The affordable housing real estate market is ripe for acquisition and development, there’s no doubt about it. With rising apartment rental rates, the need for affordable housing continues to grow and in fact, has never been higher. However, the double whammy of higher interest rates and lower tax-credit values has slowed the pace of affordable deals in recent months and has caused a financing gap, a shortfall of project proceeds (tax credit equity and loan proceeds) relative to project uses (the costs to build a property). For many facing a financing gap to get deals done, Federal Housing Administration (FHA) financing can break the stalemate caused by the hesitancy to move forward by some affordable housing developers and owners facing this dilemma.

There is no hesitancy by the KeyBank Affordable Lending Team. We are actively lending and will continue to no matter what is happening in the market. Using our integrated platform, we can provide forward commitments, permanent loans (including FHA loans), acquisition loans, bridge loans, bond financing and tax credit equity solutions to meet developer and owner’s needs. Timing is critical with these deals. With KeyBank’s one-stop shopping, we are able to meet not only timing but project proceeds solutions required to facilitate transactions in today’s tough lending environment.

### Key Takeaways

- **Closing the finance gap when interest rates are up, tax-credit proceeds are down.**
- **FHA loans offer higher proceeds for financing affordable housing.**
- **Bridge loans can help investors buy now, and re-finance with an FHA loan as market conditions improve.**
Facing up to rising rates

The rise in interest rates has made it harder for buyers and sellers to make the numbers work. Another obstacle: tax policy uncertainty. Many affordable housing deals qualify for LIHTC (Low Income Housing Tax Credits), and these credits historically have made more deals possible. However, the possibility of reduced corporate tax rates has prompted many LIHTC buyers to slow their investment decisions until they know how many credits they will need to offset their income tax liabilities. Said simply, the uncertainty surrounding tax reform makes it difficult for tax credit buyers to value the credits. The end result: reduced prices for the credits in the current market. The combination of rising interest rates and the potential for reduced tax credit values means there is a gap in the financing. This gap must then be filled by either additional equity or higher loan proceeds. That’s when KeyBank and HUD can play an important role in continuing to deliver much-needed affordable housing.

HUD gets competitive

If you haven’t worked with HUD recently, you might be cringing right now and picturing a lot of red tape. Historically, FHA loans took too long to close, and the process was complicated and uncertain. But since changes were enacted the last couple of years, the FHA financing process has become significantly more palatable, regardless of other market factors. FHA, part of the Department of Housing and Urban Development (“HUD”), has retooled its processes in response to the biggest complaints against it: the time and administrative resources it requires to cut through the red tape. The process still takes slightly longer than conventional loans, but the upside (better terms) is worth the extra trouble.

HUD affordable housing loans

lowest of the following criteria

<table>
<thead>
<tr>
<th>Loan Type</th>
<th>Program</th>
<th>LTV</th>
<th>LTC</th>
<th>DSC</th>
<th>Loan Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction/rehabilitation</td>
<td>221(d)(4)</td>
<td>–</td>
<td>Up to 90%</td>
<td>At least 1.11</td>
<td>40-year + interest-only construction period</td>
</tr>
<tr>
<td>Refinance</td>
<td>223(f)</td>
<td>Up to 90%</td>
<td>Up to 100%</td>
<td>At Least 1.11</td>
<td>35-year</td>
</tr>
<tr>
<td>Acquisition</td>
<td>223(f)</td>
<td>Up to 90%</td>
<td>Up to 90%</td>
<td>At Least 1.11</td>
<td>35-year</td>
</tr>
</tbody>
</table>
More loan proceeds, more new affordable housing

A major benefit of FHA is that borrowers with qualifying deals can obtain higher loan proceeds when compared to other financing alternatives due to higher loan-to-value ratios (no loan-to-value ratios for new construction), lower debt service requirements and an amortization schedule as long as 40 years for new construction and substantial rehabilitations. In addition, FHA loans are non-recourse, an important feature at a time when most lenders require recourse for new construction.

Another advantage of FHA loans is a fixed rate that extends through the interest-only construction period and completely through the permanent loan term, no balloon payments. This allows developers to get a project built and stabilized, and then sell (or assume) the asset or bring in additional investors without refinancing.

For these reasons, FHA has long been a go-to source for loans on affordable, multifamily, seniors housing and healthcare new construction, rehabilitation purchase and refinance loans. Increasingly FHA is becoming a strong contender for refinancing LIHTC loans that are reaching the expiration of their tax credits because of the advantages of the program.

Acquirers of LIHTC properties are gravitating to FHA to get maximum proceeds, which may be necessary to overcome the double whammy of rising interest rates and lower tax credit values. The challenge is one of timing: FHA loans require more time to close than conventional capital sources. It is important that one uses an experienced FHA affordable lender, especially one that can meet all of the affordable housing developer’s capital needs, to help one through the process.

Bridging the gap

Typically, acquirers of affordable housing properties that want to use FHA financing either pay a premium for the property to afford the extra time it takes to close the FHA loan, or they secure a mini-permanent loan or a bridge loan that enables a quick closing. After acquiring the property, they may secure FHA financing and new tax credits. Acquirers have an additional motivation for taking out a bridge loan at the moment: tax credit values are in limbo while corporate tax reform is taking shape. Securing a bridge loan is the easiest way to acquire an affordable property and can help fill the gap while FHA financing is put in place and the LIHTC equity market restabilizes. At KeyBank, we can provide both the bridge and the FHA financing.

Bridge-to-FHA financing offers a viable path for acquiring affordable housing portfolios. The easiest way to get a bridge loan is to work with a lender that offers a high-volume FHA lending business, and can stitch together all aspects of deals, one that knows the business. KeyBank can also provide the letters of credit associated with the FHA 221(d)4 new construction/substantial rehab programs.

A lender that can do it all – equity, bridge financing, letters of credit, bond placement financing, FHA loans – can provide an on-balance sheet bridge-to-FHA loan to enable the acquisition and repositioning of a property, with FHA or new tax credits as the exit strategy. That may be the best prescription for a healthy pipeline of affordable housing deals.
Let’s start the conversation.

For more information and a fresh perspective on financing your next project:

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