



USDA'S SECTION 538 GUARANTEED PROGRAM

PART II: PRESERVATION AND REHABILITATION FOR SECTION 515 RENTAL HOUSING

THE WEBINAR WILL BEGIN PROMPTLY AT 2PM (ET)

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USDA'S SECTION 538 GUARANTEED PROGRAM

**Part II: Preservation and Rehabilitation of Section 515
Rental Housing**

**June 6, 2018
2:00 PM (ET)**



Housing Assistance Council

Building Rural Communities since 1971

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Upcoming Events

SECTION 502 PACKAGING TRAINING FOR NONPROFITS DEVELOPERS
LIVERPOOL, NY
September 24-26, 2018

HAC 2018 RURAL HOUSING CONFERENCE (RHC)
Washington, DC
December 4-7, 2018

Upcoming Events

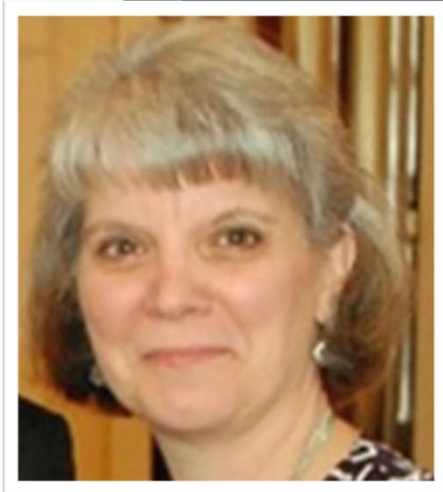
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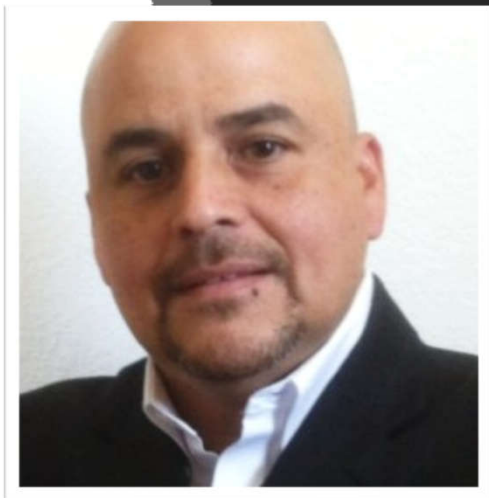
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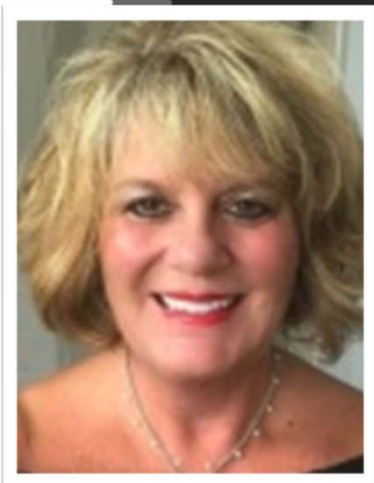


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Presented by
Melodie Taylor-Ward

Section 538 Guaranteed Program - Part II: Utilizing Sec 538 for Preservation & Rehabilitation of Section 515 Rental Housing

Section 538 Guaranteed Rural Rental Housing Program (GRRHP)

Section 538; what are we?

The program works with qualified private-sector lenders to provide financing to qualified borrowers to increase the supply of affordable rental housing for low- and moderate-income individuals and families in eligible rural areas and towns

- 👍 Loan guarantee program
- 👍 Rural rental housing
- 👍 low to moderate income tenants
- 👍 Title V of the Housing Act of 1949
- 👍 7 CFR Part 3565



Let's
Recap

Historical Perspective

The purpose of the Section 538 Guaranteed Loan Program is to increase the supply of affordable rural rental housing. It differs in some important ways from USDA's Section 515 program. Section 538 focuses on partnerships between USDA and qualified lenders, whereas Section 515 loans are directly funded from USDA to nonprofit or for-profit rural housing developers.

538 Program Overview

Types of Loans Guaranteed

- 👉 New construction
- 👉 Acquisition with Rehabilitation
- 👉 Rehabilitation



- **USDA guarantees loans made by private, USDA approved lenders, in eligible rural areas (up to 90% of the loan is guaranteed)**
- **3 Types of Loan Guarantee Products – Option 1 = perm only; Option 2 = construction/perm; Option 3 = continuous guarantee**
- **Eligible rural areas - <http://eligibility.sc.egov.usda.gov/eligibility/welcomeAction.do>**
- **No loan size restriction or cap**
- **Program allows for permanent only loans, construction/perm loans and rehab/perm loans (\$6,500/unit minimum rehab)**
- **USDA's lien must be first position**
- **USDA Fees: initial guarantee fee = 1% of the guaranteed portion of the loan; 0.50% annual fee based on principal balance of loan**
- **Rent capped at 30% of 115% of AMI**

Benefits for Developers

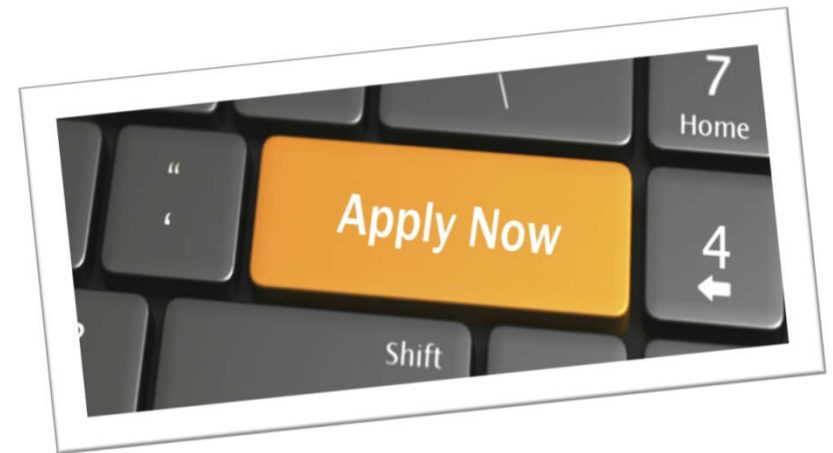
- **538 loans can be used for acquisition/rehab, rehab or new construction**
- **Maximum 90% Loan to Value (LTV) for a for-profit (97% for non-profits)**
- **Maximum Loan to Cost 90%**
- **Minimum 1.15 times DSCR on all serviceable debt**
- **Minimum term of 25 years and maximum term of 40 years**
- **Interest rate is negotiated between lender and developer is fixed over the life of the loan guarantee**
- **Program allows for conversion to perm at C of O with funding of a reserve (2% of TDC) that is used to cover operating expenses and debt service during lease up**
- **No Davis-Bacon requirement**
- **538 Loans qualify for CRA credits.**



Section 538 Guaranteed Funding

Availability of Funding

- NOSA/NOFA ??? (published in Federal Register)
- Current NOSA Open thru December 31st, 2021
- Historic annual authority averaged \$150 million
- FY 2017 Obligated \$177 million
- Program is Budget Neutral- Authority vs. Appropriations
- FY 2018 Authority level at \$230 million
- **Program is Lender Driven**



Benefits for Lenders





- 💰 90% RD Guarantee
- 💰 Lender's underwrite Loans
- 💰 100% of loan can be sold
- 💰 CRA credits
- 💰 Sell or hold servicing
- 💰 Lender retains servicing fee



Who are the Section 538 Lenders?

-  Banks
-  Mortgage Companies
-  Housing Finance Agencies
-  Real Estate Investment Trusts

Typical Section 538 Loan Funding Conduits

-  Fannie Mae
-  REIT
-  Housing Finance Agency
-  Ginnie Mae
-  Portfolio Loans

Program Participation

Questions so far?








USDA is an equal opportunity provider, employer and lender.

538 Construction/Perm vs 538 Perm Only

- Construction/Perm 538 loan
 - Funds drawn down as construction/rehab is completed
 - Interest only debt service during construction available (lender)
 - Loan typically converts to amortizing perm loan at C of O
 - Large “Conversion” Reserve needed to pay op exp & debt service during lease up
 - Equity installments accelerated to pay off construction loan at CO
- Perm only 538 loan
 - Loan closes and is fully disbursed at 90/90
 - Level Monthly P&I debt service
 - Rate locks at conversion to perm
 - Forward Rate Lock available for addition rate spread (Lender)



Preservation using Section 538

-  Guarantees gap rehab financing and limited equity payment needs
-  Used for Section 515 rehabilitation or non-Section 515 rehabilitation
-  Few owners have elected to simply pay off the Section 515 loan
-  Section 515 loan must subordinate to the new 538 loan
-  Most transactions include secondary debt financing such as HOME, FHLB, etc.
-  Minimum rehab of \$6,500/unit
-  USDA requires a CNA to determine scope of work

538/515 Matrix

COLUMN A Program Requirements	COLUMN B Section 538 Requirements	COLUMN C Section 515 Requirements	COLUMN D Sections 538/515 Projects Recommended
6. Construction Monitoring, Inspections, Payouts	<ul style="list-style-type: none"> New construction, rehabilitation, modular and manufactured structures must meet RD Instruction 1924-A. Actual work inspected by, or on behalf of the Lender. Minimum three inspections. In addition to the three inspections; Lender inspections must be done prior to each payment to the contractor. Lender must coordinate final inspection. Agency must approve all change orders. 	<ul style="list-style-type: none"> Agency to inspect all work completed and materials suitably stored on-site. Minimum three inspections at key times. In addition to the three required inspections; Agency encouraged to make monthly inspections if time and resources permit. Prior Agency concurrence with each pay request and proposed change order. MPR projects are subject to project-specific requirements under the terms of the MPR Conditional Commitment and only released for the MPR authorized purposes as required under the MPR Conditional Commitment. Follow RD Instruction 1924-A requirements. 	For Sections 515/538 projects financed with a Section 538 construction guarantee, follow the applicable provisions of HB-1-3565 for construction monitoring. If time and resources permit, State Offices are encouraged to monitor the construction through on-site reviews/inspections. State Office staff should review, but not sign, the contractor's payment requests.
7. Mortgage Terms	Term of not less than 25 years and not more than 40 years.	Third-party loans must: <ul style="list-style-type: none"> be fully amortized; or have a maturity date that is after the Rural Development/Section 515 debt matures; or include a written agreement with the third-party Lender to extend scheduled maturity through re-amortization or whatever means available to them on terms that do not require rents to exceed CRCU. 	In Section 515 transactions the Section 538 loan term must exceed the term of the Section 515 subordinate financing. The minimum term of the Section 538 loan will be 25 years or the term of the Section 515 subordinate debt whichever is greater. The maximum term of the Section 538 loan is 40 years.
8. Debt Service Coverage Ratio (DSCR)	Requires DSCR of at least 1.15 unless Agency approves lower DSCR.	The general industry minimum standard of 1.15 DSCR is used for transfers and includes all amortizing debt being placed on the property in the initial underwriting review and authorization determination based on the first-year of typical operations (rents, O&M, etc.). For transfer underwriting and analysis, the project at a minimum must meet an initial DSCR of 1.15 through year 3, and may project subsequent DSCRs of 1.1 in	The general industry minimum standard of 1.15 DSCR is used for transfers and includes all amortizing debt being placed on the property in the initial underwriting review and authorization determination based on the first-year of typical operations (rents, O&M, etc.). For transfer underwriting and analysis, the project at a minimum must meet an initial DSCR of 1.15 through year 3.

- Step by Step
- Who controls reserves
- Equity requirements
- Debt Service Requirements

Who to Contact:

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Preserving the 515 through Rehabilitation



Next Steps

Challenges Preserving Section 515 Projects

- Many older projects
- Early program regulations and guideline didn't anticipate private capital
- ADA and UFAS compliance issues
- Low-to-very-Low rent structures
- Restricted values may limit equity
- Smaller projects not competitive in 9% LIHTC preservation set-asides
- Not all units have rental Assistance
- Historically lengthy process

So what are we doing?

- Smaller projects are being pooled in Portfolio Transaction
- Portfolio projects may include non 515 projects (some limitations)
- 1 Bond and or LIHTC award w/multiple Sec 538 loans
- Use of new preservation tools
- Loan Deferrals
- MFH Preservation and Revitalization Demonstration Program (MPR)
- Use of 515/538 underwriting Matrix (revisions ongoing)
- Ginnie Mae accepts 538 loans coupled with 515 no 70% LTC limitations
- National Office (HQs) Underwriting assistance available
- Getting RD involved early! CRITICAL

Section 538 & Section 515

Private

Public

FY	Properties being Consolidated	Properties in Application or Portfolio	Sum of 3rd Party Tax Credits	Sum of Third Party Loan	Sum of Third Party Grant	Sum of Tax Exempt Financing	Sum of Owner-	Sum of HOME and CDBG	Sum of 538 Loan Funds	Sum of Deferred Developer Fee	Sum of Total Leveraged Funds	Sum of Total Non-Federal Leverage Funds
							provided Capital Contributions					
2013	1	2	3,060,594	0	0	0	0	0	0	0	3,060,594	0
2014		3	8,650,650	5,279,703	0	0	0	0	0	0	13,930,353	5,279,703
2015	31	375	61,276,893	15,277,389	150,000	0	1,557,033	4,036,043	2,465,239	242,687	85,005,284	21,263,152
2016	130	862	357,360,099	55,935,293	1,179,128	2,400,000	6,106,987	12,204,878	30,795,500	6,757	477,802,213	89,646,614
2017	74	561	327,033,371	17,695,009	2,735,198	3,995,688	5,553,396	15,220,536	54,856,500	325,410	427,790,339	45,900,469
2018	42	258	85,802,320	5,116,550	9,112,331	1,750,000	2,855,091	2,500,000	28,228,737	635,377	136,000,406	21,969,349
	739	6,369	167,761,004	6,293,571	3,837,747	0	2,777,315	6,035,744	84,767,365	2,281,222	273,753,967	21,225,598
Grand Total	1,017	8,430	\$1,010,944,930	\$105,597,514	\$17,014,404	\$8,145,688	\$18,849,821	\$39,997,201	\$201,113,341	\$3,491,453	\$1,417,343,155	\$205,284,884

Its working....



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2018 HAC Conference

Section 515 Transactions *Transfers/Renovations/Rehabilitations Preservation & Direct Loan Division*

MFH Section 515

- The intent is to restructure existing 514/516 and 515 properties to ensure sufficient resources are available to preserve the ability to provide safe and affordable housing.
 - Multi-Family Preservation & Revitalization (MPR) Program
 - Available under a NOSA only
 - Available for transfers and stay-in owners

MFH Section 515

- MPR program is available to existing 515 and 514/516 properties
- Funds cannot be used to build new units, community rooms, add additional parking areas, playgrounds, laundry rooms or offices
 - One exception is if they are needed to meet accessibility requirements
- No additional RA is available for this program
- No tenants will be displaced from any proposed rent increase
- All selected properties are required to execute a new Restrictive Use Provision (RUP)

MFH Section 515

- Selected properties can receive 1 or more available MPR tools
 - RD determines what tools are offered based on available funds, impact on tenants and physical needs of the property
 - New in the 2017 NOSA
 - Transfer applications could apply for specific tools – 0% and/or Soft Second
 - Limited to \$
- Transfers with a seller's equity payment and/or an increased Return to Owner (RTO) must first be underwritten to meet the requirements of 7 CFR 3560.406 to establish the maximum RTO.
 - Will then be underwritten with MPR tools

MFH Section 515

- Funding tools include:
 - Deferral of Existing Agency debt for up to 20 years
 - Terms & conditions listed in the MPR Debt Deferral Agreement
 - Balloon payment due at the end of deferral period
 - 0% loan
 - 30 year term, 50 year amortization (33 years for FLH)
 - Requires monthly debt service
 - 1% deferred
 - Deferred for the longest loan on the property, typically 30 years
 - 1% Interest
 - Grants
 - Available to Non-profit entities to cover Health & Safety items identified in CNA

MFH Section 515

- Other funding tools include:
 - LIHTC
 - 4% or 9%
 - Section 515 loans
 - Section 514/516 loan/grant funds for FLH
 - 3rd party loans/grants such as HOME and Section 538
 - Owner provided capital contributions in the form of a cash infusion (NOTE: This is not a loan)
 - Project reserve funds

MFH Section 515

Types of MPR Deals include:

- Simple
 - Stay-in owner. No change in ownership
- Complex
 - May consist of project transfer to new owner with or without a consolidation or transaction requiring a subordination agreement as a result of third party funds.
- Portfolio
 - Includes two or more projects with one stay-in owner or
 - Two or more projects with multiple project sale transactions to a common purchaser all located in one State
 - May include Transfers, subordinations & consolidations

Transactions within each category may utilize any or all MPR funding tools.

MFH Section 515

Applications are accepted thru an open NOSA

- 2017 NOSA closed 12/01/17 for transactions requesting MPR tools as outlined on previous slide.
- For transactions seeking deferral only, applications may be submitted thru 09/28/2018
- All transactions must be approved (not closed) by 12/31/18 or they will be considered withdrawn.

MFH Section 515

- RD can subordinate our lien position to a 3rd party lender.
- An Intercreditor Agreement or MOU would be implemented to clearly define each party's relationship and responsibility to the others
- Important to know requirements of each party upfront so that transactions can be underwritten to meet them.
- Rents are established as for any other project financed by the Agency and must comply with 7 CFR part 3560, subpart E.
- Reserve account requirements will be determined on a case-by-case basis, taking into consideration the requirements of the other participating lenders.
- All amortizing debt must be within Agency determined Security Value of the property.

MFH Section 515

?



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Contact Information
Preservation and Direct Loan Division
https://ems-team.usda.gov/sites/RD_PDL

USDA Rural Development is committed to the future of rural communities.



QUESTIONS?

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