Office of Multifamily Housing Assistance Restructuring

Deal Profile: **Reduced Number of Section 8 Units, Conventional Financing**

Date of Presentation: **March 25, 2002**

<u>Questions and Answers</u>

1. Local HUD Position

Q. What was the local HUD office's opinion on the loss of 13 Section 8 Units?

A. HUD preferred the plan of reducing the number of Section 8 units to a plan that would voucher out all the units. The HUD office was kept involved from the beginning of the Mark-to Market fact finding through the completion of the restructuring plan.

2. Rental Assistance Assessment Plan (RAAP)

Q. Why did you do a RAAP for this property that has an elderly resident profile?

A. The RAAP is an excellent tool for understanding the market. The project had a 30% vacancy rate, but the community appeared to be stable and prospering. The subject is located in an isolated, rural community without similar multifamily projects. We needed to dig into the dynamics in the market place and all the aspects of the situation before approving a restructuring plan.

3. Separation of 13 Units from the HAP and Other Documents

Q. What happens to any cash flow generated by future renting of the 13 units separated from the HAP contract?

A. Although the restructure plan was underwritten with only 27 of the 40 original apartments, the possibility remained that the Owners could rent any of the 13 non-subsidized units should the market demand prove favorable. The legal documents provide that any cash flow generated from renting these units would flow to project income. Since any additional expenditure related to these units would be minor (utilities), the cash flow generated would go right to the project's bottom line. The plan was set up with HUD receiving 85% of available annual surplus cash, (after payment of the Incentive Performance Fee), for payment towards the HUD 2nd mortgage. The Owner would receive their 15% split of cash flow from the project including any net operating income generated by renting of the non-subsidized units.

4. Pre M2M Cash Flow

Q. Did the property have positive cash flow prior to the restructure?

A. No, the property had been in a negative surplus cash position the last few years and the Owners were funding operations.

5. Conventional Financing

Q. Why was conventional financing chosen instead of the 223(a)(7) financing typically done in M2M deals?

A. After reducing the rents to Market, determining adequate expenses and increasing the monthly deposit to the Reserve for Replacement Account, the resulting Net Operating Income could only support a new first mortgage of about $110,000. The new financing was required for funding HUD's portion of the Rehab Escrow and Transaction Costs, plus increasing the Initial Deposit to the Reserve for Replacement Account by several thousand dollars. This amount is lower than the typical minimum levels for 223(a)(7) loans. There was a local institution interested in supporting the preservation of this property that agreed to provide the necessary financing.

Q. What were the terms of the new first?

A. The 8% interest rate was locked in for 30 years and there was a ½ point fee.

Q. Did the lender and the owner have an identity of interest?

A. No. The Owner had done business transactions with various branches of the bank, in other cities/towns, in the past.

6. Relocation

Q. You mentioned that the top floor of the 4-story building was underwritten as vacant and the 27 Section 8 units would be located on the first 3 floors. How did you determine to restructure the project this way and did it trigger the Uniform Relocation Act?

A. The plan was more conceptual, rather than physical. About half of the units on the top floor were already vacant. There were cost savings associated with reducing heat and electrical use in the vacant units. The Section 8 residents on the upper floor were not required to move to a lower floor. However, the plan includes renting vacant units on the first 3 floors to new residents first. The Uniform Relocation Act was not triggered for this project. Other M2M restructuring plans that call for taking units out of service should be looked at individually. OMHAR has received legal opinion in at least one instance where M2M did not trigger the Uniform Relocation Act.

7. Section 8 Savings

Q. Does the M2M Section 8 Savings calculation over the next 20 years include the loss of the 13 units?

A. The model calculates the Net Present Value of Section 8 Savings over the next 20 years at approximately $1.2 Million. This does include the loss of the 13 units. The reduction of Contract Rents to Market Rents, averaging $107 per unit per month, still provides significant savings to the government without counting the reduction of the 13 units.