

PM2M Training:
Assuming,
Subordinating and
Extending M2M
and Demo
Secretary-held
Debt and QNP
Transactions

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Authorities

- MAHRA § 517(a)(4)
- 24 CFR part 401
- Housing Notice: H 2021-02
- 24 CFR 401.461(b)(4)
- MAHRA § 517(a)(5)
- 24 CFR 401.461(b)(5)
- Portfolio Reengineering Demonstration Program, 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.

Question & Answers

- Please email Alex Sernyak at Alexander.M.Sernyak@HUD.Gov any questions you have regarding the material covered in this presentation. We intend to collect the questions and create a FAQ for dissemination to the field.
- Separately, if time permits, there will be a Q&A session at the end of this presentation.

Quick review from
last week and a
little more subject
matter context . . .



The M2M in PM2M
https://www.hud.gov/program_offices/housing/mfh/presrv/presmfh/about_m2m

Since 2000 (earlier under the Portfolio Reengineering Demonstration Program, “Demo”), as a condition to the renewal of the project’s section 8 HAP contract, owners or purchasers of projects with above-market section 8 rents and FHA-insured or formerly FHA-insured mortgage loans were required to restructure the rents and FHA debt, by

- bringing the contract rents down to comparable market rents, and
- originating (a) limited new hard debt (usually, a new 223(a)(7) or 223(f)) to an amount supportable at net reduced down to market rents, and (b) soft debt representing a loan from the Secretary needed to satisfy the balance of the existing FHA-insured loan.
- Some of the soft debt is known as a **Mortgage Restructuring Loan**, and MAHRA limits the amount of this loan to what “can reasonably be expected to be repaid”. A Mortgage Restructuring Loan is required by MAHRA to be a second priority lien unless there is no first mortgage, in which event the Mortgage Restructuring Loan must be secured by a first lien mortgage.
- Through the M2M implementing regulations, HUD added a regulatory piece to the soft debt to cover the balance needed to satisfy the existing FHA-insured loan, and this is called a **Contingent Repayment Loan**, which is recorded immediately after the mortgage securing the Mortgage Restructuring Loan.
- Since M2M restructurings commenced in 2000, there has been a total of \$3B in such soft debt originated; over \$1B is outstanding.
- The Demo program preceded M2M –

The Portfolio Reengineering Demonstration Program, 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.

Today, we are talking about how to handle transactions involving a Mortgage Restructuring Loan, Contingent Repayment Loan or Demo Loan, which will remain outstanding upon conclusion of the transaction.



All of these loans have due-on-sale and due-on-refinance clauses, and MAHRA and the M2M regulations require these provisions -

From MAHRA §517(a)(4)(A) and (B):

(4) The full amount of the second mortgage shall be immediately due and payable if—

the first mortgage is terminated or paid in full, except as otherwise provided by the holder of the second mortgage; or

the project is purchased and the second mortgage is assumed by any subsequent purchaser



From 24 CFR 401.461(b)(4)

HUD may cause the second mortgage to be immediately due and payable on the grounds provided in section 517(a)(4) of MAHRA, including an assumption of the mortgage in violation of HUD standards for approval of transfers of physical assets . . .

And the documents that evidence and secure these loans have the following provision that permits the acceleration of the indebtedness if the property is sold or refinanced

*without HUD
consent*

E. Acceleration. This Mortgage Restructuring Note shall become immediately due and payable, at the option of the holder hereof, in the event that, prior to the repayment of the indebtedness evidenced hereby, (i) there occurs a **Sale** (as hereinafter defined) (ii) there occurs a **Refinancing** (as hereinafter defined) or other termination of the Loan, if any, . . .

So, upon a sale or
refinancing of the
property,
the Secretary may
accelerate the loan

UNLESS

NOTICE

Housing
Notice
H 2021-02

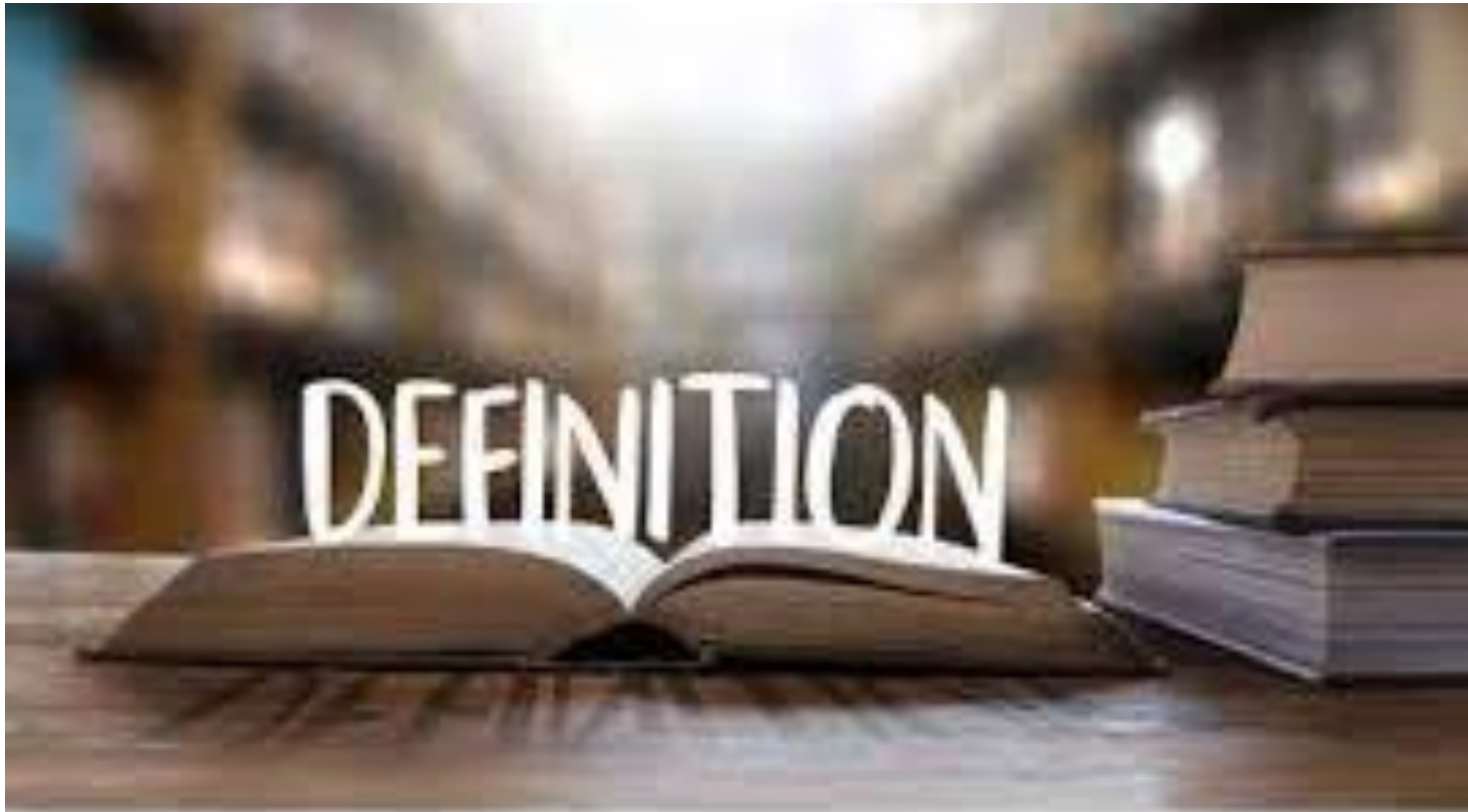
... the Owner and/or Purchaser comply with and **receive approval** from the Office of Recapitalization under the Notice, which covers:

- the assumption, subordination, or assignment of Mortgage Restructuring Loans and Contingent Repayment Loans under M2M, and the assumption and/or subordination of Portfolio Reengineering Demonstration Program or Demo Loans in transfer or refinance transactions; and
- actions in the event of default (failure to pay) upon maturity of such loans; and

Housing Notice

H 2021-02

- The Notice replaces Housing Notice 2012-10, “Guidelines for Assumption, Subordination, or Assignment of Mark-to-Market (M2M) Loans in Transfer of Physical Assets (TPA) and Refinance Transactions” in its entirety and provides new instructions for the acquisition and/or refinancing of projects which have been through a M2M debt restructuring or a Demo restructuring.
- Remember, the Notice does not apply to transactions where the M2M debt will be repaid in full, although other HUD requirements and procedures apply to such transactions, such as those covered in the soon to be published General Guidance Memorandum and Program Obligations.



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Some key definitions and concepts from the PM2M Notice (not verbatim)

Request: Defined in Section 1.41 of the PM2M Notice, a Request is made when an Owner or Purchaser asks HUD to waive the “due on sale or refinancing” clause in a Note (defined to include M2M and Demo notes) and allow the Assumption and/or Subordination of such Note without requiring the full payment of the Note. The necessary documentation to initiate all Requests will be submitted to the Project’s applicable Multifamily Regional Center and then, in most cases, referred to Recap for processing.

Some key definitions and concepts from the PM2M Notice (not verbatim)

1.4. **Assumption**. Transaction in which a Purchaser will assume a Seller's obligations under a M2M loan or Demo loan and the Seller is released from such obligations.

1.40. **Refinance**. A transaction involving the payoff of the existing first mortgage loan with funds from a new first mortgage loan from either a new lender or the existing lender, whether or not the transaction would increase the outstanding principal amount of the debt. A Refinance does not involve any change in ownership.

1.48. **Subordination**. A transaction in which the lien securing a M2M loan or Demo loan will be subordinated to a new mortgage lien.

Some key definitions and concepts from the PM2M Notice (not verbatim)

- 1.31. **Pay-Down**. The payment described in Section 2.4(I) of the Notice. The purpose of the Pay-Down is to reduce the outstanding balance of the Notes when the transaction proposed involves Proceeds that will benefit the Seller or Purchaser. The Pay-Down represents recovery of a portion of the value created through the M2M debt restructuring and for any Request reviewed by Recap, HUD will condition approval of the Request upon payment to HUD of a Pay-Down.
- 1.32. **Proceeds**. All cash, fees, and other consideration paid to or on behalf of the Seller, Purchaser, or IOI entities of either the Seller or Purchaser.
- 1.50. **Transfer**. Transfer shall mean the sale or transfer of a Project or any portion thereof, an interest in the Owner, or an interest in an entity with Control of the Owner. The analysis of a transfer may examine multi-step transfers as a whole if HUD determines that such integrated review is necessary to reflect how ownership is actually held.

How is a Request processed under the Notice?

Through the PM2M Processing Guide*

- The Guide describes HQ and Field Office responsibilities and steps for processing and conducting PM2M transactions under the PM2M Notice

(* in draft but should be released soon . . .)





Did you get the memo?

RECAP APPROVAL MEMORANDUM

If a Request is approved, Recap will issue a “Recap Approval Memorandum”, which will contain the terms and conditions for the assumption and/or subordination of the M2M or Demo loan, including any Pay-Down requirements and, more importantly, the specific terms and conditions for the new first mortgage loan that Recap has approved, to which the M2M or Demo loan will be subordinated.

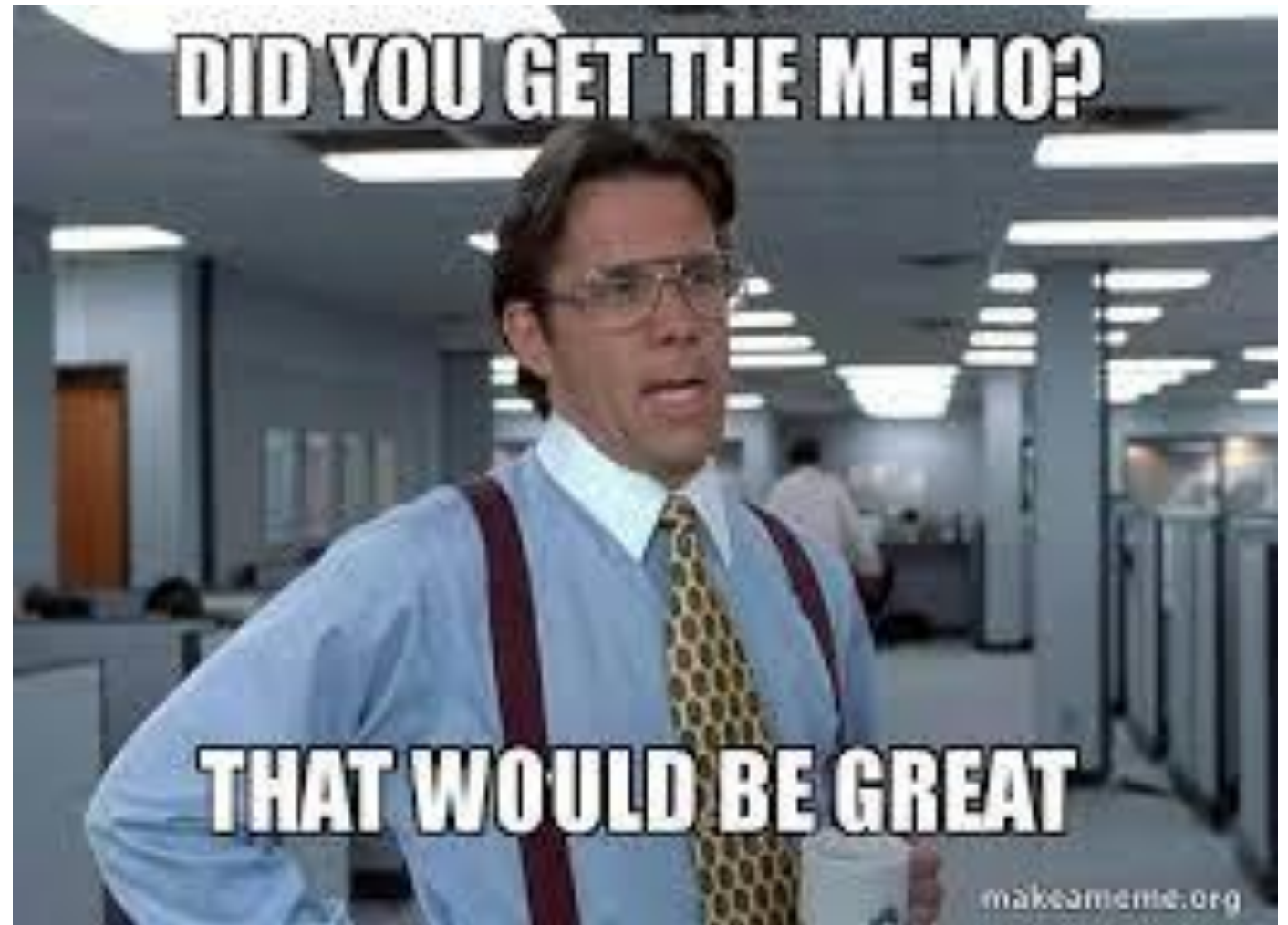
Remember:

- The Processing Guide and memoranda issued from time to time by Recap covers the M2M elements of the PM2M transaction, and the owners and purchasers in PM2M transactions must also satisfy the typical “Program Obligations”.
- The Regional Directors receive and incorporate the Recap Approval Memo and may add additional transaction specific requirements (e.g., for a TPA) pursuant to Program Obligations into the Field Office Approval Letter and added to the Recap conditions
- Going forward, Housing will require a TPA type review whenever M2M or Demo debt is Secretary-held and being assumed
 - A M2M property may never be acquired “subject to” the M2M debt



And then what?

The Multifamily Redelegations authorize PM2M actions to be taken by field office officials *if* such actions are consistent with the Recap Approval Memorandum



In addition to subordinating the lien securing a M2M or Demo loan, the maturity date of the loan will need to be extended to become coterminous with the new first mortgage loan

– we would not want the Secretary-held loan to mature prior to the new first mortgage.



But the permissible modifications to the M2M loans are limited by MAHRA – minor amendments are acceptable, but capital “M” Modifications are not. Here is the definition of Modification in the Notice

1.24. Modification. The term “Modification” refers specifically to certain changes to MAHRA required provisions in a Note excluding certain minor amendments to loan documents. 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.





The Subordination Agreement –

A decision was made to update a prior version of the M2M Subordination Agreement instead of using the FHA Public Subordination Agreement, and the updated M2M Subordination Agreement will be made available on a PM2M website under construction by Recap (and will also be going through PRA)



Section 4. HUD Action Upon Default at Maturity

The Notice also addresses how HUD will process and handle M2M and Demo loans that are maturing, in cases where the owners are unable to pay-off the loan and do not anticipate either a Transfer or Refinance.

In such cases, the Multifamily Regional Center shall process and execute all documents pertaining to any approved extension(s) of a loan pursuant to a Recap Approval Memorandum.



Finally, what
is a QNP?

From
MAHRA



What is a QNP?

From MAHRA -

(5) 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.

Most if not all of these transactions are with tenant-endorsed community-based nonprofits or **QNP**s.

Guidelines established by the Secretary = PM2M Notice



A few more definitions from the PM2M Notice on the next few slides

Definitions from the PM2M Notice (not verbatim)

- 1.41. Request. A request (a) for HUD to waive the “due on sale or refinancing” clause in a Note and allow the Assumption and/or Subordination of such Note, or, in the case of a **QNP Request**, provide Debt Relief in connection with an **acquisition of title**; or (b) for HUD to approve a proposed transfer of budget authority under Section 8(bb)(1) of the United States Housing Act of 1937 and Section 5 of this Notice.
- 1.37. QNP Request. A request for HUD’s approval as a **Qualified Nonprofit Purchaser** and for **Debt Relief**, made in conjunction with a Request.

Definitions from the PM2M Notice (not verbatim)

- 1.36. Qualified Nonprofit Purchaser or QNP. The acquiring entity eligible for **Debt Relief** upon Purchase of the Project pursuant to and as defined in more detail in Section 3. The acquiring entity must be a nonprofit entity, a nonprofit entity's directly and exclusively controlled Affiliate(s), a public agency, or a tenant organization. A QNP includes a Priority Purchaser under 24 C.F.R. § 401.2.
- 1.9. Debt Relief. The forgiveness, assignment, or Modification, as defined below, of an MRN and/or CRN, together with the security instruments that secures such Note(s), which HUD may provide in response to a QNP Request.

Debt Relief. The forgiveness, assignment, or Modification



Forgiveness – tax headaches



Modification – why (but limits non-QNP modifications)



Assignment – that's the majority, if not all, adds to the "acquiring entity's" basis in tax credit transactions

A couple of assignment wrinkles . . .

Debt Relief may only be provided to the qualifying entity, which must then take title to the property

Sponsor – Recap approves an immediate further assignment of the loan from the QNP to its sponsor (see Section 3 of the Notice)

Merger – fee and mortgage = no mortgage

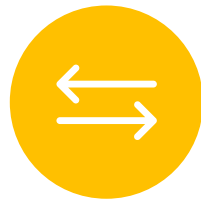
Brief rundown of the QNP documents



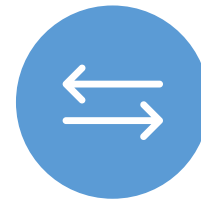
ALLONGE FROM
SECRETARY TO QNP



ALLONGE FROM QNP TO
SPONSOR



ASSIGNMENT OF
MORTGAGE FROM
SECRETARY TO QNP



ASSIGNMENT OF
MORTGAGE FROM QNP
TO SPONSOR



ASSUMPTION AND
MODIFICATION OF M2M
USE AGREEMENT
(30 TO 50 YEAR TERM)



ACCOMMODATION
AGREEMENT

A Few Universal Rules for PM2M Transactions . . .

- 1) The M2M Use Agreement **must be and remain** in full force and effect for the duration of its term, as the term may be extended, regardless of the nature of the PM2M transaction, and must not be subordinated or otherwise become subordinate to new or existing mortgages or liens. The soon to released General Guidance Memorandum will provide guidance on handling M2M Use Agreements for transactions with no outstanding M2M debt, but the guidance and documents are generally applicable to and will assist with PM2M transactions under the PM2M Notice (but may have additional terms and conditions of the Recap Approval Memorandum).
- 2) In a QNP transaction, the M2M property must be acquired by the entity that receives the Debt Relief.
- 3) Capital “M” Modifications may only be a part of Debt Relief to a QNP. A Mortgage Restructuring Loan must never be less than a second mortgage lien on the property.
- 4) All existing and subsequent renewals of the project’s HAP Contract must be on the Full Mark-to-Market Renewal Contract form Rev **03-15-2012** HUD-9642. (Posted on MFH’s website under “Section 8 Renewal Policy forms 9636 – 9644) **This holds true even if the M2M debt has been repaid.**
- 5) A M2M project must never receive M2M Exception Rents for greater than 30 years



QUESTIONS?