowest of all those calculated. This means that the same project would have a larger loan if the amount were determined by the risk-based underwriting ratios.

III. BUSINESS JUSTIFICATION

HUD's longstanding method for calculating cost-not-attributable was developed first in the early years of HUD multifamily mortgage programs. For decades the procedure was only invoked for new construction or substantial rehabilitation projects, typically higher cost proposals in high-cost markets. The method relied on the availability of detailed cost studies usually available for construction loans. Even with the availability of cost estimates, the method relied on an identification and itemization of spaces or costs not attributable to dwelling units. The method was an excessively detailed recalculation of mortgageable costs separating costs attributable to dwelling units from costs of spaces or project features not attributable to dwelling use. The distinction between an attributable versus a non-attributable space or cost was often a source of dispute. But, since costs not attributable applied to a small minority of construction loans, there was little inclination to devise a less laborious method of estimating costs-not-attributable.

But the 2020 MAP Guide published December 18, 2020, extended the concept of costs-not-attributable to refinancing of existing properties under Section 223(f). This extension recognized two facts:

1. In Mortgagee Letter 2020-03, HUD extended refinancing eligibility to newly built projects as soon as the project achieved a minimum of one-month of underwritten debt service coverage. Previously, refinancing was limited to projects with a minimum of three years of operating history.
2. Section 223(f) had limited utility in high-cost markets where Criterion 4 more frequently limited mortgage amounts to sums less than those justified by risk-based criteria such as DSCR and LTV. This restraint was (is) particularly burdensome on newly built projects now eligible for refinancing per Mortgagee Letter 2020-03.

Once consultations with lenders and HUD staff yielded a workable revision for Section 223(f) cases, HUD recognized that the same method readily applied to construction loans and if employed would result in further simplification of instructions and further underwriting efficiencies. Accordingly, the proposed new method wholly replaces former instructions for the calculation of costs-not-attributable for all insured mortgage programs. Note that Criterion 4 does not apply to refinancing of existing insured mortgages under Section 223(a)(7) because in that program mortgage amount may not exceed the original insured mortgage amount, which itself would have been underwritten consistent with the applicable statutory limits.

IV. ANTICIPATED SAVINGS / COSTS / PUBLIC BURDENS

The proposed change reduces the number of pages of MAP Guide instruction concerning cost-not-attributable from the present 10 pages to 4 pages. Anticipated savings are reduced time inputs for lenders and HUD staff. Lenders we consulted advised that average time needed to calculate cost-not-attributable would decrease by at least 4 hours in every instance in which the calculation is considered material, which means whenever there is a possibility that the Criterion 4 calculation may be material to determining the maximum mortgage on HUD form 92264A. The proposed method relies on figures or values already established as standard underwriting practice for all insured loan applications. The former method required additional detailed calculations for various project spaces and features.

We estimate that Criteria 4 is material in only about 10% of all applications which at current volume would be 100 to 150 cases per annum. This results in an estimated 400 to 600 hours of reduced lender time required to complete cost-not-attributable calculations generally with a corresponding equal amount of staff time to confirm the same calculations. However, this does not account for those cases where Criterion 4 is the lowest mortgage limit and therefore the prevailing limit. In these cases, lenders invest significant additional time and, also, often retain additional third-party expertise to carefully review and calculate every square foot of space and dollar of cost as may be considered "not-attributable" to dwelling units. This is because every dollar of such costs identified results in a corresponding increase in the allowed mortgage amount, until the calculated Criterion 4 amount equals or exceeds one of the other Criteria, usually Criterion 3, loan to value, or Criterion 5, debt service coverage. This concentrated effort can consume multiple days, additional thousands of dollars in third-party analysts costs as well as significant additional HUD staff time consumed to review these often-disputed calculations. We estimate this intense use of time and money occurs in 50 cases per year generating as many as 2,000 hours and $150,000 in lender resources.

A fundamental premise supporting the proposed revisions is that such focused attention on a few cases is wasteful and unwarranted because it does not reduce risk and has little or no impact on the general application of the statutory limits. Accordingly, the simplification of the method of calculating cost-not-attributable, is of little concern for most applicants, but a significant savings to some. While marginal in the context of HUD's overall insured loan volume, improved efficiency at any scale is highly desired in the present business environment of successive years of record loan volume and lengthy queues.

IV. POSSIBLE CONTROVERSIES

There are no observed or likely controversies or objections to the proposed simplification.

FHA's multifamily lenders are fully supportive, indeed enthusiastic, about the proposed new methodology for calculating cost not attributable.

VI. <u>HUD IT IMPACTS</u>

There are no anticipated impacts on HUD information technology.

VII. <u>TARGET PUBLICATION DATE:</u> As soon as possible following completion of Paperwork Reduction Act review. While the proposed MAP Guide changes are reviewed and given effect through the proposed Mortgagee Letter, the actual changes to the MAP Guide text will be made, (along with other errata corrections or changes approved in other Mortgagee Letters) and the MAP Guide republished at a single point in time more or less contemporaneous with the date of the Mortgagee Letter.

VIII. <u>POINT OF CONTACT:</u>

For questions about this Mortgagee Letter, Contact David B. Wilderman, Director of Technical Support at (202) 402-2803 or Thomas A. Bernaciak, Deputy Director, Office of Multifamily Production at (202) 402-3242.

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