

APPENDIX A

Underwriting Q & A

1. **How Should PAE's Determine Comparable Market Rents?** The PAE should determine the rent that the property would actually command in the open market. If the property is vouchered out and cannot command the rents the PAE determined in the underwriting, the restructuring will have been a failure.
2. **How Should PAE's Reconcile Differing Opinions About Comparable Market Rents?** OMHAR expects that experts will disagree about market rents, and that this disagreement will sometimes be substantial. This is partially because many properties to be restructured will have a shortage of ideal comparables, and partially because rent comparability involves a great deal of expert judgment. The PAE should be able to narrow the range of disagreement, based on their site visits and through discussion with affected parties. Within the narrowed range of expert disagreement, OMHAR expects the PAE to select a comparable market rent that the property can command in the open market with a high degree of certainty.
3. **How Can The Rents Be Determined If There Are No Comparable Properties?** Based on experience in the Demonstration programs and research, OMHAR believes that the vast majority of properties will have three properties from which comparability adjustments can be determined. If comparable, unassisted properties are not available, consider non-comparable rental stock in the relevant market area and make appropriate adjustments. Then consider comparable properties, in markets with similar characteristics, outside the local market area. Less than ideal comparables will require correspondingly large comparability adjustments (for location, structural type, etc.) requiring significant levels of expert judgment. The statute and regulations also provide for properties to be restructured at 90% of FMR's, but only as a last resort.
4. **What Operating Expense Level Should PAE's Use?** OMHAR expects PAE's to determine expense levels that are consistent with efficient operation of the property by competent management. The expense estimates should be no more than necessary to maintain the long term physical and financial integrity of the property given the intended use as an affordable housing resource. For properties being converted to tenant based assistance at the time of restructuring, this means the expenses necessary to operate the property in the open market (for example, removing expenses associated with project-based Section 8 paperwork, and adding expenses associated with marketing). For properties continuing under project-based assistance, this means the expenses necessary to operate the property in an ongoing project-based Section 8 environment.
5. **How Does OMHAR Categorize Operating Expenses?** OMHAR has found it useful to break operating expenses into four categories: non-discretionary base expenses, controllable expenses, other expenses, and Reserves for Replacement. Non-discretionary expenses include utilities, real estate taxes and property insurance. Controllable expenses include marketing costs, administrative salaries, maintenance salaries and expense, property management fees, other

administrative costs, and maintenance. Other necessary expenses may include protection, security, and non-housing services as Neighborhood Networks or Service Coordinators for elderly projects.

6. **Does OMHAR Expect Post-Restructuring Operating Expenses To Differ From Historical Expenses?** OMHAR expects this for all properties being converted to tenant-based assistance, and for many properties continuing with project-based assistance. PAE's should use historical expenses only as a starting point for underwriting analysis, recognizing that the post-restructuring environment will differ from the pre-restructuring environment. In particular, OMHAR expects operating expenses to decline in properties where economic discipline has been partly or largely absent (for example, high cash flow properties with limited distributions, and properties with budget based rents). However, expenses may increase for properties that have been operating under financial stress prior to restructuring.
7. **What Standards Should PAE's Use To Estimate Operating Expenses?** The PAE is expected to perform a property-specific analysis with the most appropriate data available, including an analysis of comparable market properties, the subject property's historical expenses, and subsidized properties of comparable size and similar resident profile, that the PAE knows to be competently managed. Data should be obtained from the PAE's third party limited scope appraisal, an independent analysis performed by a management company, FHA or other institutional data if available, and the PAE's own data. Other benchmarks include industry average data, reflecting a sufficient number of sufficiently comparable properties. The PAE should evaluate the project's historical operating expenses for property-specific line items (such as utilities and real estate taxes).
8. **How Should PAE's Evaluate Real Estate Tax Expense?** OMHAR expects PAE's to conduct a property-specific evaluation of the real estate tax expense to be expected in the post-restructuring environment. For properties located in taxing jurisdictions that assess assisted properties based on the property's actual NOI, OMHAR expects real estate taxes to decline. For properties with tax abatements or payment-in-lieu-of-tax agreements, the PAE should evaluate whether the abatement or PILOT will continue to be applicable after restructuring. There may also be situations in which real estate taxes might increase.
9. **How Should PAE's Evaluate Property Management Fees?** The Management Fee used in underwriting should be based on the cost a competent independent, non-Identity of Interest management agent would bid. In order for the restructuring to succeed, the management fee must be adequate to allow a competent property management agent to deliver the management services necessary for the property to operate the project as an affordable property. For properties being converted to tenant-based assistance, PAE's should use competitive fees for similar market rate properties. For properties continuing with project-based assistance, PAE's should adjust the fee to reflect the different set of management tasks required in the project-based environment. Most of the Mark to Market properties are managed by small and medium-sized agents with higher cost structures than the largest agents; accordingly, PAE's should not set fees so low that only the largest and most cost-efficient agents can manage profitably. Likewise, consideration should be given to economies of scale if the property is smaller (or larger) than the comparables. Conversely, fees should not be higher than needed to attract competent management.

10. **How Should PAE's Evaluate Front-Line Staffing?** OMHAR expects PAE's to base staffing costs on the staffing reasonably necessary to operate the property to Mark to Market standards under a competent property management agent. OMHAR expects PAE's to eliminate staffing costs associated with non-front-line tasks that must be paid for from the property management fee. If the property management agent utilizes a non-standard staffing approach (such as allocating off-site staff who perform front-line functions for several properties), OMHAR expects PAE's to underwrite staffing costs at an amount that does not exceed what a competent management agent would require under a more standard staffing approach (with front-line staff on site, dedicated solely to the property).
11. **How Should PAE's Evaluate Security / Protection Expenses?** OMHAR expects PAE's to include security expenses to the extent that such costs are reasonably necessary for a competent agent to operate the property expenses to Mark-to-Market. These expenses may be higher or lower than historical expenses.
12. **How Should PAE's Evaluate Maintenance and Repair Costs?** PAE's should include maintenance expenses to the extent they are reasonably necessary for a competent agent to operate the property to Mark to Market standards. OMHAR expects PAE's to evaluate maintenance costs in conjunction with the Physical Condition Assessment, so that costs are not double-counted. Note that historical maintenance expense figures frequently include capitalized repairs and replacement that were expensed for financial statement purposes.
13. **How Should PAE's Evaluate the Need for Neighborhood Networks and Other Non-Housing Service Costs?** OMHAR expects PAE's to include these costs to the extent that the services are effective, and that such costs are reasonably necessary to operate the property, taking into account such factors as the current and anticipated resident profile. PAE's should note that non-housing capital costs (to establish a service program or to replace capital items as they wear out) generally may not be included in the PCA. Staffing costs for non-housing services may not be included in the operating expenses, but operating expenses such as utilities and incremental maintenance expenses may be included. The use of common area (and/or conversion of revenue units) for non-housing services is allowable for properties at which services are an appropriate part of the post-restructuring environment.
14. **How Should PAE's Distinguish Between Immediate Repairs and Longer Term Repairs?** PAE's must include in the immediate repairs any items that need replacement / repair within 12 months following restructuring. Immediate repairs will be funded by FHA (up to 80%) and the owner (at least 20%). Longer term repairs will be funded from the Reserves for Replacement.