NATIONAL ASSOCIATION OF HOME BUILDERS

Testimony Of

Gary Ruping

President

Ruping Builders, Inc.

On behalf of the

National Association of Home Builders

Before the

United States House of Representatives

Housing and Community Opportunity

Subcommittee of the

Financial Services Committee

July 22, 2003

On behalf of the 211,000 members of the National Association of Home Builders, I want to thank you for inviting us to speak about the Federal Housing Administration's (FHA) multifamily mortgage insurance programs. My name is Gary Ruping, and I am the founder and owner of Ruping Builders, in Billerica, Massachusetts, which is located in the greater Boston area. Ruping Builders was formed in 1985 and has been involved in the development of a range of housing, including quality apartment homes and condominium communities. A portion of our business is focused on affordable housing. Currently, I am the second vice president of the Builders Association of Greater Boston, and I have worked on issues related to affordable housing for some time. I served as Co-chairman on former Governor Cellucci's Special Commission on the Barriers to Housing Development and have worked extensively with government and elected officials in Massachusetts on housing issues.

Introduction

NAHB is a strong supporter of the FHA multifamily mortgage insurance programs. We have worked with HUD and Congress over the years to bring improvements to the programs, which are critical to addressing the nation's affordable housing needs. In the last two years, Congress passed legislation that increased the FHA multifamily mortgage loan limits by 25 percent and, beginning in 2004, indexes the loan limits to inflation. The 25 percent increase had an immediate effect on the program, opening up markets previously unable to use the programs because the loan limits were too low. Indexing the loan limits will help stabilize the programs and give builders and lenders confidence that they will be able to use the programs in their communities every year, even as construction and land costs rise over time.

The Need to Increase the High-Cost Limits

NAHB also strongly believes that housing needs in high-cost markets where the base loan limits are too low must be addressed. There are a number of high-cost urban markets across the country, including Boston, Providence, New York, Greensboro, Chicago, Minneapolis, San Francisco, Los Angeles and Seattle, where land and construction costs are significantly higher than in other areas of the country, and the current high-cost limits have not been sufficient to allow effective use of the FHA multifamily mortgage insurance programs.

Currently, the law gives the Secretary of the U.S. Department of Housing and Urban Development (HUD) the discretion to increase the base limits by up to 110 percent in geographic areas where construction costs are very high. The Secretary is also able, at his discretion, to approve an increase of up to 140 percent for individual projects in any area, but only when certain determinations can be made, including that the housing is necessary and there is clear justification for excessive costs (e.g., confined inner city sites, remote location, scattered sites or historic condition) that makes costs higher than similar construction in the area. Supporting documentation must be provided, and HUD headquarters must approve the request.

Recent Trends

Each year, HUD publishes a list of cities it has determined to be high-cost. The list provides the high-cost percentage (HCP) that HUD has determined is appropriate for each city. The limits are expressed as a percentage of the statutory base limit (the equivalent of raising the base limit by 110 percent is multiplying the base limit by 210 percent, or a factor of 2.1). By law, the maximum high-cost percentage can be no higher than 210 percent. As of January 2003, there are 16 cities that are at the maximum 210 percent statutory limit. There are another five cities whose HCPs fall between 205 and 209 percent. This is in contrast to the limits in effect for 2002, where 13 cities were at the maximum 210 percent statutory limit and only three cities fell between 205 and 209 percent. Twelve of the 16 cities at the maximum in 2003 were at the maximum in 2002.

An analysis of HUD data reporting initial endorsements for Fiscal Year 2002 shows that Boston had three Section 221(d)(4) new construction projects. The cities of Providence, New York, Philadelphia, Chicago, Los Angeles, San Francisco and Seattle did not have any. In contrast, cities with HCPs well below the maximum fared much better, for example, Houston and San Antonio each had nine Section 221(d)(4) new construction projects.

Similar patterns are occurring in fiscal year 2003. HUD data show that, through April 2003, Boston, Providence, New York, Greensboro, Los Angeles, San Francisco and Seattle have had no Section 221(d)(4) initial endorsements. Chicago has had five, and Minneapolis/St. Paul has had two. Again, cities with HCPs well below the maximum are performing better. Atlanta and Houston have each had four Section 221(f)(4) initial endorsements.

NAHB conducted an analysis of nine high-cost urban areas (Boston, Providence, Philadelphia, New York, Chicago, Minneapolis, Los Angeles, San Francisco and Seattle), all of which are at the 210 percent maximum. The analysis is based on a hypothetical non-elevator building with 42 two-bedroom units. R.S. Means QuickCost Estimator data for 2003 was used to estimate construction costs. A minimal allowance for raw land costs was added to the construction costs. (The estimate is conservative because land costs vary significantly depending on the market.) NAHB's analysis demonstrates that, even with the recent 25 percent increase and current high-cost factors, costs in these cities exceed or closely approach the current limits. For example, the NAHB analysis shows that, in Boston, a typical building would require a mortgage that is 231 percent of the statutory base limits, well above the current statutory limits. Los Angeles would require a mortgage that is 215 percent of the statutory base limits, while New York would need a 264 percent limit.

The HUD Secretary has the ability to approve an increase in the statutory limits up to 240 percent on a case-by-case basis. However, additional administrative and paperwork burdens are required for such an approval. The biggest disadvantage is that a developer will have already expended a considerable amount of money applying for the loan before he knows if a loan is possible under those circumstances. As NAHB's analysis shows, even the case-by-case exception is not sufficient in many high-cost cities to support a new construction project financed by an FHA-insured loan. The effectiveness of the program would be greatly increased if builders in high-cost cities were confident they could proceed with an FHA-insured loan without the additional cost, time and difficulty of applying for a case-by-case exception. When the statutory limits approach or are at the maximum, builders have little incentive to pursue an FHA-insured loan. Additionally, if cities are at the maximum for multiple years, builders are even less likely to even consider using the program.

An Example of the Limitations of Using FHA in High-Cost Areas

While it's useful to look at data, it's also useful to take a closer look at an actual project to help understand why the statutory maximum limits are not sufficient in markets such as Boston. I am currently in the planning stages of developing a 180-unit, garden-style walk-up apartment located in Burlington. Twenty percent of the units will be affordable to seniors with incomes up to 80 percent of the area median, and the rest will be at market rates. The units range in size from 700 square feet for a one-bedroom unit to 1,200 square feet for a two-bedroom unit. The development will include a club house and modest outdoor pool, which are typical amenities offered in this marketplace. This development will offer quality affordable housing; it is not intended to serve the luxury, high-end market.

I decided to pursue a Section 221(d)(4) insured loan. The Section 221(d)(4) program offers terms related to the debt service coverage ratio, interest rate and loan period that are needed to make the project financially feasible. In addition, the construction loan is automatically converted to a permanent loan. Conventional loan terms are not as favorable, and I would have to obtain both a construction loan (with recourse) and a permanent loan. With interest rates about comparable right now, the Section 221(d)(4) program seemed the way to go.

However, I may not be able to actually obtain the FHA-insured loan. My total development costs are $176,000 per unit, which exceeds the high-cost limits. This figure is actually somewhat low, because I bought the land many years ago at a cost of $15,000 per unit. The land is currently worth $50,000 per unit. My hard construction costs are $113,000/unit; impact fees are $3,000/unit, and permit costs run $10,000/unit. The balance of total development costs includes architecture, engineering and legal fees, environmental testing and builder's overhead. In addition, labor costs in the Boston area are very high, which contributes to the high construction costs.

The current statutory mortgage loan limit for a two-bedroom unit in a non-elevator structure is $51,920. The maximum permitted limit (using the case-by-case exception at 240 percent HCP) is $124,608 per unit. I have struggled to find ways to save on construction costs and have already reduced my budget by $2 million. It is unclear to me at this time whether I will be able to proceed. If I cannot finance the project with a Section 221(d)(4) insured loan, I would be faced with putting a significant out-of-pocket monetary contribution into the project. My alternative is to sell the land to a large Real Estate Investment Trust (REIT). The REIT will build a luxury, high-end apartment or condominium because this market can support such a development. The community will lose the opportunity to provide quality affordable rental housing for seniors and families.

Support for H.R. 1985

NAHB strongly supports H.R. 1985, introduced by Representatives Miller (R-CA) and Frank (D-MA), which would amend the National Housing Act to increase the maximum mortgage amount limit for FHA-insured mortgages for multifamily housing located in high-cost areas. The bill would give the Secretary of HUD additional flexibility in high-cost areas by allowing the base loan limits to be increased by up to 170 percent instead of 110 percent (in other words, to increase the maximum HCP to 270 from 210 percent).

NAHB believes that the proposed increase should be sufficient to address the most critical cases, such as New York and Los Angeles, neither of which have had one initial endorsement yet in FY 2003, as well as those cities that soon may be constrained by the current statutory maximum limits. As a builder, I am always pursuing the most economical way to finance my developments. Currently, the FHA multifamily insurance programs simply are not open to me because I conduct business in a high-cost area. Additionally, thousands of families, including seniors, are being deprived of quality affordable housing that could be built if the program were more effective. NAHB urges the House of Representatives' Subcommittee on Housing and Community Opportunity to move forward with H.R. 1985.

Thank you for the opportunity to present NAHB's views this morning.

Estimated Cost of a Multifamily Unit in Selected Areas

	Cost of a 50,000 sq ft project in 2003	Number of units in the project	Cost Per Unit	With minimal allowance for raw land added	Percentage of 221(d)4 Basic Limit
Boston, MA	$4,707,000	42	$112,071	$120,077	231%
Chicago, IL	$4,579,000	42	$109,024	$116,811	225%
Los Angeles, CA	$4,370,000	42	$104,048	$111,480	215%
Minneapolis, MN	$4,588,000	42	$109,238	$117,041	225%
New York, NY	$5,372,000	42	$127,905	$137,041	264%
Philadelphia, PA	$4,559,000	42	$108,548	$116,301	224%
Providence, RI	$4,255,000	42	$101,310	$108,546	209%
San Francisco, CA	$5,085,000	42	$121,071	$129,719	250%
Seattle, WA	$4,223,000	42	$100,548	$107,730	207%

Based on a hypothetical low-rise project with 42 2-Bedroom Units @ 1050 sq ft each plus 5900 sq ft in common areas.
The cost of a 50,000 sq ft building in 2003 is estimated by using R.S. Means QuickCost Estimator.

The allowance for raw land is based on a general rule developed by real estate consultant Bob Sheehan: value of a multifamily unit tends to be roughly 15 times the value of raw land. Using this ratio should provide a conservative estimate of raw land cost in the case of a low-rise building in a high cost area.

Selected FHA Multifamily Mortgage Loan Limits Comparison of Current and Proposed High Cost Percentages

City	Current Base Limit (1)	Current High %	Est. Cost Per Unit (2)	Percent of Current Base Limit	Est. New High Cost Percentage (3) %	$
Boston, MA	$51,920	210%	$120,077	231%	231%	$120,077
Chicago, IL	$51,920	210%	$116,811	225%	225%	$116,811
Los Angeles, CA	$51,920	210%	$111,480	215%	215%	$111,480
Minneapolis, MN	$51,920	210%	$117,041	225%	225%	$117,041
New York, NY	$51,920	210%	$137,041	264%	264%	$137,041
Philadelphia, PA	$51,920	210%	$116,301	224%	224%	$116,301
Providence, RI	$51,920	210%	$108,546	209%	209%	$108,546
San Francisco, CA	$51,920	210%	$129,719	250%	250%	$129,719
Seattle, WA	$51,920	210%	$107,730	207%	207%	$107,730

(1) For 221(d)(4) two-bedroom unit, non-elevator building.
(2) Estimated cost of a two-bedroom unit using RS Means Quick Cost Estimator with an allowance for land costs. See chart above which describes how the estimated construction costs were derived.
(3) Estimate of level at which HUD would set high cost percentages if current 210% maximum is increased to 270%