

## **BSPRA (Builder Sponsor Profit Risk Allowance)**

BSPRA is paper equity. A BSPRA allowance of up to 10% of all hard and soft costs combined is added to those costs and then the value of the land (or as-is value of the property in sub rehab cases) is included to arrive at the total estimated replacement cost of the property. (The BSPRA allowance could be any amount up to 10% but is always the full 10% in practice.) The maximum mortgage by the cost test is then 90% of the replacement cost. In a simplistic example, let's say that for every \$60 in hard costs, there were \$30 in soft costs. So the total of the two would be \$90 and the allowable BSPRA \$9. Then say the land value is \$1. The total replacement cost is \$100 (\$60 + \$30 + \$9 + \$1) and the maximum mortgage \$90. If the general contractor and developer agreed not to take any part of the BSPRA in cash, but to leave it in the deal, then they can fully mortgage out their hard and soft costs. If the land owner is also in the deal, which sometimes happens, the project can be built with no upfront cash equity requirement.

Here is HUD's definition of BSPRA: "A. Builder's and Sponsor's Profit and Risk Allowance (BSPRA). An amount included in replacement cost for profit motivated and limited distribution mortgages where an identity of interest (See paragraph 4-9) exists between the mortgagee and general contractor. BSPRA is no more than 10 percent of the total estimated cost of: on-site land improvements; structures; general requirements; general overhead expenses; architect's fees; carrying and financing charges; and legal, organizational and audit expenses." In order for the BSPRA allowance to be used, there must be a recognizable identity of interest between the general contractor and the owner/developer. And here is HUD's description of what constitutes an identity of interest:

"4-9. IDENTITY OF INTEREST. An identity of interest exists if:

- A. The mortgagee (or any general or limited partner, shareholder, director, officer, employee or authorized representative of the mortgagee) has a financial interest in or contractual arrangement with the contractor regarding the project, including site procurement, other than the construction contract or vice versa.
- B. Any general or limited partner, shareholder, director, officer, employee or authorized representative of the mortgagee is also a general or limited partner, shareholder, director, officer, employee or authorized representative of the contractor or vice versa.
- C. The contractor advances funds for any obligation of the mortgagee, including site procurement, or pays on behalf of the mortgagee (or provides without cost) architectural or engineering services, except those permitted by the construction contract or owner-architect agreement.

- D. The mortgagor (or any general or limited partner, shareholder, director, officer, employee or authorized representative of the mortgagor) can directly or through one or more intermediaries control or influence the decisions or policies of the contractor, including apparent control or influence over the decisions or policies, or vice versa. "Apparent control or influence" means any relationship that exists between the mortgagor and contractor (or any general or limited partner, shareholder, director, officer, employee or authorized representative of the mortgagor and contractor) by blood or marriage.
- E. The mortgagor and contractor at any time enter into any agreement, contract or undertaking that changes or cancels any obligation of the other party that is required by the documents executed at initial endorsement." In cases where a identity of interest does not already exist, the most common way of establishing the identity of interest is "B" above. The general practice is to give the contractor (or one of its principals) a non-controlling minority interest in the ownership entity (5%-25%), which is then bought out at the end of construction and final endorsement by the payment of a fixed price (the builder's profit). If BSPRA is used, then no Builder's Profit is included in the construction contract and the contract cannot be of the "fixed price" type but must be of the "cost plus a fixed fee" type. Builder's Overhead (2%) is permitted to be included in the contract in BSPRA cases. If no identity of interest exists or is created as described above, then the builder's profit is included in the contract and must be met with upfront equity. The contract may then be of the fixed price type.

The developer may only receive a SPRA allowance as paper equity. SPRA is equal to 10% of the soft costs only. Here is HUD's definition of SPRA.:

Sponsor's Profit and Risk Allowance (SPRA). An amount included in replacement cost where no identity of interest (see paragraph 4-9) exists between the general contractor and mortgagor. SPRA is no more than 10 percent of the total estimated cost of: architect's fee; carrying and financing charges; and legal, organizational and audit expenses." In our simplistic example above, this is what happens. Hard costs equal \$60 and a builder's profit of say 10% is added to those costs. Soft costs equal \$30 and a SPRA of \$3 is permitted. Land is still \$1. So, total replacement cost is the same ( $\$60 + \$6 + \$30 + \$3 + \$1 = \$100$ ) and maximum mortgage is still the same at \$90. But the builder's profit is not now paper equity; it's real cash equity. The developer has got to put up the \$6 before first mortgage proceeds are released. Furthermore, it is unusual for HUD to allow a 10% builder's profit in non-identity of interest cases. Most I've ever seen is about 8%. So what would really happen to our simplistic example is this:  $\$60 + \$4.80 + \$30 + \$3 + \$1 = \$98.80$  and the maximum mortgage is \$88.92.

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So, even if the land owner still chucks in his buck, the mortgagor has to come up with \$5.88 in real hard cash at the initial closing. This way both developer and general contractor lose.

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