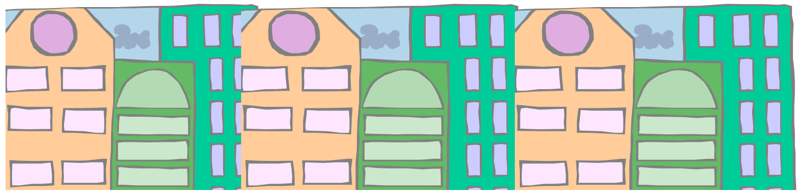
Office of Multifamily Housing Assistance Restructuring



Deal Profile: *Rural Portfolio, Transfer to Non-Profit, Tax Credits, Bonds, and FHA Claim Payment.*

Date of Presentation: *November 19, 2001.*

<u>Questions and Answers</u>

1. A follow up comment from the property owner.

Thank you; we think you did a good job of talking about the process and policies resulting from these deals. A couple of quick comments:

A. We believe you understated the additional rehab – we think the total was more like $10,000.
B. An important additional policy innovation was your willingness to increase the A7 insurance amount to the higher level made possible by the lower RR and lower interest rate.
C. While difficult perhaps to discuss at the current state of things, the assignment of debt, as alternative to the forgiveness is critical to the overall economics of the bond deal. I'd like to suggest that the determination of qualification for debt forgiveness be formally integrated into the 'base case' thereby laying the groundwork for a policy/economic equivalence of assignment, when its legality is clarified.
D. Finally, we would like to have had the chance to identify ourselves; we had understood the format would allow that, and were surprised when it did not; I agree with a premise of confidentiality, unless specifically waived by the owner, but we would have preferred to do so.

The owner is now Preservation of Affordable Housing, Inc. (POAH). At the time of the transaction, the seller was Midland Properties and the purchaser was NEF Properties, Inc. (NEFPI), a subsidiary of NEF (The National Equity Fund). Just prior to closing, NEFPI acquired the properties. Subsequent to closing, NEFPI was fully separated from NEF, and was renamed POAH.

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2. A Question on the mechanics of the claim 'lock-down.'

Q. Please expand on how the claim amount remains the same, but the first mortgage is increased by either or both the reduction in RR deposit or reduced interest rate bond financing for the new first mortgage.

A. The central concept in Additional Funds (AF) restructuring is 'the baseline transaction.' This means that the deal must first be structured normally (on a stay-in owner basis, without factoring in the additional funds); the payment of claim is established at this 'baseline.' Because the claim has already been set at the 'baseline,' the additional funds serve as increased sources, rather than as an offset to the claim. In this way, the owner (or purchaser) benefits through its ability to raise additional, needed funds, and the property benefits when these are applied to the transaction.

The chart below illustrates the three stages of a sample AF deal, as it progresses through underwriting.

- Stage One: Pre-restructuring, showing the property's large, unsupportable first;
- Stage Two: Baseline, showing the property's standard restructuring with the current owner – without the benefit of additional funds; and,
- Stage Three: Additional Funds, demonstrating the benefits to the property (without consequence to the payment of claim) of the additional funds. In this example, a higher first mortgage is financed through the use of tax exempt bonds. The lower interest rate of bonds allows for a greater first than with conventional financing. The difference in this example between the baseline first mortgage (8.5% interest rate) and the AF first mortgage (6% interest rate) is $111,000.

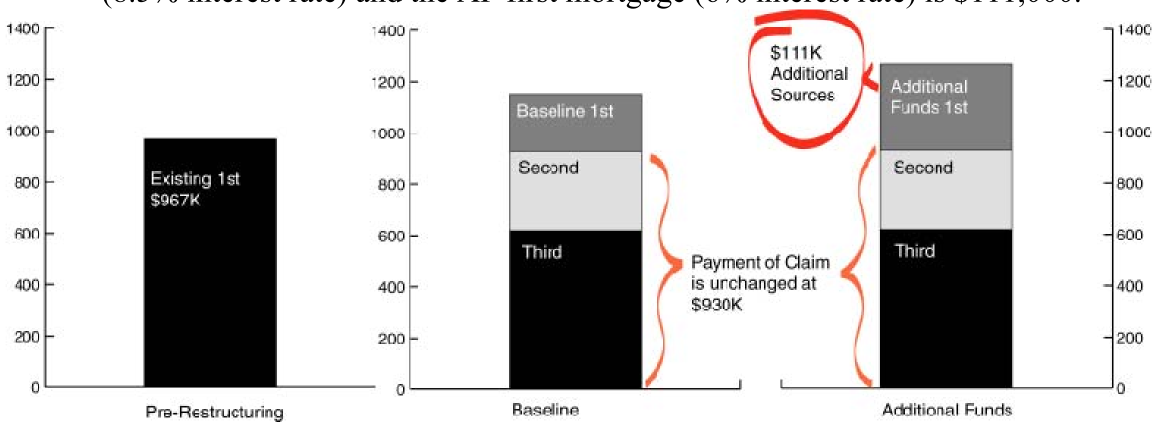

Figure 1. Illustrative Example: Additional Funds Provided by Tax Exempt Bond Financing

To underwrite this property at the bond interest rate in the baseline scenario would have simply reduced the payment of claim, providing no benefit to the property and no incentive to the owner to seek out the bond financing. HUD's desire to encourage other public funds was noted in the Preamble to the Interim Rule (Federal Register (/11/98) .

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3. Use Restrictions

Q. Which is subordinate, the tax credit agreement or the OMHAR agreement?

A. The tax credit agreement is subordinate. The OMHAR Use Agreement is a covenant running with the land, ahead of any other liens or use restrictions. Note that in MAHRA 401.408, the M2M Use Restrictions are generally consistent with the tax credit restriction.

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4. Timing of transfer and transaction

Q. In the transaction that you described was the transfer done after a restructuring with the existing owners or as a part of the restructuring?

A. The exiting owner, a for-profit, sold the management company to the purchaser previous to the entry of the properties into the Mark-to-Market program. Additionally and at that time, the exiting owner had reached agreement on the sale of the property. All negotiations were therefore conducted with the Purchaser, throughout the M2M process. A TPA was consummated prior to closing of the M2M transaction. The following was the order of events:

1. The exiting owner signed the restructuring commitment (subject to the successful TPA);
2. The TPA was consummated, and the RC conveyed to the purchaser;
3. The M2M transaction closed at the same time the additional funds were brought in.

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4. Developer's Fee

Q. Was the NP permitted a development fee, which was included in the (a)(7) financing?

A. The NP earned a developer fee under the applicable policies of the State HFA that allocated the tax credits. The developer fee was paid from tax credit equity proceeds.

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5 Acquisition Transaction Costs.

Q. Were acquisition transaction costs rolled into the financing?

A. Yes. Per the owner / purchaser incentive matrix, 80% of certain acquisition transaction costs are eligible to be financed, subject to a maximum amount of $15,000 (80% -- $12,000 -- of which can be financed). The actual acquisition transaction costs in this very complex transaction exceeded the maximum, and thus less than 80% of the actual acquisition transaction costs were financed.

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6. Debt Forgiveness

Q. Was there debt forgiveness?

A. The purchaser was eligible for, but did not request, debt forgiveness.

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7. Process in a TPA, Approach to Restructuring Commitment

Q. I've heard that OMHAR prefers to make its restructuring commitment to the current owner and have the transfer to the NP occur after the restructuring with the current owner. Is this generally true? Taking this approach would presumably deny the non-profit purchaser the opportunity to roll 80% of the acquisition transaction costs and a developer's fee into the financing, or is there some way to structure it in?

A. OMHAR does not have a preference regarding the order of events in a TPA/Restructuring. Note, however, that sellers are generally reticent to enter into a restructuring commitment (RC) on a property that they will soon sell, given the long-term obligations associated with these agreements. This reticence conflicts with the need to have the party with legal authority to enter into agreements (i.e., the current owner) to do so. In this transaction, both the seller and purchaser signed the Restructuring Commitment. The seller was allowed to attach a condition to the RC, removing any obligations thereunder, should the planned TPA fail to materialize prior to closing of the restructuring. It should also be noted that the order of transactions (TPA followed by M2M, or the reverse) can have material consequences (including income tax consequences) for seller and purchaser; accordingly, sellers and purchasers and PAEs should discuss transaction sequencing in detail, and reach agreement, early in the M2M process so as to avoid problems in closing.

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8. Subsidy Layering

There were comments and questions forwarded regarding the issue of subsidy layering generally. These are being addressed in forthcoming guidance, rather than being answered here.