

OAHQ Headquarters Underwriting Issues Updated Exception Rent Guidance

A key goal of the M2M program is the reduction of rent to comparable market levels. Mortgage debt is also reduced to allow payment of reasonable operating expenses, replacement reserves and owner incentives. MAHRA provides limited authority to set rents above market when the housing needs of the tenants and the community cannot be met otherwise. This authority has been used to support preservation. Often, the project was a critical element of the local affordable housing market and could not have been preserved without above market rents. We expect to continue using this authority to preserve affordable housing. At times, however, exception rents can be reduced or eliminated with minor adjustments to the elements of the underwriting. The rent level established in the debt restructuring represents a 20-year commitment to above market rents. Budget pressures make it imperative that we maximize our scarce subsidy dollars.

The PAEs and OAHQ underwriters and Debt Restructuring Specialists should increase their focus on limiting the use of exception rent to the most preservation worthy projects. The level of exception rent should be limited to the amount needed for long-term economic viability. Market Rent is still the program standard. Exception Rent above 120% of FMR is extremely limited and should be reserved for the most preservation worthy projects. It will no longer be available for restructurings supported by tax credits. Communicate this to the owners early and often during the restructuring process.

When a PAE completes its initial underwriting and exception rents appear necessary, the elements of the underwriting should be revisited to make adjustments that will bring the rent back to market. This guidance applies to standard 223(a)(7) financed transactions and also to the Baseline and Additional Funds modeling. The following are suggested items for adjustment. The choice of items and the amounts can be discussed with the owner. A single adjustment may be adequate or more than one adjustment may be warranted. The following adjustments are suggested for standard M2M deals. A second list below contains additional adjustments for tax credit supported restructurings.

- Reduce operating expenses that are higher than necessary.
- Eliminate non-essential items from the rehab escrow.
- Remove short-term expenses from the operating pro forma and cover them with a short term operating deficit. e.g. extra short-term security for turn around.
- Set the IPF closer to the minimum
- Extend the term of the CRP up to 15 years.
- Reduce the CRP spread by up to 150 basis points.
- If a TPA is involved, defer some or all of the Developer Fee allowed in 223a7 transaction.
- If a TPA is involved, reduce or remove payables from consideration as transaction costs. If the review still supports exception rents, remove payables from coverage
- Look for Other Sources such as HOME funds

- If the project includes a HUD approved Neighborhood Network center, look for other sources of support, limit the staff funding to 2 or 3 years and fund through an escrow.
- Adjust the exception rent level downward if the underwritten 1st mortgage interest rate declines prior to closing.
- Increase the Nonprofit owner's contribution to Transaction Costs to 20%, if that contribution has previously been waived.

The following items should be added to the above list for deals involving tax credits.

- Eliminate IPF – (CRP already eliminated)
- Maximize Deferral of Developer Fees
- Reduce Seller proceeds that are in excess of CPA certified Exit Tax
- Underwrite to 1.20 DCR, if more favorable than the OAHP expense cushion.

This guidance is effective immediately for all properties for which the RC has not yet been issued. PAEs, as part of their case submission, should discuss efforts they have made to minimize exception rents. OAHP reviewers should also discuss these efforts in the Income section of the Transaction Review. If the PAE has already submitted a Restructuring Plan with Exception Rents and the application of this guidance threatens the closing, exceptions will be considered by the OAHP DAS on a case-by-case basis.

For any tax credit supported restructurings requiring exception rents, a waiver will be required from the OAHP DAS.