Tools for Multifamily HUD Insured Loans in Light of COVID-19

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Like other areas of commercial lending, loans insured by the Department of Housing and Urban Development (HUD) are facing changes in light of the COVID-19 outbreak. While HUD does not typically make direct loans for real property, it underwrites and insures loans made by lenders approved by the Federal Housing Administration (FHA) and drives many of the underlying requirements made by those lenders. Although there are a variety of HUD and FHA programs, our focus for this article will mainly be on HUD-insured loans for multifamily properties, such as those under the Sections 223(f) and 221(d)(4) programs.

View part II of this topic here: Tools for Multifamily HUD Insured Loans in Light of COVID-19 Part II

General Guidelines for Property Owners

Currently, HUD's response to the COVID-19 pandemic has been limited with respect to HUD-insured loans for multifamily properties, but HUD is providing advice with respect to interpreting existing guidelines. First and foremost, HUD reminds owners and their agents to follow directions from the Centers for Disease Control and Prevention (CDC), which is being updated daily. In addition to CDC guidelines, property owners should also continue to track the recommendations from local health officials where their properties are located.

If a property owner is aware of a resident or family member who is required to be kept separate from other family members he or she is living with, a property owner may temporarily relocate that person to an available vacant unit. Before relocating the tenant or family member, the property owner or manager should request written verification from a medical health professional or through the local health department. Additionally, the property owner should make sure that any areas, including common areas, hallways and elevators, that are suspected of being visited by someone infected

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by COVID-19 are disinfected pursuant to CDC guidance.

HUD Policy & Operations of Multifamily Facilities

Multifamily Emergency/Disaster Guidance. Chapter 38 of the Multifamily Asset Management and Project Servicing handbook (Asset Management Handbook) pertains to HUD Multifamily Emergency/Disaster Guidance. Although that chapter does not specifically contemplate the sort of issues everyone is dealing with during the current pandemic, HUD is in the process of updating the chapter to include infectious disease protocol. That being said, HUD does recommend that owners review Chapter 38 in its current form for assistance in dealing with the pandemic and authorizes program participants to rely on its guidance.

Operating Accounts. The Asset Management Handbook is also a good source to determine what funds can be utilized and accessed in responding to the virus outbreak. According to Questions and Answers for Office of Multifamily Housing Stakeholders (Q&A), issued on April 2, 2020, by FHA, owners of multifamily properties may use operating accounts for a property to cover expenses that are reasonable and necessary to prepare and respond to the COVID-19 pandemic, including supplies, staff hours and overtime. The use of operating accounts in this manner does not require prior approval from HUD.

Reserve for Replacement or Residual Receipts Accounts. If a property owner advances funds, then the owner needs to obtain prior approval from HUD before making such an advance, and repayment of those funds can only be prepaid once there is sufficient cash flow to meet all of the property's needs. Chapters 4 and 25 of the Asset Management Handbook detail additional requirements for accessing funds held in a Reserve for Replacement Account or Residual Receipts Account (each requiring prior HUD approval to access). HUD may authorize use of funds being held in Reserve for Replacement Accounts to pay debt service, but the property owner will need to request the release of those funds through their Account Executive and local field office using the form HUD-9250. The owner should provide explanations of the cash shortfall and promise to repay those funds into the Reserve for

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Replacement Account in the future. In its review of such a request, HUD will consider the history of the property, including cash flow, amount of funds available in its Reserve for Replacement Account, and compliance with HUD requirements.

Debt Service Requirements. In Mortgagee Letter 2020-11, HUD addresses Section 223(f) Underwriting Mitigants for Multifamily Housing Projects Due to Economic Impact of COVID-19 Emergency. Most notably, this mortgagee letter provides guidance that HUD underwriting will use to offset anticipated operating losses for 223(f) transactions after closing. For market rate transactions that have not rate-locked yet, HUD will require a nine-month debt service reserve fund (cash or letter of credit) to be held by the lender.

For projects with new Low-Income Housing Tax Credits, HUD will review the investor lease-up requirements and the investor operating deficit reserve requirements with respect to their adequacy and availability to the borrower. If HUD determines the reserves are not adequate, HUD may increase the reserve amounts up to an additional six to nine-months of debt service. For refinance projects with existing credits, HUD will require a 12-month reserve which may be modified.

Projects with greater than 90% Section 8 Project Based Rental Assistance will not be required to post a debt service reserve escrow.

Significantly, if a project has already received a firm commitment not within the above parameters, HUD has decided that the COVID-19 pandemic has resulted in a material adverse change in the real estate markets, and HUD will require the above mitigants to offset this additional risk.

Recertifications. In addition to owners being required to operate their properties consistent with HUD guidelines, owners and tenants must continue to perform annual and interim recertifications as compelled by statute. HUD statute and regulations dictate that family incomes be reviewed on at least an annual basis to determine the rent amount to be paid by the family. HUD considers the CDC recommendations for shelter-in-place and similar orders

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as extenuating circumstances and, therefore, it will allow tenants that may have lost income due to the COVID-19 pandemic to self-certify for annual or interim certifications.

Access for Repairs. With a significant part of the country facing stay-in-place and similar orders, making repairs to facilities becomes more difficult. When required to make repairs that necessitate entry into a tenant unit, HUD advises that maintenance personnel may ask if it is safe to enter the unit but not if the resident is infected with the COVID-19 virus. If the required repairs are non-essential or non-health and safety related, and maintenance personnel are not comfortable entering the unit because of potential COVID-19 exposure, the property owner or manager should consult local health officials regarding any precautions that should be taken.

Surety Bonds and Builder's Risk Insurance. For HUD projects undergoing construction, the property owner needs to review any Owner-Architect Agreement or Owner-General Contractor Agreement to determine what contingencies (if any) are provided for in the event of an emergency. The parties to these agreements need to understand that HUD cannot change any of those provisions. However, the parties should be in communication with HUD if any changes are to be made to mitigate any affects as a result of the COVID-19 outbreak. In addition to keeping contact with the FHA lender and HUD, property owners and general contractors need to be proactive in assuring that Surety Bonds and Builder's Risk Insurance policies remain in place and will not be impaired.

Suspended or Limited Access During Construction. If construction is halted due to a shelter-in-place or similar orders, the parties should make regular updates to the FHA lender and HUD. Additionally, if a job site is shut down, the general contractor (or the owner if there is no general contractor) needs to ensure that the worksite is properly secured and unused materials are secured. In the event that limited work is continuing on a job site, procedures should be put in place for employees to exercise appropriate "social distancing" practices.

Change Orders. Whether a job site is facing a temporary shutdown or a reduced work schedule, it is expected that the current

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pandemic will result in delays in construction work. With respect to such delays on a HUD project, the appropriate party, whether it is the owner, the architect, or the general contractor, should make progress reports on the construction on a monthly basis with their requests for reimbursement of cost and associated inspection trip report. Requests for change orders for time extensions should include documentation specifically identifying delays that are a result of the COVID-19 situation. Ordinarily, HUD does not allow for time extensions to the Repair Escrows under Sections 223(f) and 223(a)(7) (these sections pertain to acquisition or refinancing of multifamily properties), HUD will consider amendments to Repair Escrow Agreements for projects facing delays due to the coronavirus.

Construction Inspections. Projects that are undergoing new construction or substantial rehabilitation require that a HUD Inspector verify the work that was completed. Because of problems of having HUD Inspectors being able to verify completed work on-site due to the COVID-19 pandemic, HUD is authorizing virtual inspections to take the place of on-site inspections. In most cases, HUD will accept a recorded virtual inspection, along with a virtual site meeting, of the completed work from the supervising architect. If faced with a situation that may result in a virtual inspection, parties will need to coordinate these efforts among the supervising architect, HUD Inspector, general contractor and owner's representative. Even though HUD is involved with this process, the responsibility and liability of checking the work will remain with the supervising architect on the reimbursement request. Under normal circumstances, HUD requires both the supervising architect and HUD Inspector to sign off on completed work in order submit a draw request, but HUD is currently allowing a draw without the HUD Inspector's signature as a one-time event. If any work is later disallowed by the HUD Inspector, HUD will subtract that work from the draw request for the following month. In the event that neither the supervising architect nor the HUD Inspector can inspect the work, HUD is operating under the assumption that the work site has been shut down. Nevertheless, the parties should make every effort to arrange a virtual inspection as soon as possible to establish and very the amount of work that was completed prior to the shutdown

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but not yet paid.

Repair Escrows. The construction supervision and inspection requirements for Repair Escrows vary by the type and cost of the repairs. If an owner is required to make repairs that require entry into a tenant unit, then the owner should delay beginning such repairs and any current work should be completed promptly, even if not fully completed. However, unfinished work should not inhibit the tenants' full and safe use of their units, and work shall be completed as soon as practicable in accordance with CDC guidelines. In many instances, owners can provide photographs and self-certify that work is completed to draw on the repair escrows, but with construction and rehabilitation projects as noted above, the more extensive repairs can be verified as completed with a recorded virtual inspection. In cases where the owner has assurance of completion funds or a surplus cash hold-back pending completion of repairs, HUD will consider releasing surplus cash funds with adequate evidence that the repairs are complete. However, HUD will not release assurance of completion funds until all HUD required inspections are completed.

Property Reviews, Inspections & Appraisals

REAC Inspections. Until further notice, all Real Estate Assessment Center (REAC) Inspections are postponed for multifamily properties. In cases where there may be a threat to life or property at a specific location, HUD quality assurance inspectors will conduct inspections in accordance with CDC guideline.

MOR and PCBA. Because of the COVID-19 outbreak, HUD is suspending all Management and Occupancy Reviews (MOR) to be performed by Performance-Based Contract Administrators (PCBA). Once the PCBA has determined that local conditions permit such inspections safely, MORs will then resume.

RCS. HUD Rent Comparability Studies (RCS) are suspended in areas that are under a state or nationally declared emergency, or where health officials have imposed limited travel.

Site Visit Requirements for Third Parties & Lenders. If a third-party inspector cannot physically inspect the required sample units due

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to concerns over the COVID-19 outbreak, the Regional Production Director may waive the sampling requirements in favor of inspecting only vacant and model units on a case-by-case basis for recently built properties (within 10 years for currently FHA insured properties, or within 5 years for non FHA insured properties). Properties not constructed within these timeframes will require a complete inspection prior to issuance of a firm commitment.

Appraisals. Due to travel restrictions because of the coronavirus, lenders and third-party appraisers may be unable to conduct inspections of subject properties and appropriate comparable properties as required by the MAP Guide. If an appraiser cannot physically inspect the site, the appraiser should contact a local, appropriately credentialed appraiser to perform the inspection. The report must identify the appraiser, the appraiser's credentials, and a certification regarding the limit to the inspection.

If an on-site appraisal is not possible due to COVID-19-related issues, the appraiser should conduct inspections as able of vacant units. In this situation the appraiser should also consult construction drawings and other documentation to supplement the physical inspection. The appraiser should clearly document all sources used in the appraisal and contact the local field office for further guidance.

Environmental Review

On-site Visits. If access to a property is limited due to COVID-19 restrictions, and inspections regarding asbestos, lead-based paint hazards and/or radon testing are required and cannot be completed, HUD will allow lenders to submit applications without those reports. However, HUD will not issue a firm commitment until those reports have been submitted and reviewed by Multifamily Housing Production. In cases of new construction or substantial rehabilitation where such inspections would take place after project completion, the required reports must be submitted to HUD at the final completion inspection before occupancy.

HUD currently requires a site inspection for all environmental reviews. The Regional Production Director can waive this

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requirement on a case-by-case basis for applications for which an environmental report has been submitted with no significant issues (*e.g.*, underground storage tanks, site contamination, floodplain or floodways, etc.). In these cases, HUD will allow submission of an application, but will require a site visit prior to issuing a firm commitment.

Mortgagee Letter 2020-10

Site Access Issues Related to Section 232 Mortgage Insurance Applications. In addition to the guidance provided by HUD with respect to access by third parties to multifamily properties, Mortgagee Letter 2020-10 provides similar guidance to residential care facilities seeking insurance under the Section 232 program.

When parties are conducting inspections, such as Project Capital Needs Assessments, Appraisals, Phase I Environmental Site Assessments, Asbestos Surveys and Radon Testing, relief is being granted in allowing inspectors to make virtual inspections, review publicly available sources, including satellite photographs, and other means to allow the application process to proceed.

Although these steps will allow for application with HUD, the department may include special conditions to the firm commitment adding requirements that must be satisfied prior to closing. The underwriter for the FHA lender and borrower should closely coordinate their efforts to ensure all inspections will meet HUD requirements under the current conditions.

Waivers, Extensions & Other Relief

Rent Payments & Forbearance Agreements. At this time, no additional subsidy funding has been made available for tenants impacted by conditions created by COVID-19. HUD, however, does encourage all property owners to work with impacted tenants and their families to adjust rent payments, enter into forbearance agreements, and lessen the impact on affected residents.

Mortgagee Letter 2020-09. To provide additional guidance to lenders, HUD issued Mortgagee Letter 2020-09 on April 10, 2020, regarding Implementation of the Coronavirus Aid, Relief, and

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Economic Security (CARES) Act Forbearance. When contemplating their options for relief, Multifamily borrowers, lenders, servicers and HUD staff should review this letter.

Although HUD recommends pursuing other options to mitigate cash flow shortfalls due to the COVID-19 pandemic, HUD will consider requests for forbearance on multifamily loans that were current through February 1, 2020. Upon request from the multifamily borrower, the servicer shall document the financial hardship and provide the forbearance for up to 30 days (2 additional 30 day extensions may be available provided the requests are made at least 15 days before the end of the current forbearance agreement).

If a multifamily borrower receives a forbearance under the CARES Act, the borrower's rights with respect to tenant evictions, charging of late fees and penalties and other remedies are significantly curtailed. The parties will need to weigh their options carefully when contemplating relief under the CARES Act. Additionally, distributions will not be allowed under a forbearance agreement or during its repayment period.

HUD will typically not be involved with negotiations with respect to a mortgage forbearance, but the agreement will need to be approved by HUD. HUD is also requiring that lender fees related to drafting the forbearance agreement should be reasonable. For the purposes of a forbearance agreement, HUD has stated that lender fees under $750 will be considered reasonable.

During the forbearance period all material terms of the FHA Regulatory Agreement will remain in full force and effect. The provisions of the FHA Regulatory Agreement that should be kept in mind are: (i) the borrower must continue to stay current with all utilities, unless the borrower has entered into a separate forbearance agreement with the applicable utility company; (ii) the borrower must notify HUD of any property tax relief that is being offered prior to its acceptance; (iii) the borrower can only use collected rents for reasonable operating expenses or payments due to the lender pursuant to the terms of the loan documents; and (iv) the borrower shall not accept any relief that could encumber the property without the prior written approval of HUD.

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Moreover, any forbearance agreement entered into cannot require a modification of the mortgage. A modification of the mortgage will affect the underlying Ginnie Mae security and such a modification will require review and approval on an individual basis.

Continuity of HUD Operations

Electronic Signatures. Asset Management allows for electronic signatures for all subsidy administration; state and local law determines the requirements for leases and the Owner's Certification of Compliance with HUD's Tenant Eligibility and Rent Procedures (HUD-50059). With respect to HUD closings, HUD requires wet ink originals of the Note, Security Instrument, Regulatory Agreement, and other loan documents. However, closing attorneys will accept electronic copies of the original executed documents for purposes of releasing the Note at closing.

Even though HUD will accept electronic copies, HUD will not allow any additional qualifications or limitations in the HUD Opinion Letters. For documents that require HUD execution, HUD will still require originals to be delivered to and executed by the appropriate HUD Signatory. Lender's counsel should provide mailing labels for delivery of the HUD executed documents, and counsel should also be prepared to arrange for a mobile notary service for HUD to use.

Concept Meetings. Concept meetings will be conducted remotely.

Submissions. Multifamily Housing Production usually requires the submission of one original and two hard copies of the application, along with a physical thumb drive. Under current circumstances, HUD guidance is to permit applications and required documents to be submitted electronically, using a secure cloud storage device (as determined by the lender), instead of requiring hard copies. HUD will make arrangements for architectural plans and specifications to be sent to the construction analyst to review remotely.

HUD closing attorneys should accept draft closing packages in electronic form for review. Hard copies of the survey should be provided by mail to the HUD closing attorney but closing attorneys have been advised to not delay review of a closing package until the hard copy of the survey is available. However, closing will be

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contingent on adequate title and survey review and appropriate resolution of any issues.

Closings. Section 223(f) and 223(a)(7) reviews and closings are routinely completed by mail. HUD is working to expand reviews and closings by mail to include Section 221(d)(4) (new construction or substantial rehabilitation). Additional guidance will be provided by HUD as soon as it becomes available. When a closing by mail is not feasible, HUD will conduct in-person closings to the extent possible. In most cases, the only parties that would be required to attend an in-person closing are the FHA lender's counsel, HUD counsel and support staff.

Title Policies/Recorded Documents. HUD typically requires that recorded documents get recorded prior to the HUD closing. Due to recording office closings, HUD will accept gap coverage when pre-recording is not possible. That coverage will need to insure the first lien status through recordation, regardless of any unusual delay due to office closures.

A Note on Ginnie Mae Servicers. Under the Ginnie Mae Mortgage Backed Security program, servicers are required to make scheduled payments of principal and interest (P&I) to investors, even when monthly payments are not received from the borrowers. Ginnie Mae anticipates implementing a program through which issuers with a P&I shortfall may request an advance of the difference from Ginnie Mae to the investors. Details have yet to be provided, but it is expected that Ginnie Mae will offer relief first for single family projects, followed by multifamily projects shortly thereafter.

View part II of this topic here: Tools for Multifamily HUD Insured Loans in Light of COVID-19 Part II

For more information, please contact Geoff White, Amy Curry or Bob Cummings, or any attorney in Frost Brown Todd's Real Estate or Multifamily Housing team.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a Coronavirus Response Team. Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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Links to supporting documents:

HUD Mortgagee Letter 2020-09:
https://www.hud.gov/sites/dfiles/OCHCO/documents/2020-09hsngml.pdf

HUD Mortgagee Letter 2020-10:
https://www.hud.gov/sites/dfiles/OCHCO/documents/2020-10hsngml.pdf

HUD Mortgagee Letter 2020-11:
https://www.hud.gov/sites/dfiles/OCHCO/documents/2020-11hsngml.pdf

Best Practice Recommendations for Electronic Submission of Documents for Multifamily Closings during the COVIC-19 Pandemic Emergency:
https://www.hud.gov/sites/dfiles/Housing/documents/Best_Practices_for_elec
19_pandemic.pdf

Questions and Answers for Office of Multifamily Housing Stakeholders:
https://www.hud.gov/sites/dfiles/Housing/documents/HUD_Multifamily_Corona

HUD Handbook 4350.3: Occupancy Requirements of Subsidized Multifamily Housing Programs:
https://www.hud.gov/program_offices/administration/hudclips/handbooks/hsg

HUD Handbook 4350.1: Multifamily Asset Management and Project Servicing:
https://www.hud.gov/program_offices/administration/hudclips/handbooks/hsg

Ginnie in Brief – March 27, 2020:
https://www.ginniemae.gov/newsroom/GinnieInBrief/Pages/Post.aspx?PostID=4

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