BedfordLending

BSPRA Credit Explained

When developing or rehabilitating a multifamily project via the HUD 221(d)(4) program, some cash or equivalent equity is required. One way to offset the amount of cash required at closing is to utilize HUD's BSPRA credit. The BSPRA credit was created by HUD as an alternative to a Developer's Fee, as the latter is not allowed for market rate, for-profit borrowers utilizing HUD financing.

By using BSPRA, a developer is essentially mortgaging equity that would be due at closing into the loan. The loan amount is higher, and the cash required is in turn, lower. It's a "paper" credit.

How it Works

"Debt coverage" and "Loan to cost" 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 "debt coverage" than "loan to cost".** Bedford Lending will determine this as part of our initial deal sizing. See below for an example:

Estimated Net Earnings (from H-7)	$	5,001,621
DCR		1.11
Net Earnings Available for Debt Service	$	4,505,965
Maximum Mortgage based on Debt Service Coverage	**$**	**65,836,255**

Total Estimated Replacement Cost of Project (from G-47)	$	68,644,566
LTC		90%
Maximum Mortgage based on Replacement Costs	**$**	**61,780,110**

The mortgage that your income can support must be greater than mortgage based upon loan to cost.

BSPRA helps a transaction like this:

Hypothetical Scenario 1 – No BSPRA

- Assume a project has $9,000,000 in hard and soft costs and the borrower is acquiring land (to be developed) for $1,000,000.
- This creates a total cost of $10,000,000.
- If BSPRA were not part of the HUD 221(d)(4) program, the maximum loan to cost (for a market rate transaction) would be 87-90%. Assuming 87%, the mortgage is **$8,700,000**, requiring a total borrower equity injection of **$1,300,000** *($10,000,000-$8,700,000).*
- In reality, temporary contingency escrows would also be required during the construction and lease-up period which would increase equity due at closing, but that is 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	17. Source of Cash:		
3. Subtotal (Lines 1 + 2)		$ 10,000,000	a. BSPRA	$ -	
4. Mortgage Amount	$ 8,700,000		b. Cash	$ 1,300,000	
5. Development/Cash (Lines 3 minus 4)		$ 1,300,000	c. Letter of Credit for IOD/WC	$ -	
6. Initial Operating Deficit		$ -	d. Pre-Paids	$ -	
7. Discount Costs		$ -	**Subtotal** (a + b + c)	$ 1,300,000	
8. Interest Yield Costs		$ -	18. Source of Fees and Grants:		$ 1,300,000
9. Working Capital (4% of Mortgage Amount)		$ -	a.	$ -	
10. Min. Capital Investment (Sec. 202)		$ -	b.	$ -	
11. Off-Site Construction Costs / Demo		$ -	c.	$ -	
12. LIHTC Dev Fee		-	d.	$ -	
13. LIHTC Costs		$ -	e.	$ -	
14. Other		$ -	**Subtotal** (a + b + c)		$ -
15. Other		$ -	**19. Total Cash, Fees and Grants**		
16. Total Estimated Cash Required					$ 1,300,000
(Sum of Lines 5 through 13)		$ 1,300,000			

Hypothetical Scenario 2 – With BSPRA

- Assume a project has $9,000,000 in hard and soft costs and the borrower is acquiring land (to be developed) for $1,000,000.
- 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 cost of $10,000,000, the total cost becomes $10,900,000.
- The maximum loan with BSPRA would then be **$9,483,000** *(87% x $10,900,000).*
- Normally, this would require borrower's equity of $1,417,000 *($10,900,000 minus $9,483,000).*
- However, the BSPRA credit is ***offsetting itself,*** requiring net cash at closing of **$517,000.**

This is why BSPRA was previously referred to as a "paper" credit. BSPRA is included as both a source and use of funds, because its sole purpose is to increase the mortgage amount and reduce borrower equity. It's not an actual cost to be paid during construction.

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	17. Source of Cash:		
3. Subtotal (Lines 1 + 2)		$ 10,900,000	a. BSPRA	$ 900,000	
4. Mortgage Amount	$ 9,483,000		b. Cash	$ 517,000	
5. Development/Cash (Lines 3 minus 4)		$ 1,417,000	c. Letter of Credit for IOD/WC	$ -	
6. Initial Operating Deficit		$ -	d. Pre-Paids	$ -	
7. Discount Costs		$ -	**Subtotal** (a + b + c)	$ 1,417,000	
8. Interest Yield Costs		$ -	18. Source of Fees and Grants:		$ 1,417,000
9. Working Capital (4% of Mortgage Amount)		$ -	a.	$ -	
10. Min. Capital Investment (Sec. 202)		$ -	b.	$ -	
11. Off-Site Construction Costs / Demo		$ -	c.	$ -	
12. LIHTC Dev Fee		$ -	d.	$ -	
13. LIHTC Costs		$ -	e.	$ -	
14. Other		$ -	**Subtotal** (a + b + c)		$ -
15. Other		$ -	**19. Total Cash, Fees and Grants**		
16. Total Estimated Cash Required					$ 1,417,000
(Sum of Lines 5 through 13)		$ 1,417,000			

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 (relationship) between the general contractor and the owner.** An identity of interest can be created in many ways, but the most common option is for the contractor to acquire limited ownership interest in the mortgagor entity.

By using BSPRA the builder is **restricted from including a Builder's Profit in the mortgage**. **General Requirements/Conditions and Overhead can still be paid from mortgage proceeds, but Builder's Profit cannot.** 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?

Because BSPRA is increasing the loan amount, you are reducing cash required at closing, but your ongoing debt service payments will be higher (and thus, year end surplus cash, lower).

Sample BSPRA Ownership Structure

The following sample ownership structure was pulled from a 221(d)(4) transaction that involved BSPRA that we underwrote and closed. Names have been changed for privacy:

- **ABC LLC (Mortgagor Entity)-** ABC LLC was formed as a single asset entity for the proposed real estate transaction. The ownership structure and percentage of ownership of ABC LLC is as follows:
    - ***DEF, LLC (45.4544% Managing Member of ABC LLC) -*** *this entity is owned by Jane Doe (70%) and John Doe (30%). Mrs Doe. and Mr. Doe will also serve as Co-Executive Managers of the borrowing entity, ABC LLC. Due to their ownership percentages, they will be considered "Active Principals" subject to full credit review. The remaining members of ABC LLC are as follows:*
    - ***General Contractor, LLC (13.6364% Member of ABC LLC)*** *An entity formed by the principals of Builders Incorporated, the General Contractor of record for the proposed project. This will enable the project to secure the "BSPRA" credit.*
    - ***Steve Jobs (13.6364% Member of ABC LLC)*** *Mr. Jobs has been involved in the automotive industry for a number of years and recently sold a major Toyota dealership. Due to the passive nature of his ownership and limited ownership percentage, a review of personal financials and credit is not required.*
    - ***Larry Ellison (13.6364% Member of ABC LLC)*** *– Mr. Ellison has been in the reinsurance industry for a number of years. Mr. Ellison recently sold his company for approx. $94mm. Due to the passive nature of his ownership and limited ownership percentage, a review of personal financials and credit is not required.*
    - ***Bill Gates (13.6364% Member of ABC LLC****) – Dr. Gates is a retired periodontist. Due to the passive nature of his ownership and limited ownership percentage, a review of personal financials and credit is not required.*

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:

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 HUD 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 as construction nears completion.
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.
6. The form of the construction contract will be cost-plus versus lump sum.
7. Other miscellaneous changes, including differences in retainage, can be provided upon request.