

Fannie Mae and FHA Apartment Financing by Dan Shaheen

Government-Affiliated Loans are a Bright Spot in Today's Tight Mortgage Market

Apartment building owners across the country are turning in increasing numbers to mortgage financing offered through Fannie Mae and the FHA. This is partly to do with the fact that traditional portfolio lenders have reduced their loan-to-value limits and are keeping an ever-tighter grip on the purse strings. It is also because Fannie Mae and FHA interest rates are much more competitive than most traditional lending sources. Most portfolio lenders will not currently lend above 60% LTV. As recently as 18 months ago, those same lenders financed up to 80%.

This is where the Fannie Mae and FHA loans come in. Let's look at Fannie Mae first.

Fannie Mae

The Federal National Mortgage Association (aka Fannie Mae) was chartered by Congress in 1938 to provide liquidity and stability to the U.S. housing and mortgage markets. Fannie Mae has offered its DUS (Delegated Underwriting and Servicing) loan program since 1998 exclusively through a network of lenders across the United States.

Loan amounts are between \$750,000 and \$3 million (higher loan amounts are available case by case). Loan to value ratio goes as high as 80% for a purchase or 75% for a refinance.

Current interest rates are in the mid 5% range for a five year fixed rate or a little above 6% for a 10 year fixed. At the end of the fixed term, a balloon payment is due so you should consider refinance options within the final year of the fixed term if you plan on keeping the property.

A great feature of the Fannie Mae program, unlike most portfolio loans, is that it is assumable to a new buyer for a 1% fee. Let's say you lock in a great rate and decide to sell your property when prevailing rates are higher. You can offer the new buyers the chance to take over your existing loan, thereby potentially adding tremendous value to them. Qualification for Fannie Mae loans is not as difficult as some people believe. First, the property must demonstrate positive cash-flow of at least 1.25%. Generally speaking, for every dollar in expenses the building has, including the new mortgage payment, \$1.25 in income must be received. This is a fairly typical lending requirement, and has been for many years. If the property demonstrates particularly good cash-flow then interest rates are even better. There is no requirement for tax returns or personal income verification, and in most cases these are non-recourse loans. All borrowers must have a minimum fico score of 680 and there can be no history of bankruptcy. At closing, a borrower must demonstrate liquid net worth equal to at least 10% of the loan amount. It takes, on average, 60 days to close a Fannie Mae DUS loan, and with typical closing costs running at about 1.4% of the loan amount, they are a very competitive option for today's apartment owners.

FHA

The FHA (Federal Housing Administration) was created in 1934 to provide home buying opportunities to Americans who were previously unable to qualify through traditional lending sources. What many people don't know is that the FHA also provides extremely competitive financing on apartment buildings. Section 223(f) of the National Housing Act was added by Section 311(a) of the Housing and Community Development Act of 1974.

The program allows for long- term mortgages (up to 35 years) that can be financed with Government National Mortgage Association (GNMA) Mortgage-Backed Securities. This eligibility for purchase in the secondary mortgage market improves the availability of loan funds and permits more favorable interest rates. This program allows loan amounts up to 85% LTV for purchases or 80% for refinancing with a minimum positive cash-flow requirement of only 1.18%. These loans are primarily designed for larger buildings which must be at least three years old.

The program allows for non-critical repairs that must be completed within 12 months of loan closing. In 2008 the average FHA Section 223 loan amount was \$3.74 million and today, many lenders are only underwriting loans of at least \$5 million. Unlike the vast majority of commercial loans, interest rates are fixed and fully amortized for up to 35 years. Last week, I obtained a letter of interest for a building in Hollywood at an astonishingly low rate of 4.95%, fixed for 35 years. The potential payment on that building is \$6,000 per month less than the best rate offered by one of the large banks. Due to their increasing popularity, turn times on FHA Section 223 loans are currently six to eight months so make sure to get started early. Total closing costs are approximately 2.5% of the loan amount, part of which is the FHA insurance which allows this program to exist.

Like the Fannie Mae program these loans are assumable for 1% and they are non-recourse. Income verification is required for underwriting. This program clearly isn't for everyone, but for apartment owners in search of larger loan amounts, there is simply nothing out there that even comes close.

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