AGENDA

- History of the Mark-to-Market (M2M) Program
- Financial Management of the M2M Portfolio
- Post-M2M 101
- What’s new in the PM2M Notice!
- What’s Needed from the Field Office?
History of the M2M Program

Mark Abraham

OGC Insured Housing – Multifamily Mortgage Division
THE M2M PROGRAM

THE HISTORY OF THE MARK-TO-MARKET PROGRAM

• 44 years ago, Congress created Section 8 as a primary subsidy mechanism.

• Over the years, 10,000 properties were thought to have above-market contracts and if continuously renewed would eventually exceed HUD’s total budget.

• But the reduction to market rents, without a reduction in debt service, potentially jeopardizes property operations and the mortgage encumbering the property.

• Accordingly, Congress passed the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA). Properties eligible for M2M rent and debt restructuring – Rents exceed comparable properties/project-based assistance/encumbered by a mortgage insured or held by the Secretary under the National Housing Act.

• Demo program ran from 1997-2000. The first M2M rent and debt restructuring occurred in 2000.
WHAT IS A MARK-TO-MARKET RENT AND DEBT RESTRUCTURING?

- Restructure a Property to be financially and physically viable at market rents, benefiting the owner, tenants and other stakeholders.
  - Existing mortgage is refinanced with a new, first mortgage loan, sized by the market rents.
  - HUD pays off the existing FHA-insured first mortgage through a claim on behalf of the Property owner under the existing mortgage insurance contract.
  - An owner’s obligation to repay the claim is evidenced by a Mortgage Restructuring Note (MRN) and/or a Contingent Repayment Note (CRN), or a Demo Note.

- M2M Program sunsets on October 1, 2022.
THE M2M PROGRAM

KEY M2M STATUTORY REQUIREMENTS

• **MAHRA § 514(e)(6)** requires that projects that undergo M2M debt restructuring receive a minimum 30-year M2M Use Agreement.
  o Provides affordability pursuant to 24 CFR 401.408
  o Gets recorded among the land records and “runs with the land”

• **MAHRA § 517(a)(5)** provides that: “The Secretary may modify the terms of the second mortgage, assign the second mortgage to the acquiring organization or agency, or forgive all or part of the second mortgage ... if the project is acquired ... by a tenant organization or tenant-endorsed community-based nonprofit or public agency.”
  o AKA Qualified Nonprofit Purchaser (QNP)

• **MAHRA § 514(e)(2)** requires that during the term of the M2M Use Agreement, M2M Renewal Contracts adjust contract rents by OCAF only and BBRI or RCS resets are prohibited rent adjustments or renewals for restructured projects
THE M2M PROGRAM

UNFORTUNATELY....

• The OCAF only requirements on M2M properties has created an income shortfall for some properties. This has resulted in:
  
   o Unaddressed Capital Needs
   o Difficulty leveraging debt and equity for preservation
   o Estimated $235M in additional Section 8 funding to address rent levels for the majority of the M2M portfolio below FMR

• What can HUD do to help?
  
   o 8(bb) + M2M as covered in the new PM2M Notice
   o QNP assignment/forgiveness
   o Section 209 of Division L, Title II of the Consolidated Appropriations Act of 2021 + High-Risk PM2M Properties Memo (2019)

“the Secretary of Housing and Urban Development may authorize the transfer of some or all project-based assistance, debt held or insured by the Secretary and statutorily required low-income and very low-income use restrictions if any, associated with one or more multifamily housing project or projects.”
Financial Management of the M2M Portfolio

Michael Murphy
Housing Program Officer
THE M2M PROGRAM

FINANCIAL MANAGEMENT OF M2M PORTFOLIO

• HUD-held mortgages are repaid via Annual Surplus Cash
  o Typical split is 75% to HUD and 25% to Owner
• Capital Recovery Payments (CRP)
  o Owner contribution costs repaid with interest
  o Underwritten as an operating expense
• Incentive Performance Fees (IPF)
  o Exceptional fee to recognize exceptional performance
  o Percent of EGI
  o First priority in Surplus Cash waterfall
  o Does not accrue if conditions do not permit payment
THE M2M PROGRAM

M2M ASSET MANAGEMENT:

• Meet HUD’s critical timelines
• Assist HUD’s loan servicer for the M2M program
• Assist HUD Account Executives (AEs), Departmental Enforcement Center (DEC) analysts, and Property Owners
• Produce quality analyses under program guidelines and OAMPO oversight and monitoring
• Ensures that HUD is collecting proper debt payments under the M2M program

POST CLOSING PORTFOLIO MANAGER (PCPM) CONTRACTOR:

• Reviews Owner’s Annual Financial Statement (AFS),
• Compares actual performance to M2M underwriting conclusions
• Identifies significant variances, makes necessary adjustments, and computes the surplus cash due
• Maximizes the value of M2M Notes by making sure HUD receives the correct surplus cash payment
THE M2M PROGRAM

HUD ACCOUNT EXECUTIVE ROLE:

• Review Preliminary and Final SCA report and respond
• Work with PCPM to provide relevant information (REAC, Management or other HUD findings; DEC)
• Provide your knowledge of the property
• Approve the SCA

OAMPO PORTFOLIO DASHBOARD:

• Provides real-time, web-based information
• Access controlled via permissions
• Provides user with personalized perspective on the information they access
  • PCPM analysts can access SCAs and work progress reports
  • HUD Account Executives view PSCAs and FSCAs for approval
  • OAMPO staff monitor PCPM progress and research property information.
PM2M: 101

Kara Williams-Kief
Branch Chief
WHAT HAPPENS AFTER THE M2M RESTRUCTURE?

- M2M has restructured 3,599 transactions for a total of 315,158 units since 2000.

- Pursuant to statutory and regulatory requirements for MAHRA, M2M debt (MRN/CRN/Demo) must contain a due-on-sale or refinance provision.

- The due-on-sale or refinance provision requires the M2M or Demo Notes to be repaid in the event of a Refinance or Sale.

- An owner/purchaser must request a waiver of the due-on-sale or refinance clauses, if the M2M debt will not be fully satisfied as part of the transaction.

- HUD must also review non-standard requests such as changes in ownership structure, partial release of security & M2M Use Agreements, 8bb & M2M budget authority transfers, matured Note(s) evaluation, etc.
THE PM2M PROGRAM

WHEN IN DOUBT – REACH OUT!

When is Recap Involved?

- All refinances of the first mortgage that increases debt service
- All QNP Requests for Debt Relief
- Transfer of budget authority to or from the Project pursuant to Section 8(bb)
- Transfer of a portfolio of Projects between a Seller and a Purchaser
- Changes to the Project ownership at any level

All Assumptions and Subordinations with Note Modifications

All Assumptions and Subordinations with Proceeds

WHEN IN DOUBT – REACH OUT!
WHAT IS RECAP LOOKING AT?

- Are there Proceeds?
- Is there a Negative Impact to the Note(s)?
- PM2M Underwriting Analysis
  - Generally, 50% of Proceeds to Paydown the Notes
  - NPV of Actual vs. Proposed Surplus Cash
### The PM2M Program

#### HUD Asset Management Requirements for PM2M

<table>
<thead>
<tr>
<th>Requirement</th>
<th>M2M Restructured Rents</th>
<th>M2M Exception Rents</th>
<th>QNP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual Termination &amp; HAP Renewal</td>
<td>Option 3b</td>
<td>Option 3b</td>
<td>Option 3b</td>
</tr>
<tr>
<td>Rent Setting</td>
<td>OCAF only through M2M UA Term</td>
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</tr>
<tr>
<td>HAP Contract Term</td>
<td>20 Years</td>
<td>Remaining term on the M2M UA</td>
<td>20 Years</td>
</tr>
<tr>
<td>M2M UA</td>
<td>30 years; may be extended to be coterminous with the new HAP Contract</td>
<td>30 years; may not be extended beyond original M2M UA term.</td>
<td>Additional 20 years; cumulative 50 years.</td>
</tr>
</tbody>
</table>
THE PM2M TEAM

• Office of Recapitalization
  o Underwriting
  o Closing

• Asset Management
  o Account Executives
  o AFS and Surplus Cash
  o PCPM

• Office of General Counsel
  o Field Counsel
  o HQ Program Counsel

• Multifamily Notes Servicing Branch
  o Prepayments
  o Paydowns
The New PM2M Notice

Kara Williams-Kief
THE NEW PM2M NOTICE

OVERVIEW OF THE NEW PM2M NOTICE

• Replaces Housing Notice H 2012-10.

• Key Components:

  o Streamlines the underwriting process for requests.
  o Replaces Strategic Communities with “High Priority Projects” – emphasis on preservation.
  o Folds Appendix C of the Mark-to-Market OPG into the Notice.
  o Expands guidance regarding review of proposed QNPs.
  o Provides guidance on M2M Matured Loans.
  o Establishes guidance on processing a request that includes 8(bb) and the transfer of HAP Assistance.

• Does not address M2M rents
THE NEW PM2M NOTICE

QUALIFIED NONPROFIT PURCHASER (QNP) CHANGES

• The Notice now incorporates Appendix C of the M2M OPG.

• Tightens up the review criteria for approval of QNPs.

• Accommodation Agreement extended from 10 years to 15 years.

• **Affordability Commitments.** The Purchaser shall accept an extension to the Use Agreement for a total term of fifty (50) years from the date of the M2M restructuring event.
  
  o **NEW!** After the expiration of thirty (30) years from the date of the M2M restructuring event, the Purchaser shall be obligated and contractually commits to renew the HAP Contract under any renewal option for which the project is eligible at the time; ie: Option 3b lifted after year 30!
THE NEW PM2M NOTICE

ADDRESSING MATURED & MATURING M2M AND DEMO NOTES

• HUD expects full repayment of the Note(s) at maturity.

• The primary option is a refinance or sale of the Project that pays off the M2M Notes.

• Work-outs will be considered when:
  
  o The Owner will be able to realistically make the payments per the terms of the work-out; and
  
  o The anticipated debt recovery as a result of the work-out is greater than the anticipated recovery in the event of default or foreclosure.

• HUD does not have flexibility to only consider the housing impact. HUD must comply with the Credit Reform Act in collecting these loans.
THE NEW PM2M NOTICE
ADDRESSING MATURED & MATURING M2M AND DEMO NOTES

REFINANCE/SELL
• Waiver Request
• Prepay or Resubordinate M2M Debt
• Can Extend M2M Note(s) Maturity Date

WORK-OUT
• Request to A/E and Recap
• Viable Exit Strategy by Owner
• Max 3-Years
• Impact on IPFs and Servicing Fees
THE NEW PM2M NOTICE

M2M AND 8(bb) TRANSACTIONS

• The current Section 8(bb) Notice excludes proposals involving a project that is subject to a Full M2M Renewal Contract from its applicability “until additional guidance is released.”

• This Notice supplements the Section 8(bb) Notice and serves as that “additional guidance” and does not supersede the Section 8(bb) Notice except where specifically noted.

• Limited to Projects with existing M2M Note(s) and Projects that have already satisfied their M2M subordinate debt obligation, but still have a M2M Use Agreement and a Full M2M Renewal Contract.

• Transfer of Budget Authority only; 8(bb) doesn’t provide for the transfer of the M2M Use Agreement and/or HUD subordinate debt (Section 209).
THE NEW PM2M NOTICE
M2M AND 8(bb) TRANSACTIONS: SCENARIO 1

Project A: Non-M2M
• Mutual Termination and Renewal of all or part of HAP Contract.
• All requirements in Section V ("Project A") of the Section 8(bb) Notice shall apply to Project A.
• Preservation Agreement for Contract A only.

Project B: M2M
• 8(bb) units are added to Option 3b Full M2M Renewal Contract.
• Rents for existing M2M units remain as-is.
• Rents for 8(bb) units may not exceed the comparable market rents, based on an RCS.
• HAP and Use Agreement Term follow exception vs. non-exception rent guidance.
M2M AND 8(bb) TRANSACTIONS: SCENARIO 2

**Project A: M2M**
- Mutual Termination and Renewal of the HAP Contract.
- Property remains subject to one of the affordability requirements set forth in the M2M Use Agreement.
- M2M Use Agreement remains at Project A.

**Project B: Non-M2M**
- Owner B to assume any remaining M2M Note(s).
- The IPF, Surplus Cash, and payments to the HUD Note(s) will be based on Project B.
- 8(bb) units are added to a new HAP or an amended existing HAP Contract.
- Rents for 8(bb) units may not exceed the comparable market rents, based on an RCS.
- Preservation Agreement for Contract B only.

*Section 209*
THE NEW PM2M NOTICE

M2M AND 8(bb) TRANSACTIONS: SCENARIO 2

Project A: M2M

- Mutual Termination and Renewal of a HAP Contract (A1 and A2).
- Rents for Contract A1 remain as-is and renew under an Option 3b Full M2M Renewal Contract.
- HAP and Use Agreement Term for Contract A1 follows previous exception vs. non-exception rent guidance.
- The IPF, Surplus Cash, and payments to the HUD Note(s) will be based on Project A.
- M2M Use Agreement remains at Project A.

Project B: M2M

- Owner B to assume some or all the remaining M2M Note(s).
- The IPF, Surplus Cash, and payments to the HUD Note(s) will be based on Project B.
- 8(bb) units are added to a new HAP or an amended existing HAP Contract.
- Rents for 8(bb) units may not exceed the comparable market rents, based on an RCS.
- Preservation Agreement for Contract B only.

Partial Budget Authority

Section 209
What’s Needed from the Field Office?

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WHAT’S NEEDED FROM THE FIELD OFFICE

BRING IT!

• The PM2M Notice(s) cover what is required for Recap and OAMPO to review and process a PM2M transaction.

• **A/Es need to research and know their Property when processing a PM2M request including:**
  - Copies of original Restructuring documents
  - Remaining term of M2M Use Agreement
  - Length of HAP Contract, Option 3b Renewal, Exception Rents
  - Details on outstanding M2M (V and W Notes typically) debt
  - Details on any proposed new debt or refinance of existing debt
  - Understanding of current Ownership structure and new Ownership structure, if proposed
  - Any Secretary imposed sale restrictions (past QNP transaction – Accommodation Agreement),
  - Contact information for key participants
  - Recap and Regional Director Memoranda

• **A/E Coordination with Field Counsel**

• **Remember:** Recap has no role when there is no outstanding M2M debt.
WHAT’S NEEDED FROM THE FIELD OFFICE

CASE STUDY 1

**Sale of the M2M Property with an Outstanding MRN and/or CRN or Demo (M2M debt)**

- Follow requirements contained in Recap and Regional Director approval memoranda and customary FHA requirements (e.g., Pay-Down and TPA review, respectively). If FHA-insured is being assumed there will be a Release and Assumption of Mortgage.

- The M2M debt (subject to a Pay-Down) must be assumed by the Purchaser in a recorded Assumption Agreement.

- If there will be a new first mortgage loan, the M2M debt (as reduced by Pay-Down and assumed by purchaser) will need to be subordinated to it in accordance with the Recap approval memorandum.

- There will be an Assignment of HAP Contract (Option 3b).

- HAP Term and M2M Use Agreement Extension per the Section 8 Renewal Guide.

- All new and existing loans will need to be subordinated to the M2M Use Agreement as assumed and extended by the Purchaser and/or there will need to be a recording agreement to record the Modification and Assumption of M2M Use Agreement prior to any new loans.

- Escrow letter to place documents in escrow, with HUD requirements; produced by Recap Closing Coordinator.
WHAT’S NEEDED FROM THE FIELD OFFICE

CASE STUDY 2

Refinance of M2M Property with Outstanding MRN and/or CRN or Demo (M2M debt)

• Follow requirements contained in Recap and Regional Director approval memoranda and customary FHA requirements (e.g., Pay-Down and TPA review, respectively).

• The M2M debt (subject to a Pay-Down) must be assumed by the Purchaser in a recorded Assumption Agreement and subordinated to it in accordance with the Recap approval memorandum.

• HAP Term (Option 3b) and M2M Use Agreement Extension per the Section 8 Renewal Guide.

• If the new term of the M2M Use Agreement is extended, all new and existing loans will need to be subordinated to the M2M Use Agreement as extended by the owner and/or there will need to be a recording agreement to record the Modification and Assumption of M2M Use Agreement prior to any new loans.

• Escrow letter to place documents in escrow, with HUD requirements; produced by Recap Closing Coordinator.
CASE STUDY 3 “THE ODDBALL” EXAMPLE

Sale of a M2M Property that was Previously the Subject of a QNP Assignment of Debt Transaction

• QNP transactions impose sale restrictions in a Recorded Accommodation Agreement:
  o Presently 10 years but will be 15 years under the new PM2M Notice.
  o Require the consent of the Secretary through Recap and, if given, must assume the Accommodation Agreement for its remaining term.

• Assumption of M2M Use Agreement which will have an extended term to 50 years from the original Restructure because of the QNP transaction.

• Assignment of HAP Contract (Option 3b).

• If TPA or new financing, see Case Studies 1 and/or 2 for some of the additional requirements.

• **When in doubt ask!** PM2M requests can take form in many “oddball” ways.
WHAT’S NEXT FROM RECAP?

BE ON THE LOOK OUT FOR:

• General Guidance Memorandum (GGM)
• PM2M Specific Legal Document Samples
• Targeted Out-Reach Efforts for Maturing Note(s)
• Redesign of the PM2M Website to Include:
  o PM2M Toolkit
  o PM2M FAQs
  o PM2M Case Studies
  o PM2M and HUD Contact Lists
Q&A
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