HUD 236 Preservation

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Bedford Lending

www.bedfordlending.com

Who is Bedford Lending

- Company formed in 1991 – family owned
- Headquartered in Bedford, N.H. with 5 offices nationwide
- Approved to finance Apartment, Healthcare, and Hospital loans
- Management averages 30 years commercial experience
- Maintains highest designations –MAP and LEAN Approved
- Direct FHA Lender
- Certified to underwrite HUD loans Nationwide
- Has closed over $2 billion in loans

Our Difference

- Bedford Lending works as a partner with both market rate and affordable property owners throughout the country.
- We never take upfront fees, and pride ourselves on rapid turnaround time and a singular focus on customer service.
- Many times we act as "consultants" (at no cost) to help preserve or structure deals that other lenders turn down due to complexity.
- We are happy to provide references and contacts and have worked hard over the past 25 years to carry one of the best reputations in the industry.

Finance Process

Step 1 – BLC and Client work together to define scope of the project.

Step 2 - BLC to prepare a financial analysis outlining optimal financing options.

Step 3 - BLC to prepare extensive timeline and detail each step in process.

Step 4 – BLC to engage client.

Step 5 – BLC to send weekly progress reports.

HUD Timeline

- HUD refinance and acquisitions generally take 3-4 months from start to finish.
- HUD new construction and substantial rehabilitations generally take 5-6 months from start to finish.

About the 236 Program

- The Section 236 program was established in 1968 and provides affordable housing for low-income families and individuals.
- Owners can be for-profit or non-profits.
- Rents must be restricted to a HUD approved, cost-based rent.
- PBRA is included with many properties using Rent Supp, RAP, or Section 8 contracts.

236 Subsidies

- An Interest Reduction Payment (IRP) subsidizes 236 borrower's mortgage payment, making it equivalent to a rate of 1%. This is funded with the entire 40 year mortgage term.
- Some 236 properties have a Flex Sub loan, which is often a non-amortizing balloon note due at maturity or prepayment of the underlying Section 236 loan.

Preservation Option Challenges

- Most Section 236 projects were constructed long ago and are reaching the end of their loan term.
- Many carry deferred maintenance, are under capitalized, or need a way to pay the Flex Sub (if ballooning) at time of maturity.
- Current revenue from existing rent subsidy are not enough to prepay or repair property.

Preservation Options

An owner can refinance to:

- Raise capital in order to prepay the 236 loan
- Decouple and continue to use the IRP mortgage subsidy
- Payoff the Flex Sub note

And can secure:

- Rent increases through a new Section 8 contract
- Tenant Protection Vouchers
- PBV conversion of the TPVs through the RAD 2 program.

Refinancing Benefits

- Preserves project to offer long term affordable housing for an additional 35 years
- Non-recourse, fixed rate for life of loan, and is assumable
- Provides funds to complete repairs or cash to support other affordable properties in portfolio.
- Can be combined with grants, LIHTC, and other soft debt.

Prepayment Benefits

- As part of a refinance, your existing 236 loan will be paid off.
- Owners with Rent Supp or RAP (non-renewable) may prepay to trigger termination of these subsidy contracts in order to secure Tenant Protection Vouchers (TPV). This process (or natural expiration of the current contracts) allows the owner to participate in RAD 2 in order for the vouchers to be converted to a project-based subsidy.
- Can payoff the Flex Sub loan to proactively address the looming balloon note.
- For owners who do not need HUD permission to prepay, can trigger Enhanced Vouchers (EVs) for tenant protection which would deregulate/eliminate the property's use restrictions while also providing vouchers to tenants to protect them from rent increases.
- In general, prepayment will trigger the termination of the Section 236 Regulatory Agreement.

Prepayment Permission

- Not every 236 loan can be prepaid without HUD permission.
- The first mortgage note typically states whether HUD permission is required per verbiage like the below:

  "The debt … may not be prepaid … prior to final maturity without the prior written approval of the Federal Housing Commissioner, except that a … limited dividend corporation may prepay without such approval after 20 years."

- Non-profits cannot prepay without HUD approval, and properties with both Rent Supp and 221d3 mortgages also require consent.
- Limited dividend owners may prepay after 20 years unless they have waived their prepayment ability by receiving a Flex Sub (or other subsequent transaction).
- In all cases, the right to prepay must be verified by HUD's Office of General Counsel.

Prepayment Permission (con't)

Therefore the first step of any 236 refinance process is to consult with HUD and/or the governing Housing Authority to determine your prepayment restrictions and options.

Prepayment Steps

- When prepayment permission is required, owners must provide 150 days advance notice to the head of the local government, residents, and the HUD project manager/account executive.
- A continuing use agreement will remain in place through the term of the original Reg Agreement (affordable limitations must remain), and relocation assistance can be provided, as applicable.

- When prepayment permission is not required, owners must provide 150-270 days advance notice to the head of the local *or* state government, residents, and the HUD project manager/account executive.
- Upon prepayment, the Reg Agreement is dissolved, but no rent increases may be implemented for 60 days.

Does Prepayment Require Rehab?

- For owners that do not need HUD permission to prepay, there are no rehabilitation requirements.
- For owners that need HUD approval, one or more of the following criteria must be met:
- Total hard costs (rehabilitation costs) are at least $15,000 per unit.
- The rehabilitation includes the replacement or modernization of at least one major system or major building component.
- The total hard costs are greater than or equal to 25% of the Total Development Cost, which include all costs of the transaction including acquisition, rehabilitation, reserves, and fees.

Prepayment Req for 236 Properties Financed by State HFAs

- Most Section 236 properties were created using HUD via FHA insured loans, however a number were originated by state FHAs without federal mortgage insurance.
- "HFA 236 loans" are identical in terms (carry IRP + reg agreement), however prepayment terms are governed by the HFA.
- Despite managing the prepayment approval process, the notification provisions still apply.
- An early discussion with your HFA's asset management division, and a discussion with the HUD Office of Recapitalization (for properties with IRP decoupling) is critical.

Prepayment with ELIHPA and LIHPRHA

- Some Section 236 projects have Use Agreements under the Emergency Low-Income Housing Preservation Act (ELIHPA) of 1987 or the Low-Income Housing Preservation and Resident Homeownership Act (LIHPRHA) of 1990.

- Most ELIHPA Use Agreements have already expired however LIHPRHA Use Agreements remain in effect for the remaining useful life of the property.

- Many ELIHPA and LIHPRHA properties have very low-income non-Section 8 residents who are currently rent burdened, or who may face rent increases when ELIHPA Use Agreements expire. Prepayment of the Section 236 loan can make Enhanced Vouchers available to assist those residents and to support new financing for rehabilitation.

Prepayment Review

REVIEW: Prepayment	
Prepayment when HUD Consent is Required *Governed by Section 250(a) of the National Housing Act*	**Prepayment when HUD Consent is NOT Required** *Governed by Section 219 of the FY 1999 HUD Appropriations Act (Wellstone Amendment)*
Who: • Nonprofits, properties with Flex Sub Loans, certain FHA loans with Rent Supp or RAP **Tenant Notification Requirements:** • Notify tenants, HUD, and local government at least 150 days before prepayment **HUD Rehab Requirements:** • Minimum rehab requirements—see policy clarification memo for prepayments subject to Section 250(a) of the National Housing Act **Affordability Requirements:** • Property must be maintained with equal benefits for low-income residents through the original mortgage note term • Owner must execute a new Use Agreement (HUD Form 93142)	**Who:** • Usually for-profit entities **Tenant Notification Requirements:** • Notify tenants, HUD, and state or local government 150 -270 days before prepayment may occur **HUD Rehab Requirements:** • None **No rent increases** for 60 days after prepayment **Prepayment of State HFA Loans** • The HFA manages the Section 236 prepayment approval process, but the federal Wellstone Notice provisions still apply • All Section 236 preservation rules and incentives apply to these properties • Apply for approvals through HUD as with all Section 236 projects PLUS contact the HFA about their required prepayment approvals

IRP Decoupling

- Original 236 loans have an Interest Reduction Payment (IRP) to effectively lower the interest rate to the owner to 1% in return for affordable rents.
- A “decoupling” is retaining the IRP even if a 236 loan is prepaid/refinanced. Essentially the IRP is separated (“decoupled”) from its current loan and “recoupled” with the new one.
- The “recoupled” IRP with the new loan can either flow to the mortgagee with its original maturity/amortization date, or it can be paid over a longer period if monthly payments are reduced.

Decoupling methods

There are two core uses of a decoupled loan:

- 1) The remaining IRP can essentially be used as the payments for a "B" loan (secondary to the primary loan). The "B" loan amount is as large as the remaining balance of the IRP can support (depending on amortization schedule).
- 2) Or the remaining IRP can be used to subsidize the new loan, essentially offering a way to help cover debt service payments. Generally this is the most used option, as the balance of the IRP is typically too small to justify the costs involved with securing a separate "B" loan specifically with remaining IRP funds.

What's the catch?

- In return for the IRP decoupling, the owner must agree to a Use Agreement that extends the affordability restriction 5 years past the term of the Section 236 Reg Agreement (or 5 years from termination of IRP if being spread out over a longer period).
- During this period, any unsubsidized rents must still be set by the 236 rules for cost-based Basic Rent and Market Rent, including surplus cash restrictions.

Flex Sub Loan Deferral

- Many 236 projects have a Flexible Subsidy (Flex Sub) loan, which is often a non-amortizing balloon note due at maturity or prepayment of the underlying 236 loan.
- There are two categories of loans, Capital Improvement Loan Program (CILP) and Operating Assistance Program (OAP) loans.
- The CLIP loans should have low outstanding balances as they had fully amortizing terms that matched the term of the 236 loan.
- OAP loans are fully deferred balloon notes, which can create difficulty at time of maturity or prepayment (if funds not available to cover full Flex Sub payoff). In order to prevent a Flex Sub from causing a default, HUD may permit an owner to defer the loan for a period not to exceed the term of any new financing, or if there is no new debt, for up to 20 years.

Flex Sub Loan Deferral Qualifications

A request for a Flex Sub Loan deferral must include:

- Narrative to demonstrate how deferring the loan will benefit the project
- Evidence that there are no other sources of funds for repayment of the Flex Sub Loan
- A copy of the current year's budget and the most recent interim financial statement
- Last three annual audits
- Cash flow projections showing repayment of the Flex Sub
- Loan during the prescribed period
- Written agreement to comply with program requirements

Flex Sub Loan Deferral Qualifications (cont'd)

Additionally the owner must evidence:

- A passing score on a Real Estate Assessment Center (REAC) physical inspection (60 or above)
- Compliance with fair housing and civil rights laws
- Satisfactory Management and Occupancy Review for the prior three years
- Compliance with audited financial statement filings for the prior three years
- Mortgage kept current over prior three years
- Compliance with excess income reporting requirements for a seven year period
- No other outstanding defaults or violations

Flex Sub Loan Deferral Qualifications (cont'd)

Owners that receive a Flex Sub Loan deferral will be expected to enter into a new Extended Use Agreement that restricts the property to the same affordability requirements as were required under the original financing for the new term of the Flex Sub Loan.

To get started, owners should visit HUD's "Multifamily Preservation Resource Desk" online.

Flex Sub Loan Deferral Review

REVIEW

Flexible Subsidy Loan Deferral

Flex Sub Loans are required to be paid in full at the maturity or prepayment of the Section 236 Loan or at sale of the property.

- *Capital Improvement* Loans were amortized and typically have low balances.
- *Operating Assistance* Loans were structured as balloon payments.

The repayment requirement can cause difficulty when an owner is putting together an application to prepay and refinance a loan. As an incentive to owners to preserve the affordability of their properties, HUD allows the owner to request to defer repayment of the Flex Sub *Operating* Loan, which will allow it to be re-amortized for the term of the new loan.

Rent Subsidy Options

Section 8

- Many 236 properties have either PBRA contracts with a HAP Contract from HUD, or PBV HAP contracts from Public Housing Authorities.

- When decoupling an IRP with PBRA, the existing HAP contract must be terminated and renewed for 20 years at (or just before) refinancing closing. The owner must also execute a Preservation Exhibit as part of the new PBRA HAP contract that allows for automatic renewal after the 20 year term.

Increasing Section 8 Rents

- When refinancing, the owner may have the opportunity to increase rents if they are currently below market.
- Non-profits and some for-profits can use the Mark-Up-To-Budget (MU2B) process, or;
- The Mark-Up-To-Market (MU2M) process allows owners to increase rents without a budget-based request.
- The Section 8 Renewal Guide published in November 2015 will determine the best available option.

Tenant Protection & Enhanced Vouchers

- When tenants are at risk of being displaced as a result of a change in project subsidy (or 236 prepayment), Tenant Protection Vouchers may be provided by HUD.
- TPVs are administered by a PHA, and tenants would have to re-qualify (based on income) to receive the TPV. TPV are simply Housing Choice Vouchers and provide no occupancy protection or higher rents.
- TPVs can be converted into PBVs via RAD 2.

- Enhanced Vouchers (EVs) are a special class of TPVs triggered in certain scenarios. These triggers are:
- When HUD permission is not required to refinance (including HFA 236 loans), the owner can request EVs for the units not already assisted with PBRA.
- If a property has received a Flex Sub loan, then EVs are available while the project is preserved as affordable (as determined by HUD)
- If a PBRA contract is not renewed at expiration/prepayment, EVs can be issued.

Enhanced Voucher Definition

Enhanced Vouchers have two special features that make them "enhanced" for residents:

1. A household receiving an EV has the right to remain in their previously assisted home, and the owner must accept the EV as long as the home continues to be used as rental property. Instead of accepting an EV, a household may move right away with a regular voucher. If a household accepting an EV chooses to move later, its EV converts to a regular voucher.
2. An EV pays the difference between a tenant's required contribution toward rent and the new market-based rent charged by the owner after the housing conversion action, even if that new rent is greater than the PHA's basic voucher payment standard. A PHA's regular voucher payment standard is between 90% and 110% of the Fair Market Rent (FMR). EV payment standards must be adjusted in response to future rent increases.

Enhanced Voucher Quick Notes

- To re-iterate, the EV contract rent may be equal to comparable "reasonable" market rent (up to ~95% AMI) versus the PHA's Payment Standard for TPVs.
- The tenant has the right to remain in the unit (unless it is being substantially rehabilitated or converted from rental housing use) even if project is converted to market rate, and generally won't see a rent increase.
- If a tenant moves, the EV simply becomes a regular Housing Choice Voucher.
- For non-Section 8 tenants (ie. 236 tenants paying a ceiling rent at the 236 "market" rent), rents may increase substantially and be unfeasible for existing tenants to pay.
- Owners have the right to dispute whether requested rent is "reasonable", can request a higher security deposit (up to 2 months of new market rent), and units must pass PHA Housing Qualify Standards, all of which may prevent EVs from being viable and require tenants to move to a different project as available.

More Information

- EV vs TPV is complex, therefore owners should read housing Notice H 2012-03 "Guidance on Eligibility for Tenant Protection Vouchers Following Certain Housing Conversion Actions," which summarizes the distinctions among different circumstances that trigger TPVs and EVs.

RAD 2

- RAD 2 allows conversion of expiring, non-renewable Rent Supp and RAP contracts into long-term project-based Section 8.
- Rent Supp and RAP are terminated upon prepayment and/or contract expiration. Upon termination, TPVs will be awarded to eligible residents.
- RAD 2 allows project-basing of those TPVs as PBVs.

Getting Started

Apply for Financing & HUD Approval

- 1) Determine the scope of work. If repairs are needed, a property condition report is recommended.
- 2) Determine your financing request, with either HUD/FHA, or HFA, and any grants or soft debt available.
- 3) Issue tenant notices with a large lead time.
- 4) Discuss your requested options (Flex Sub deferral, IRP decoupling, TPV, EV, RAD 2, etc) with HUD and/or your PHA.

Bedford Lending will help you through the process!

Examples of BLC Affordable Housing Closings

$10,000,000 - New Construction of 83 Unit Workforce Housing Apartment

30% of units are affordable housing and project was financed through the 221(d)(4) program.

$2,500,000 RAD conversion

Secured PBRA and converted Housing Choice Vouchers to PBVs to increase income, which allowed property to be refinanced and complete $200,000 in capital improvements, and secure $400,000 cash out for owners to deploy to other affordable housing properties in their portfolio.

Stabilize and Repair Property

Worked with our affordable housing consultant to source grants, which allowed owner to complete necessary capital repairs to increase occupancy and stabilize property. At stabilization, refinanced property to complete additional $400,000 in improvements. Without Bedford Lending, property would have entered default.

$5,100,000 Refinance 223(f)

Refinanced a bank loan, and reduced interest rate from 6.35% to 3.85% fixed for 35 years, which allowed for long term preservation of affordable housing in market with strong low-income demand.

Section 236 Refinance

BLC assisted non-profit owner with a Mark-up-to-Budget which resulted in a significant rent increase. Able to complete over $1,000,000 in capital improvements.

Section 202 Refinances

Berlin, NH

Center Sandwich, NH

Manchester, NH

Norwich, VT

Northumberland, NH

Philips, ME

$9,400,000 refinance of Existing Tax Credit Deal- $700,000 cash out.

Property was constructed in 2000 through NH Housing with Tax Credits. Refinance lowered debt service by $100,000 a year.

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