BedfordLending

BSPRA Credit Explained

When developing a housing project using the 221(d)(4) program, some cash or equivalent equity is required. One way to offset some of the required equity is to utilize the allowable BSPRA "paper" credit. The BSPRA credit was created as an alternative to a Developer's Fee, as the latter is not allowed for market rate, for-profit borrowers requesting HUD financing.

By using BSPRA, a developer is essentially mortgaging a portion of the cash required at closing.

How it Works

"Income" and "Costs" are two constraints used to determine the mortgage amount under the 221(d)(4) program. The BSPRA credit is only eligible if the project can support a larger mortgage amount based on "income" than the actual construction "costs". Bedford Lending will determine this as part of our initial deal sizing. See below for an example:

Estimated Net Earnings (from H -5)	$737,960
85%, 87%, or 90% Limitation	85.0%
	$627,266
Net Earnings Available for Debt Service	
Maximum Mortgage based on DSC	$10,245,870
Total Maximum Mortgage based on DSC "Income"	$10,245,870

If this amount is larger than the below amount, a BSPRA credit can be included as a cost.

Total Estimated Replacement Cost of Project (from G-47)	$ 12,022,877
85% , 87% , or 90% Limitation	85.0%
Maximum Mortgage based on Replacement Costs	$ 10,219,445

BSPRA helps a transaction like this:

Hypothetical Scenario 1 – No BSPRA

- Assume a project has $9,000,000 in hard and soft costs and they are acquiring land at $1,000,000. The land acquisition/debt will be included in the HUD loan.
- This creates a total cost of $10,000,000.
- If BSPRA were not part of the FHA program, under today's rules, the maximum loan based on cost would be **$8,500,000** (85% LTC), requiring a total borrower equity injection of **$1,500,000.**

- In reality, escrows would also be required during the fill-up period which would increase the requisite equity, but those are not relevant for demonstrative purposes.

Scenario 1 Source and Use Example:

Section J - Total Settlement Requirements

1. Development Costs (Line 45, Section G)		$9,000,000	**Funds Available for Cash Requirements**	
2. Cash Req. for Land Debt/Acquisition		$1,000,000	15. Source of Cash:	
3. Subtotal (Lines 1 + 2)		$10,000,000	a. BSPRA	$0
4. Mortgage Amount	$8,500,000		b. Equity injection by borrower	$1,500,000
5. Development/Cash (Lines 3 minus 4)		$1,500,000	c. Line of credit for IOD &WC	$0
6. Initial Operating Deficit	estimate	$0	d. Owners "Other Fees" paid	$0
7. Discount Costs		$0	**Subtotal** (a + b + c)	$1,500,000
8. Interest Yield Costs		$0	16. Source of Fees and Grants:	
9. Working Capital (4% of Mortgage Amount)		$0	a.__________	$0
10. Min. Capital Investment (Sec. 202)		$0	b.__________	$0
11. Off-Site Construction Costs		$0	c.__________	$0
12. Non-Mortgagable Relocation Expenses			**Subtotal** (a + b + c)	
13. Other		$0	17. **Total Cash, Fees and Grants**	
14. **Total Estimated Cash Required**			(Sum of Items 15 plus 16)	
(Sum of Lines 5 through 13)		$1,500,000		

Hypothetical Scenario 2 – With BSPRA

- Assume a project has $9,000,000 in hard and soft costs and a developer is acquiring land at $1,000,000. The land acquisition/debt will be included in the HUD loan.
- This creates a total cost of $10,000,000.
- The maximum BSPRA amount = 10% of hard and soft costs (10% x $9,000,000 = $900,000).
- Therefore, when adding the BSPRA amount to the previous total cost of $10,000,000, the total cost becomes $10,900,000.
- The maximum loan with BSPRA would then be **$9,265,000** (85% LTC of $10,900,000).
- Normally, this would require borrower's equity of $1,635,000 ($10,900,000 minus $9,265,000).
- However, the BSPRA credit is ***offsetting*** the equity by $900,000, requiring cash at closing of **$735,000.**

This is why BSPRA was previously referred to as a "paper" credit. It's a mortgageable "cost", but this cost is simply a way to amortize the equity due at closing throughout the loan versus coming up with it as a lump sum.

Scenario 2 Source and Use Example below:

Section J - Total Settlement Requirements				
1. Development Costs (Line 45, Section G)		$9,900,000	**Funds Available for Cash Requirements**	
2. Cash Req. for Land Debt/Acquisition		$1,000,000	15. Source of Cash:	
3. Subtotal (Lines 1 + 2)		$10,900,000	a. BSPRA	$900,000
4. Mortgage Amount	$9,265,000		b. Equity injection by borrower	$735,000
5. Development/Cash (Lines 3 minus 4)		$1,635,000	c. Line of credit for IOD &WC	$0
6. Initial Operating Deficit	estimate	$0	d. Owners "Other Fees" paid	$0
7. Discount Costs		$0	**Subtotal** (a + b + c)	$1,635,000
8. Interest Yield Costs		$0	16. Source of Fees and Grants:	
9. Working Capital (4% of Mortgage Amount		$0	a.	$0
10. Min. Capital Investment (Sec. 202)		$0	b.	$0
11. Off-Site Construction Costs		$0	c.	$0
12. Non-Mortgagable Relocation Expenses			**Subtotal** (a + b + c)	
13. Other		$0	17. **Total Cash, Fees and Grants**	
14. **Total Estimated Cash Required**			(Sum of Items 15 plus 16)	
(Sum of Lines 5 through 13)		$1,635,000		

HUD does not consider BSPRA a credit risk because it is treated the same as any other mortgageable cost.

How to Qualify?

HUD does not allow every project to use the BSPRA credit:

- For affordable programs (LIHTC, RAD, Section 202), a Developer's Fee is allowable, but a Developer's Fee and BSPRA are **not allowed** in the same loan.
- Borrowers **must be for-profit**, but a non-profit can apply as a for-profit entity to secure BSPRA if desired.
- Eligible under section 221(d)(4), 220, and 231.
- Section 241a supplemental loans are not eligible for BSPRA.
- Section 232 (Healthcare) projects are not eligible for BSPRA.

BSPRA requires an **identity of interest between the general contractor and the owner.** An identity of interest can be created in many ways, but the most frequently used methods are for one of the general partners of the mortgagor entity to acquire a small interest in the contractor, or for the contractor to acquire limited partnership interest in the mortgagor entity.

By using BSPRA you are **restricted from including a Builder's Profit in the mortgage**. If the contractor is not affiliated with the developer, it's unlikely that the contractor would be willing to waive their profit in total. In these scenarios, the contractor will generally:

1. Accept a minority ownership percentage of the project in lieu of their profit, where the equivalent profit is paid out of surplus cash over time.
2. Or their profit must be paid from sources other than mortgage proceeds, and by an entity other than the mortgagor entity.

To reiterate

- An identity of interest must be formed with the general contractor and mortgagor entity.

- No builder's profit can be included in the loan.
- The contractor can still receive their profit either through surplus cash or through payment outside of HUD proceeds.
- If no BSPRA is sought (or a project does not qualify), a Builder's Profit is allowed as a mortgageable cost under HUD. You simply can't have both a BSPRA credit *and* Builder's Profit in the same loan.

What's the catch?

Virtually all new construction projects that qualify for BSPRA end up using the credit, as there is little downside. The builder still receives their profit either through surplus cash or separate payment, and the developer is able to significantly reduce their cash required at closing.

For Developers who also wish to be the General Contractor

If the developer owns or has a prior relationship with the proposed general contractor, in many cases this is the easiest option, as the general contractor's interests are aligned with the mortgagor, and the entirety of the BSPRA credit can be contributed towards the loan (versus paying a builder's profit back to the builder out of surplus cash).

HUD allows developers to own, construct, and manage a property (all at once) as long as an identity of interest is recognized.

In these circumstances, we are often asked about the requirements to qualify as a general contractor for HUD/FHA:

1. HUD does not require previous HUD experience, however the GC should have experience successfully building projects of a similar size and scope to the proposed project.
2. Must be familiar with Davis Bacon wage rate reporting, including payroll certification.
3. Must be familiar with FHA construction requisitions and cost certification process. In BSPRA transactions, both the general contractor and mortgagor must cost certify with an independent accountant to determine the actual final mortgage amount from HUD.
4. The GC's working capital should equal 5% or more of the estimated construction contract (including all other projects in construction). In situations where this is not feasible, the GC can align themselves with stronger GCs, or hypothecate their fixed assets to secure loans or lines of credit.
5. Must be bondable.