Understanding HUD Multifamily Programs

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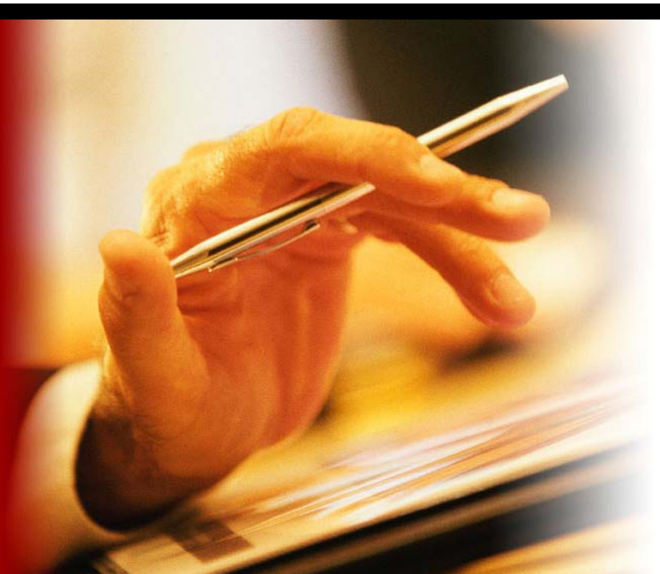

Overview of HUD Multifamily Programs

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General

- **<u>Honoring Precedents</u>**
  - **Administrative Waivers**
    - **PPC**
    - **Flexible Subsidy**
    - **Mark-to-Market Sharing**
    - **3 year Extension**
    - **Non Profit Proceeds**
    - **236, 221(d)(3), 202**
    - **Conversions**
    - **Unit Drop**
  - **Good Ideas – 20 year HAP and Use Agreement**
  - **Don’t Ask Don’t Tell**
  - **Distribution Cap Removal**

General

- **<u>HUD Budget</u>**
  - **Commitment Authority**
  - **Balanced Approach to Programs/Investment Deficit Reduction**
  - **9.7% increase in Section 8**
  - **Back to 2011 level**
  - **Sequestration – Full HAP Funding for 12 months**
  - **Some Texas PHAs**
  - **Legislative Package**
    - **Risk Sharing 5 to 49 units**
    - **Administrative Flexibility**
    - **RAD - Mod Rehab/Rent Supplement**

General

- **Non Profit/Total Needs/Compton**
- **LIHTC Coordination**
  - **LIHTC Pilot**
- **Multifamily Reorganization**

Advantages of HUD with LIHTC

- **Section 8 rents can exceed LIHTC limits**
- **Section 8 and other programs can eliminate the 10-year rule**
- **Several large and aging HUD portfolios in need of substantial rea**

Difficulties with HUD and LIHTC

- **Many redevelopment projects cannot permit involuntary displacement of over-income tenants**
- **Davis Bacon wage rates**
- **Extended Use Agreement terms**
- **HUD inspection and reporting requirements.**
- **Ownership and distribution limits**

Overview of HUD Multifamily Programs

- **FHA Insurance**
- **Rental Subsidy**
- **Grant/Direct Loan Programs**
- **Public Housing**

FHA/HUD Insurance for Multifamily

- **National Housing Act**
- **Common names – 221(d)(3), 221(d)(4), 223(f), 223(a)(7), 232, 241, 236**
- **Private Lenders qualified by HUD for FHA lending**
- **Generally placed with Ginnie Mae – “Ginnie Mae Backed Securities”**
- **Documented with Promissory Note, Mortgage, Regulatory Agreement, etc.**
- **Promissory Endorsed for insurance by HUD at the closing table.**
- **Transfers of Interest in the owner, or transfers of property and assumption require a “TPA”**

FHA Insurance Programs

- **221(d)(4),**
- **223(f), 223(a)(7)**
- **232**
- **241**
- **221(d)(3), 236**

Sections 221(d)(4)

- **Construction/Substantial rehabilitation**
- **May provide over $80,000 per unit.**
- **May have a 40 year term**
- **Non-Recourse construction loan**
- **Davis Bacon required**
- **May take 10 months to process**

Sections 223(f) and 223(a)(7)

Refinancing programs

223(f)

- **Refinance or purchase**
- **up to 35 year term**
- **No Davis Bacon required**
- **Amortizes immediately**
- **Limited rehabilitation ($16,000 generally, but subject to calculation)**

but:

- **223(f) PILOT up to $40,000 per unit rehab**

Sections 223(f) and 223(a)(7)

Refinancing programs

223(a)(7)

- 35 year term – generally
- Only for refinancing FHA-insured debt
- Limited to original principal amount of original mortgage
- Term limited to 12 years beyond original mortgage term
- Very quick processing
- Common for Mark-to-Market processing

Section 232

- Housing for the elderly and those in need of supportive services
- Nursing homes, assisted living facilities, board and care
- LEAN program undergoing changes with new regulations and loan documents this year
- Can be used for purchase, new construction, substantial rehabilitation, or refinance (in coordination with 221(d)(4), 223(f), and 223(a)(7)

Section 236 and Section 221(d)(3)

- Older loan new construction and rehab programs - mostly paid off
- 221(d)(3) still available for nonprofit owners
- IRP – Interest Reduction Payment
- Most have left behind extended Use Agreements (250(a) and Wellstone)
- Tenant incomes limited to 80%/95% of AMI
- Often Partially Subsidized
- Prepayment of remaining 236 projects often triggers Enhanced Section 8 Vouchers.
- RAP/Rent Supp.

Common Issues and Use With LIHTC

- FHA-insured Loan as source for Tax-Exempt Bond credit enhancement
- Regulatory Agreement and Mortgage must be priority liens (over LIHTC LURA)
- Limited Distributions (timing – annual or semi-annual)
- Differences between “mortgageable costs” and “eligible basis”
- Equity Pay-In requirements
  - minimum 20% of credit equity underwritten for payment of mortgageable costs at closing (generally)
  - Subsequent draws subject to underwriting and loan limits
- GP or SLP change may require TPA (HUD approval)
- No Subsidy Layering

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Rental Subsidy

- **Project-based Section 8 (HAP)**
- **Vouchers**
  - **Tenant-based**
  - **Project-based**

Project-Based HAP

- **Section 8 of the United States Housing Act of 1937**
- **Contract between owner and HUD**
- **Specified number of units**
- **Specified rent levels**
- **Tenant pays 30% of income toward rent**
- **Utility allowance**

Project-Based Section 8 – original HAP contracts

- **Original HAP Contracts - 15 to 40 year terms – fully appropriated**
- **Rent increases either through AAF or budget-based**

Section 8 HAP Contracts– “Old Reg”

- Pre-1980, except for LMSA
- Tenant income limit 50% or 80% of AMI
- Generally otherwise few restrictions
- Owner rents the unit, HUD pays the rent.

Section 8 HAP Contracts – “New Reg”

- **Post 1980**
- **Tenant income limited to 50% of AMI**
- **Commonly a limited distribution**
  - **6% or 10% of equity**
- **replacement reserve requirement**
- **Residual Receipts**

Expiring or Renewed Section 8 HAP Contracts

- **Renewals now governed by MAHRAA 9/30/97)**
- **6 options**
  - **Option 1 - Mark-up-to-Market (Mup2M)**
    - **1-A - no LURA, for-profit owned, REAC over 60**
    - **1-B - vulnerable population, community priority, low vacancy area**
  - **Option 2 - At or below Comp Rents (rechecked every 5 years)**
  - **Option 3 - Mark-to-Market (M2M) or M2M Lite**
  - **Option 4 - Exception project (lesser of current or budget-based, not rechecked)**
  - **Option 5 - Demonstration/LIHPHRA/ELIHPA**
  - **Option 6 – Opt Out of HAP Contract**

Expiring or Renewed Section 8 HAP Contracts

- **Forms of renewal HAP Contract:**
  - **Option 2 or 4**
    Basic Renewal Contract (20 Years)
  - **Option 1**
    Mark-Up-To-Market Contract (5-20 years)
  - **Option 3**
    Full Mark-to-Market Contract, or
    Watch List Contract (1 year)
  - **Option 5**
    Preservation Renewal Contract (up to 20 years)
- **OCAF adjustment annually**

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Post-Rehabilitation Rent Setting

- **Chapter 15 for Nonprofits**
  - **Available for LIHTC owners with nonprofit GP/Managing Member**
  - **Set rents at post-rehab Comp Rents**
  - **Rents effective upon completion**
- **Available if for-profit sponsored**
  - **under waiver (look for seller cash-out)**
- **Wait for Mup2M upon completion**

Section 8 Vouchers

- **Tenant-Based Section 8 subsidy**
  - **Issued by Public Housing Agency**
- **Tenant pays 30% of income**
- **Tenant can move and take voucher**
- **Rents set at 110% of FMR (generally)**
  - **Not Comp Rents**
- **Enhanced Vouchers**
  - **Upon HAP Opt Out, or 236 prepayment, or Flex Sub**
  - **“Reasonable Rent” – comp rent (post-rehab)**

Project-Based Vouchers (PBV)

- Tied to the project
- Granted/administered by the local PHA
- Competitively bid – except for other competition qualification (such as LIHTC)
- Not more than 25% of project – some exception for elderly
- Fifteen year terms (with renewals)
- Rents capped at LIHTC???

RAP/Rent Supp/Mod Rehab/RAD

- **RAP and Rent Supp are project-based**
  - **Similar to HAP Contracts (but no OCAF)**
  - **Terminate on prepayment of mortgage**
  - **no 20 year extensions**
- **Mod Rehab once prohibited use of LIHTC**
  - **Similar to HAP Contract (but lesser of 120% FMR, Comp Rents, current with OCAF)**
  - **No long term renewal (annual only)**
- **RAD (Rental Assistance Demonstration) PIH2012-18 convert to PBVs**

Current HUD Policies

- **Focus on maturing properties**
- **202s where HUD consent required**
- **Expiring affordability restrictions**
- **Notice PIH 2013-8 (April 12) – TBV Priorities**
- **Memo on Processing Interest Rate Reductions (April 19)**
- **SPRAC**
  - **New funding**
- **Processing Priorities (July 15)**
  - **Affordable LIHTC, Section 8 or mortgage based restrictions/subsidies with 15 years left, market rate 221(d)(4), Section 223(a)(7), Section 223(f)**
- **H 2013-17 (Payment and Refinance of 202 Direct Loans) (June 4) and**

Current HUD Policies (cont.)

- June 26 memo covering developer fee and use of proceeds
- Elderly issue
  - Changes to MAP Guide
  - Sullivan Solution (?)
- Residual Receipts
- Section 236 centralization to OHAP (July 1)
  - Assignment of IRP; equity takeout; eliminate LD; amend 236(e)(2) use agreement
  - Flex subsidy deferral
  - Excess Income Compliance
  - Issues of TPVs and Enhanced Vouchers
  - Prepayments

Grant/Direct Loan Programs

- **HOME (Community Development)**
- **202**
- **Mark-to-Market**
- **Public Housing**

HOME

- **Most commonly awarded and funded by local/city/county**
- **Most commonly as soft loan/grant to nonprofit sponsor (but can be direct loan)**
- **May trigger Davis Bacon (funds 13 units)**
- **May trigger Subsidy Layering – depending on use (construction or predevelopment)**

202 Program

- **Evolution from 1950’s 1954**
  - **pre-1974 (BMIR loan, no HAP)**
  - **1975-1990 (market-rate loan, HAP Contracts)**
  - **Post-1990 – “Capital Advance”, PRAC**
- **Once only for 501(c), but no longer**
- **More potential since 2000, and recent H2012-8**

Section 202 (pre-1990)

- **1000s of projects**
- **Direct HUD loan – new construction or substantial rehab**
- **40 year terms**
- **Prepayment lockout (except 1977-1982)**
- **Only available to 501(c)(3)’s**
- **Often Option 4 HAP Contracts (above-market Section 8) – both New Reg and Old Reg**

Authorization for Redevelopment/Prepayment of 202’s

- **AHEOA of 200/HUD Notice 2002-16/ 2012 Appropriations Act/H2012-8**
- **Permits ownership by Partnerships and LLCs**
- **Must have a sole GP or sole Managing Member that is wholly owned by nonprofit**
- **Permits prepayment of 1975-1990 202s if:**
  - **interest rate goes down**
  - **debt service is reduced**
- **Permits subordination of BMIR loans**

Authorization for Redevelopment/Prepayment of 202's

Prepayment requires:

- **Use Agreement for 20 years beyond original term**
- **20 year HAP Contract extension**
- **May restrict 202 nonprofit proceeds**

Common Tools:

- **Commonly uses Chapter 15 (Post-rehab rents) for HAP Contract renewal.**
- **Special Limited Partners?**
- **Seller debt.**

Redevelopment/Prepayment of 202's Caution

- **Over-income tenants (no involuntary displacement**
- **Assisted Living Conversions**
- **Unit Conversions**
  - **demonstrated lack of marketability**
  - **tenant notice and comment requirements**

Eligible for Mark-to-Market if:

- **Section 8 HAP Contract above market, and**
- **FHA Insured**
- **Exempt:**
  - **State insured**
  - **Section 202 elderly**
  - **Not FHA insured**
  - **LIHPRHA projects**
- **Beware of unexpired original HAP Contracts**

Mark-to-Market (Mortgage Restructuring)

- **Section 8 reduced to comparable market rents.**
- **Original mortgage prepaid/partial payment of claim**
- **FHA-insured mortgage bifurcated**
  - **223(a)(7)**
  - **HUD-held Mortgage Restructuring Mortgage (1%; 75% of cash flow) - MRM**
  - **HUD –held Contingent Repayment Mortgage (1%; 25% of cash flow/or none) – CRM**
  - **HUD-held MRM and CRM payable in full upon sale**
- **25% of cash flow to owner**
- **30 year use restriction, 20 year HAP Contract**

Mark-to-Market Lite

- **Owner requests HAP reduction to comparable market but does not want mortgage restructuring**
- **Watchlist HAP Contract (3 years)**
- **Once eligible always eligible for full M2M restructuring**

Redevelopment of M2M Projects

Need:

- **Not substantially rehabilitated at M2M restructuring**
- **1000's of units in every state**

Common Redevelopment execution - One:

- **Acquisition and substantial rehab by LIHTC Partnership with 9% credits**
- **Assumption of all debt**

Common Redevelopment execution - Two:

- **Acquisition and substantial rehab bonds/credits**
- **Assumption of HUD-held MRM & CRM**

Common Redevelopment execution – Three (QNP)

Redevelopment of M2M Projects

Acquisition and Rehabilitation requires:

- **Submission of TPA to Field Office requesting approval of LIHTC entity's assumption of HAP and debt.**
- **Submission to OAHP (Office of Affordable Housing Preservation) of request to retain MRM and CRM (possibly resubordinate to new first lien bond debt)**

Redevelopment of M2M Projects review and approval

- **OAHP & field office will review for four concerns:**
  - **Will property's financial and physical viability be maintained/enhanced**
  - **Will the MRM and CRM value (NPV) be maintained/enhanced**
  - **Appropriate distribution of transaction proceeds**
  - **best interest of HUD/tenants/community**
- **NPV based on 10 year projections (discount at 5.5%).**
  - **New first lien debt must be offset by cost savings**
  - **HUD will take an "even share"**

    1/2 of seller proceeds, or

    1/3 of seller/developer proceeds

Redevelopment of M2M Projects Common Results

- **Sale price not excessive due to 25% of cash flow limit.**
- **MRM and CRM assumed with partial paydown from "HUD share of proceeds"**
- **MRM and CRM resubordinated to new bond-debt**
- **HAP Contract extended for 20 years (<u>OCAF only</u>)**
- **, but:**
  - **watch NPV of MRM and CRM (and consider extended maturity)**
  - **watch for "exception rent" M2M HAP Contracts**
  - **watch for "non-project expense" needs (investor required reserves, investor fees, developer fees)**

Redevelopment of M2M Projects with QNP involvement

Request non-profit (QNP Incentive) of assignment of CRM and MRM to nonprofit sponsor

Requires:

- **TPA and OAHP waiver submission**
  - **but no NPV evaluation**
- **Submission to OAHP for qualification of QNP**
  - **501(c) owner of entire GP interest**
  - **community-based (CHDO) – 1/3 of Board locally or tenant-controlled.**
  - **History of housing**
  - **Financial needs of transaction requires QNP treatment**
  - **NO seller participation in purchaser**

Redevelopment of M2M Projects with QNP involvement Common Results

- **Sale price not excessive due to 25% of cash flow limit. Perhaps insert QNP as intervening owner – acquisition basis.**
- **HAP Contract extended for 20 years (OCAF only)**
- **M2M Use Agreement extended to 50 years.**
- **MRM and CRM now held by QNP with partial paydown from “HUD share of proceeds”**
- **MRM and CRM subordinated and restructured to meet transaction and participant needs (including possible QNP seller debt).**

but:

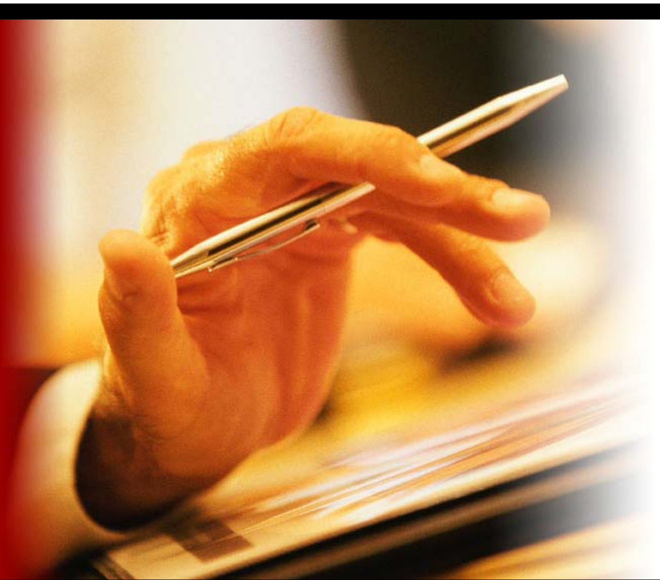
  – **carful with SLP/guarantor controls in LP agreement and requirement that QNP always be GP for 10 years.**

Public Housing

- U.S. Housing Act of 1937
- 3000+ Local Agencies funded almost exclusively by HUD
- Traditional Public Housing "Projects"
- Mixed Finance & HOPE VI
- PHA's use their resources with LIHTC
- Capital Funds & Operating Funds
- RAD
- Guarantee limits

Public Housing Structures

- **Disposition**
- **Mixed-Finance**
- **Ground Lease**
- **GP ownership**
- **ROFR**
- **PBVs**



Programmatic Requisites

Programmatic Requisites

- 2530/Previous Participation/APPS/
- LLCI (limited liability corporate investor)
- Removal of GP by investor SLP – new guidance – possible if SLP runs through 2530 qualification
- REAC
- Cost Certification
- Annual Audits for Insured & Section 8

2530/APPS

- Previous participation record and clearance
- Applies to Section 8 and all FHA programs
- Flags can be triggered by
- Mortgage default
- REAC below 60
- Other bad acts
- LLCI for “passive investors” (no flags had)

REAC
(Real Estate Assessment Center)

- **HUD's annual physical inspection program**
- **Applies to project-based Section 8 and FHA insurance**
- **Operated by private contractors**
- **Score of 60+ is passing**
- **Below 60 may receives a 2530/APPS flag**
- **Score 90+ - no inspection for three years**
- **Score 80+ - no inspection for two years**
- **Appeals are available in very short time frames (15 to 30 days)**
- **"PREAC?"**

Less Common but Growing Trends

- **LIHPRHA**
- **RAP/Rent Supp expirations/conversions**
- **Flexible Subsidy waivers**