

# POST MARK-2-MARKET (PM2M)

OGC Office of Insured Housing Presentation  
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# Any day now . . .

Housing's new Post M2M Notice will be published.

This Notice - "Guidelines for Certain HUD Approvals Regarding Properties Encumbered by HUD-Held Mark-to-Market Program Debt and Portfolio Reengineering Demonstration Program Debt" will replace

- Housing Notice H 2012-10, titled "Guidelines for Assumption, Subordination, or Assignment of Mark-to-Market (M2M) Loans in Transfer of Physical Assets (TPA) and Refinance Transactions", and
- Appendix C of the Mark-to-Market Operating Procedures Guide



# What does it do?

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- Impacts M2M debt on aging Section 8 properties
- Provides additional preservations tools to HUD
- Resolves issues surrounding matured Demo loans
- Addresses requests to transfer Section 8 budget authority when the property is encumbered with M2M or Demo loan(s)



# What does that mean to us?

- Housing/Recap needs us to help move these loans and affordable housing projects forward through the Post M2M process.
- Under the Notice and the 2020 MF Redelegations, Housing's Regional leadership will work closely with the Office of Recapitalization in many of these Post M2M transactions, and for those transactions - and others without Recap's direct involvement – Housing needs our help.
- But field counsel did not work on M2M rent and debt restructurings



# So,

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- The Notice – 38 pages of substance
- We (OGC Insured Housing) are putting together a guide with sample documents
- Recap is developing a series Memoranda (or cheat sheets to quote the client) for each type of transaction, and in some instances, for each transaction, to guide the process, including who is authorized to sign

# But First, How Did We Get Here?



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For today, we thought it would be good to provide context or background information about these Housing programs, after which we will discuss common themes found in PM2M transactions

# DEMO & M2M

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A Brief History





# Historical Context

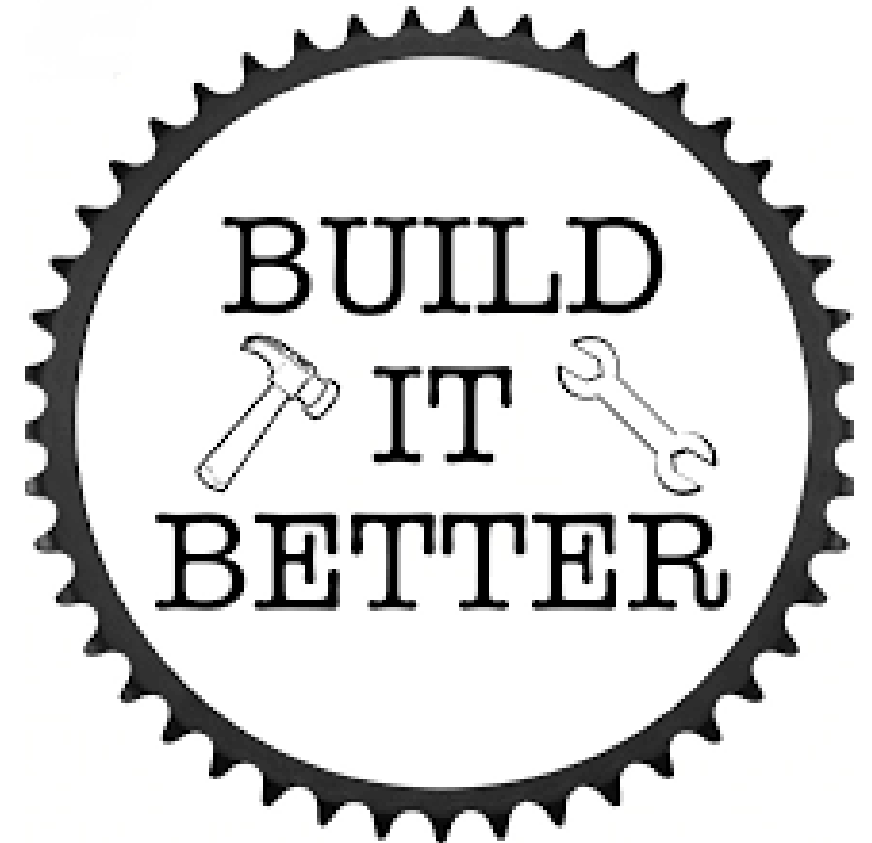
- Above-Market Rents
  - Introduced in the 1970s
  - Incentivized production and maintenance of affordable housing
- Concerns:
  - Contributed to higher cost for subsidizing insured Section 8 properties
  - HUD's Section 8 Renewal costs expected to increase dramatically
  - Insured Section 8 projects would default at higher rates if HAP Ks were not renewed or were renewed at lower funding levels
  - Projects were failing to provide physically and financially sound housing



# Prototypes

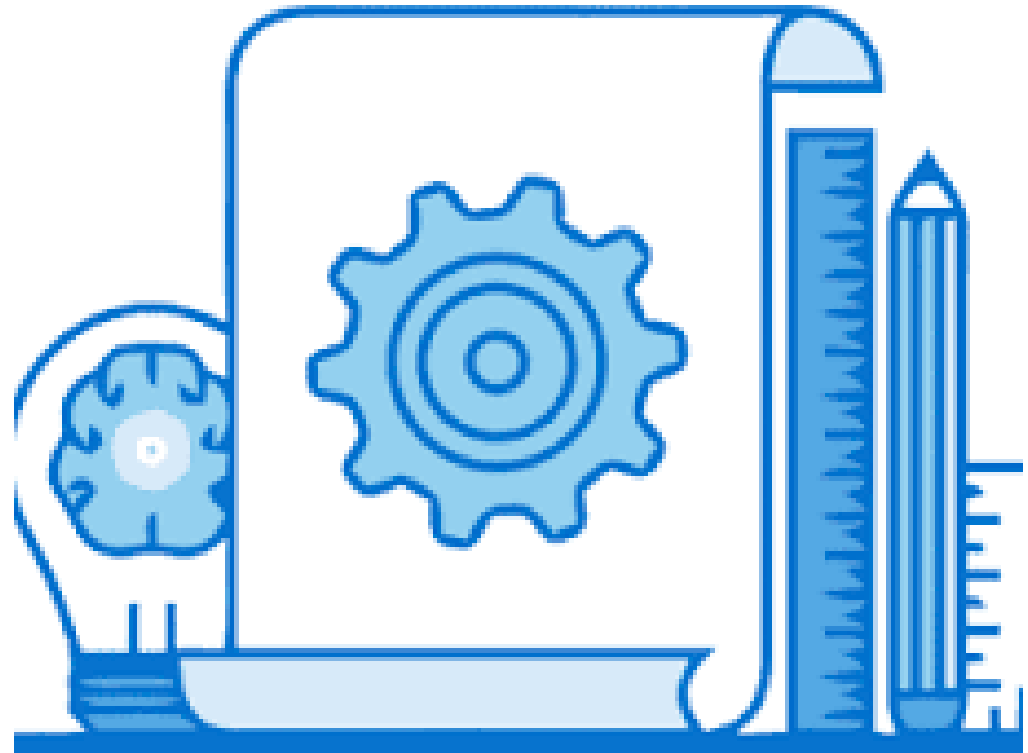
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- 1995
  - HUD proposes a “Mark-to-Market” strategy to align Section 8 properties with the commercial marketplace
  - HUD received substantial feedback
- 1996
  - HUD amends “Mark-to-Market” concept and introduces it as the “Portfolio Reengineering Demonstration Program”
  - Gave priority to reengineering properties with above-market rents
  - Allowed state and local governments to choose to continue project-based subsidies at individual properties
  - Allowed property owners to apply for FHA insurance on restructured loans



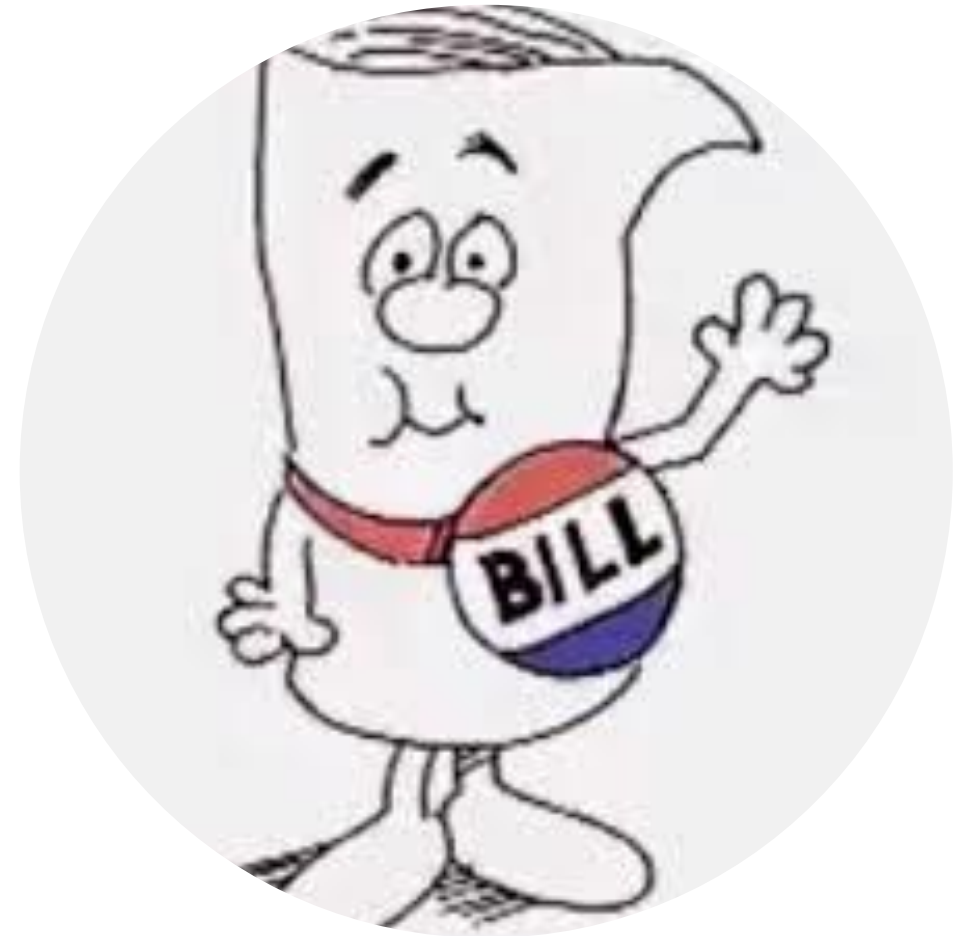
# The Portfolio Reengineering Demonstration Program (Demo Program)

- Predecessor program to M2M
- First Created in Section 210 of the Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act, 1996, P.L. 104-134 in section 210 of HUD's Appropriations Act for 1996



# Multifamily Housing Reform and Affordability Act (MAHRA)

- Congress enacted the Multifamily Housing Reform and Affordability Act of 1997, Pub. L. No. 105-65, § 510, 111 Stat. 1344, 1385 (1997) (MAHRA), to make this restructuring process a permanent program and to replace the Demo program.
- MAHRA established the Multifamily Housing Mortgage and Housing Assistance Restructuring Program (AKA Mark-to-Market or M2M)
- Implementing regulations at 24 CFR Parts 401 & 402.
- Note: Just because M2M came out in 1997 does not mean that this was when HUD fully implemented M2M. Demo program continued into approximately 2000 and the first M2M rent and debt restructuring occurred in 2000.



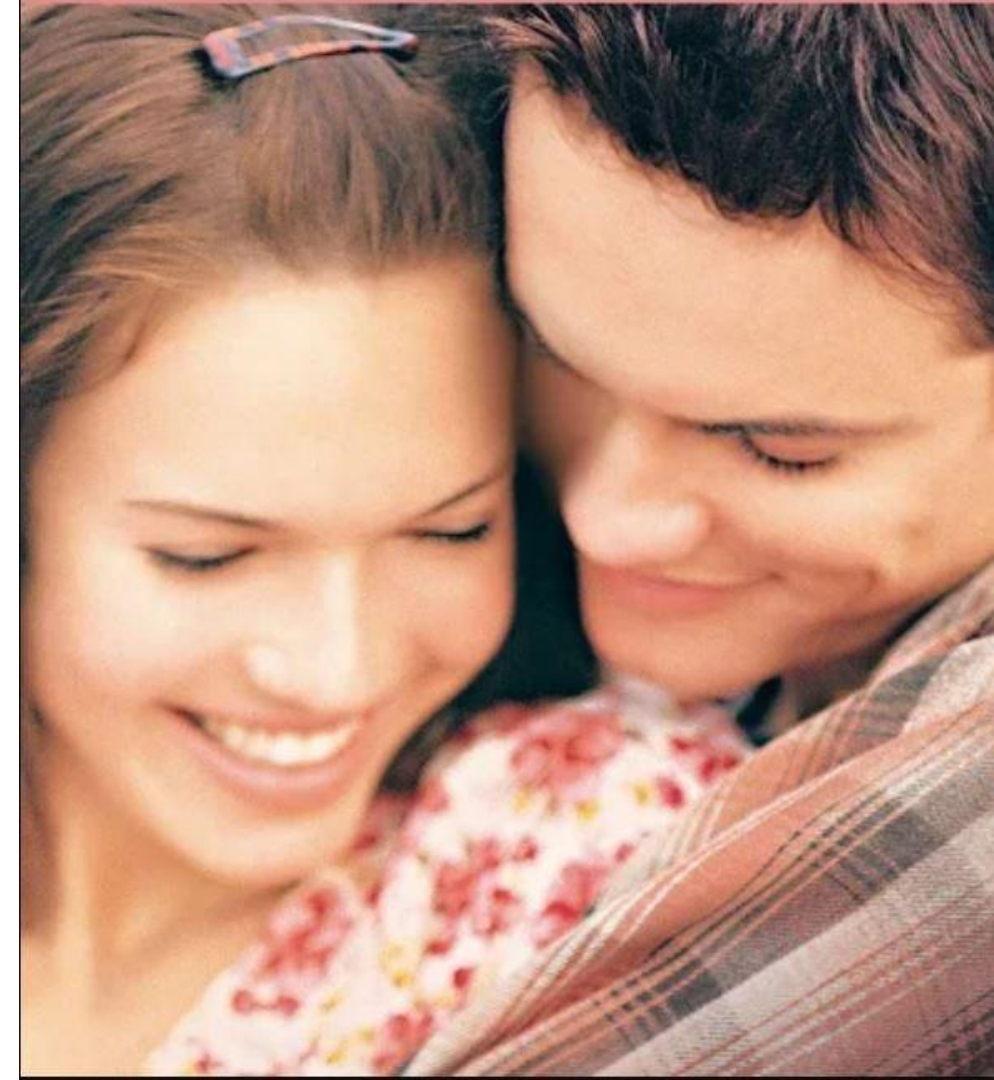
- **Social:** Preserving the affordable housing stock by maintaining the long-term physical and financial integrity of certain privately-owned, HUD-subsidized rental housing insured by FHA.
- **Economic:** Reducing long-term project-based Section 8 rental assistance costs; and reducing the cost of insurance claims paid by FHA.
- **Administrative:** Establishing a nationwide network of locally-based Participating Administrative Entities (PAEs) to administer the M2M program; promoting greater operating and cost efficiencies in Section 8 assisted properties; and addressing problem properties by terminating relationships with “bad owners” where appropriate.

## Purposes in Establishing M2M

## ALWAYS REMEMBER

MAHRA § 514(e)(6) requires that projects that undergo M2M debt restructuring receive a minimum 30-year M2M Use Agreement.

FROM THE BESTSELLING NOVEL  
**SHANE WEST MANDY MOORE**  
**A PROVISION TO  
REMEMBER**



# Key PM2M Common Themes

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The M2M Use Agreement – Always first because its the quid-pro-quo (first discussed and first in prime)

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Statutory requirement for 30-year minimum Use Agreement

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M2M Debt \*m\*odifications are different than M2M Debt \*M\*odifications

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Qualified Non-Profits (QNP)

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# The M2M UA must remain in effect for a minimum of 30 years

- Provides affordability pursuant to 24 CFR 401.408
- Gets recorded among the land records and “runs with the land”.
- Avoid an inadvertent subordination in a TPA/refinance transaction when M2M debt is being subordinated – the definition of Subordinate Loan Documents, from the Fannie Mae Public Subordination Agreement form

**“Subordinate Loan Documents”** means the Subordinate Note, the Subordinate Mortgage, the Subordinate Loan Agreement and all other documents evidencing, securing or otherwise executed and delivered in connection with the Subordinate Loan.

(In the guide we are preparing, we will have a sample provision to share that carves-out the M2M Use Agreement and HAP Contract from the definition of Subordinate Loan Documents.)

- In a TPA, HUD requires an assumption of the M2M Use Agreement by the purchaser.



Sometimes, when there is a HAP Contract renewal request for a term that extends beyond the remaining term of the M2M Use Agreement, the term of the M2M Use Agreement is extended.



Always, in a “QNP” transaction, the M2M Use Agreement is amended to extend the term from 30 to 50 years.



NB - You will have a new owner with new financing, so remember – do not inadvertently subordinate the M2M Use Agreement (as/if modified) to the new loan.

# Modifying M2M Debt: “Modification” vs. “modification”

- MAHRA MRN requirements (at origination and PM2M, unless QNP):
  - Second mortgage (unless no first)
  - Interest rate 1% to applicable Federal
  - Surplus cash – 75/25 split
  - Due-on-sale/due-on-refinance (waivable pursuant to PM2M Notice)
- Little m - Minor amendments include items such as those that (a) evidence the change in responsible parties associated with any assumption, subordination, or assignment under this Notice; (b) eliminate the CRP (when a CRP is present); and/or (c) extend the maturity date to make it coterminous with a new first mortgage loan, if appropriate.
- TPA – M2M debt must be assumed by the purchaser (vs. acquiring the property “subject to” the M2M debt)
- Big M - QNP transactions: “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 Secretary holds the second mortgage and if the project is acquired by a tenant organization or tenant-endorsed community-based nonprofit or public agency, pursuant to guidelines established by the Secretary.”

# And when the debt is gone

- The project reverts back to the section 8 distribution (surplus cash/residual receipts) limitations that were in place prior to the M2M rent and debt restructuring, typically controlled by the HAP Contract and/or Section 8 regulations



IF QNP, free to modify, but the purchaser typically selects an assignment of the debt

- Usually requires two transfers of the debt, first to the “acquiring organization or agency”, the entity actually taking title and then a transfer (usually up) to the controlling nonprofit organization.

## M2M and OCAF

- For the minimum required 30 year term, HUD will only allow OCAF annual adjustments to the project's HAP Contract. This statutory restriction has been problematic, but there is a way to provide financial relief and promote affordable housing preservation.



# Transferring Project Based Assistance, Debt, and Use Agreements

- Where does the authority come from?  
Appropriations Acts
- “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 to another multifamily housing project or projects.”
- Currently in Section 209 of Division L, Title II of the Consolidated Appropriations Act of 2021

# Conditions for Approval of a Transfer

- No reduction in number and sized of low-income and very-low income units
- Transferring project is physically obsolete or economically nonviable
- Receiving project must meet physical standards
- Consult with tenants
- HUD determines transfer is in best interest of tenants
- Tenants at transferring project who remain eligible for assistance don't vacate until new units at receiving project are ready
- Additional financing on receiving project subordinated to an FHA insured loan
- Update pre-existing Use Agreement at receiving project if applicable
- Cost of FHA insured mortgage can't be increased





Transfer of Use Agreement facilitates provision of new debt and equity to rehabilitate and preserve an M2M Project



Transfer of HAP Contract may facilitate tax-credit financing to rehabilitate project



HUD may also require transfer of M2M subordinate debt where a HAP Contract or HAP Contract budget authority is transferred

What makes  
Section 209  
a Good  
Preservation  
Tool?

# What Might a Regional Attorney Encounter In Relation to a Section 209 Transaction

Releases of Use Agreement at transferring property and new or amended Use Agreement at receiving property.

*Note: Existing debt at receiving property must be subordinated to the Use Agreement.*

Transfers of HAP Contracts

Transfers of HUD-Insured or M2M subordinate debt

# Conclusion and Next Steps

- Written guidance on transaction types, with sample documents and provisions
- Memoranda from Recap that will authorize execution of documents in the field and contain closing requirements and conditions
- Until then and after – please reach out to our office for any M2M or Demo questions and comments



**ANYONE...**

QUESTIONS?

**ANYONE, ANYONE?**