

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



OFFICE OF HOUSING

Date: April 10, 2020

MORTGAGEE LETTER 2020-11

TO: All Multifamily Regional Directors  
All Multifamily Production Directors  
All Multifamily Operations Officers  
Multifamily FHA MAP Lenders

SUBJECT: Section 223(f) Underwriting Mitigants for Multifamily Housing  
Projects Due to Economic Impact of COVID-19 Emergency

PURPOSE

The global pandemic relating to the COVID-19 Emergency has disrupted the U.S. economy with significantly increased unemployment and overall economic instability. This instability has carried over to real estate markets in general, including multifamily commercial markets. During these challenging times, HUD remains open for business and will continue as an active participant in sourcing new construction and refinance debt through its mortgage insurance programs. At the same time, HUD has reevaluated its underwriting requirements, particularly for market rate refinance transactions that may now experience increased vacancy, rent collection losses and income disruption both in the near and long term.

Section 207 of the National Housing Act provides that no mortgage shall be acceptable for insurance unless the Secretary finds that the project is economically sound, and the MAP guide permits specific mitigants to be employed to reduce risk for transactions currently in process but yet to receive a Firm Commitment to insure. These mitigants include but are not limited to the requirement of a Debt Service Reserve (DSR) for Section 223(f) transactions to offset anticipated operating losses post endorsement.

To address risk and/or changed economic circumstances for transactions that have been issued a commitment to insure but have yet to endorse, HUD includes language in the Firm Commitment affirming that no material adverse change (MAC) has occurred between the issuance of the commitment and endorsement. Accordingly, HUD has taken the position that the impact of the COVID-19 Emergency has resulted in a material change in most, if not all, real estate markets and therefore, HUD will require mitigants to offset this additional risk. Accordingly, this mortgagee letter provides clarification and instructions to HUD staff describing additional mitigants that may be included in the Firm Commitment for Section 223(f) loans that are in processing, as well as for those projects for which a Firm Commitment has been issued. A description of these mitigants is described below.

### **A. Debt Service Reserve Requirements - Market Rate Transactions**

For all projects that have yet to reach endorsement, or projects that have been issued a commitment but have not yet locked the interest rate, HUD will require a nine-month debt service reserve fund in the form of cash or letter of credit to be created at endorsement and held by the lender. The escrow will be held until such time as the project has achieved three consecutive months of program debt service coverage or six months from the date of endorsement, whichever last occurs.

For projects that have a commitment in place and have rate locked, HUD will accept, in place of a fixed escrow, a twelve-month stress test that assumes an economic vacancy based upon local market conditions and renter profile of the project, but in any event no less than 30%. The escrow will equal the annual shortfall in debt service payments (including principal, interest, reserve for replacements and mortgage insurance premium) for one year as compared to the required 1.176 debt service coverage for that same period.

### **B. Debt Service Reserve Requirements – Affordable Transactions**

For projects with new Low-Income Housing Tax Credits financed pursuant to section 223(f), HUD will review the investor lease-up and operating deficit reserve requirements for adequacy and availability to the Borrower. If these investor required reserves are either not adequate to current economic risks, are not funded by the investor at endorsement, or are not accessible to the borrower due to operating deficit guarantees imposed by the investor, HUD may increase the reserve amounts to the extent of current risk, up to an additional six to nine-months of debt service.

For refinance projects with existing credits, HUD will require a twelve-month reserve as may be modified by the results of a stress test that assumes an economic vacancy based upon local market conditions and renter profile of the project, but in any event no less than 50%, and a debt service coverage ratio of 1.15. In no event will the reserve requirement be less than a nine-month period unless the investor has released the borrower's operating deficit guaranty and the operating deficit reserve is readily accessible to the borrower to cover shortfalls, both of which may be considered as additional mitigants to be accounted for in HUD's determination of the appropriate debt service reserve escrow.

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

### **C. Cash Out Refinance Transactions**

At endorsement, cash out proceeds in excess of 250% of the non-critical repair escrow must be used to fund the debt service reserve account. Proceeds over and above that which is required to fund the repair escrow and debt service reserve may be released to the borrower. The Form HUD 92476.1M Escrow Agreement for Deferred Repairs will be modified by Rider

to reflect the dual purpose of the escrow. The release of the escrow will be the later of (1) completion of all non-critical repairs; or (2) achievement of three consecutive months of program debt service coverage or six months from the date of endorsement, whichever last occurs.

#### **D. Duration of Mortgagee Letter**

This mortgagee letter is effective immediately and will remain in effect until such time as HUD determines that the real estate markets that have been negatively affected by the COVID-19 Emergency have stabilized and additional mitigants for Section 223(f) transactions are no longer required.

Please contact Thomas A. Bernaciak, Deputy Director, Office of Multifamily Production with any question or comments at (202) 402-3242, or [Thomas.a.bernaciak@hud.gov](mailto:Thomas.a.bernaciak@hud.gov).

#### **PAPERWORK REDUCTION ACT**

The information collection requirements in this Housing Notice are already approved under OMB Approval numbers 2502-0541, 2502-0598 and 2502-0029, issued under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520), for multifamily mortgage insurance applications, processing and endorsement. In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

---

Brian D. Montgomery  
Assistant Secretary for Housing –  
Federal Housing Commissioner