

Program Requirements and Standards

Executive Summary

Section 3-1

This chapter describes M2M program requirements and standards including eligibility requirements, Section 8 contract administration issues, tenant participation, affordability requirements, and owner returns unique to M2M.

General Owner/Project Eligibility Requirements

Section 3-2

- A. **Eligible Properties.** In order to be eligible for the M2M program, a property must have:
 - 1. An FHA insured or HUD-held mortgage.
 - 2. A project-based Section 8 contract(s) (including Mod Rehab, Non-Single Room occupancy (SRO) contracts) with aggregate rents above comparable market rents (for the units receiving project-based assistance). Projects can meet this requirement if either (a) the contract rents were above market at the property's first post-MAHRA expiration or (b) the contract rents are above market at the time of the owner's election to enter the M2M program.
 - 3. An owner in good standing or willing to transfer the property.
- B. **Once Eligible Always Eligible:** Properties that meet the above three criteria will still be eligible if the Property has gone through a Lite Restructuring or received a Watch List contract (previously referred to as a Potentially Troubled Contract) after entering the M2M Program.
- C. **Ineligible Properties.** The following properties are not eligible for M2M:
 - 1. Preservation properties with Use Agreements under LIHPRHA or ELIHPA unless the property is being sold pursuant to a Restructuring Plan.

2. Properties with debt restructurings under the Portfolio Re-engineering Demonstration program.
3. Properties with state/local financing for which OAHF determines that the applicable law or terms of such financing would be in conflict with a M2M restructuring.
4. Section 202 properties, including properties that have been refinanced with FHA insured mortgages.
5. Moderate Rehabilitation Single Room Occupancy (SRO) properties.

D. Other Considerations

1. Prepaid Mortgages or Mortgages with Lockouts. If an owner prepays an FHA insured or HUD-held mortgage after making an election to enter the M2M program or if the mortgage has a lockout that does not allow prepayment, the property remains eligible for the M2M program; and the rents will be reduced to market. The property would not, however, be able to take advantage of a Partial Payment of Claim.
2. Post Sunset expirations. Properties that are otherwise eligible and that have Section 8 contracts expiring after OAHF's authority sunsets (September 30, 2006) are eligible, provided that a binding commitment exists to allow a debt restructuring after sunset.
3. Ineligibility. OAHF may refuse to consider Restructuring Plans for properties that are owned by entities or affiliates with material adverse financial or managerial actions or omissions, or do not cooperate with the Restructuring process, or are otherwise determined ineligible. (See Chapter 6.)
4. "Bad projects". Projects in poor condition generally require additional scrutiny to determine whether a Restructuring Plan is appropriate or feasible. (See Chapter 6.)
5. Rent Supplement Contracts. MAHRA defines eligible multifamily housing projects to include projects with project based assistance under Rent Supplement Contracts (Rent Supp). However, the lack of Rent Supp amendment funds or authority to enter into new project based Section 8 contracts severely restricts restructuring options. Rent Supp projects are generally not viable for restructuring as: 1) the Rent Supp funds remaining under those contracts are limited; 2) Section 8 cannot be used to amend Rent Supp contracts (cannot extend term or increase rents if exception rents required); and 3) the old Rent Supp contracts cannot be terminated and new Section 8 contracts entered into as part of restructurings. Based on these factors, it is infeasible to restructure projects with Rent Supp contracts.

Multiple Project-based Section 8 Contracts

Section 3-3

- A. **General.** Generally, multiple contracts will be combined at closing of a Full debt restructuring and HUD will rescind all recaptured funds. However, the contracts need not be combined if one or more of the contracts expire *after* September 30, 2006 and a Recapture Agreement is executed (see Outyear Contract discussion in the next Section). In the case of Lite transactions, owners are encouraged but not required to combine contracts.
- B. **Multiple Contracts With Differing Rents.** When a property has multiple contracts, or stages within a contract, the rents in an expiring Section 8 contract(s) may differ from the rents for the other Section 8 contracts or stages.
1. Project is Above-Market but the Expiring Section 8 Contract is At-or-Below-Market. If the Current Potential Rent (i.e., total of all contract rents) for all the project-based Section 8 units in the project is equal to or greater than the total of market rents for such units, and the contract rents in the expiring project-based Section 8 contract(s) are below-market, the project will be renewed at existing rents. In these cases, the owner has the option of processing a debt restructuring (if needed) now.
 2. Project is At-or-Below-Market but Expiring Section 8 Contract is Above-Market. If the Current Potential Rent (i.e., total of all contract rents) for all project-based Section 8 units in the project is equal to or less than the total of market rents for such units, and the contract rents in the expiring project-based Section 8 contract(s) are above market, the project is not eligible for restructuring its mortgage debt. The Section 8 contract renewal will be processed by Multifamily Hub or program Center.

Outyear Section 8 Contracts and Recapture Agreements

Section 3-4

- A. **Multiple Section 8 Contracts/Stages.** Special procedures apply in the case of multiple Section 8 contracts, or stages, where some or all contracts, or stages, expire after the closing of the Restructuring occurs (“outyear”). If the outyear contract or stage originated prior to the enactment of MAHRA, the owner may request that the outyear contract or stage(s) remain in place without rescission of the Section 8 funds. However, if an outyear contract will remain in place, the owner is required to sign a Recapture Agreement. The Agreement will provide that excess Section 8 payments (defined as payments

above the market comparable rent) be applied to (a) the second mortgage, (b) the Reserve for Replacement account, or (c) other uses approved by the OAHP. (Generally, OAHP will agree to leave the outyear contract in place only if six months or more remain on the contract after the M2M closing).

- B. **Rider to the Section 8 Contract.** The owners of properties with outyear contracts must also execute a rider to the Section 8 contract (when they request restructuring), agreeing to cooperate in the restructuring process and other terms.

Return to the Owner

Section 3-5

A. Capital Recovery Payment

1. Owner Contributions. In most M2M transactions, owners are required to invest new money (either out of pocket or through borrowing). This new investment **cannot** be provided through a loan secured by the property. Therefore, M2M provides the owner with Capital Recovery Payment. This payment provides a “market” rate of return to the owners on the new money invested.
2. Included as an Expense. The Capital Recovery Payment is calculated by the PAE based on the requirements in paragraph 3 below and included as an “expense” in underwriting. It will be paid to the owner so long as the conditions of payment in paragraph 4 below are met.
3. Calculation of Capital Recovery Payment. The Capital Recovery Payment is based on:
 - a) The amount of new money contributed by the owner (including any new funds for reserves, repairs, transaction costs, or similar property costs).
 - b) A rate of return of 350 basis points over like-term treasuries (rounded up to the nearest quarter); this limit is based on the approximate market cost of borrowing such funds without recourse to the property.
 - c) An amortization period of 7-10 years. Generally, exception rent situations would warrant a 10 year term.
4. Terms and Conditions of Payment. The Owner may collect this payment, on a monthly basis if:
 - a) all expenses are paid,
 - b) the first mortgage is current,

- c) the property is in acceptable physical condition (the most recently issued REAC score is 60 or better or the Multifamily Hub or Program Center has accepted the owner's proposal for curing a less favorable score),
- d) there are no unresolved HUD audit or management findings, including any finding that the owner is not in compliance with the Rehabilitation Escrow Deposit Agreement,
- e) the project's most recently issued audited financial statements reflected positive Surplus Cash, and any payables shown as due on the Surplus Cash schedule have been paid, and
- f) funds are not available; payment will accrue for payment at a later date if Surplus Cash becomes available. No additional interest is paid on the accrued amount.

B. Incentive Performance Fee

- 1. Imputed Owner Equity. The incentive Performance Fee recognizes owner equity and provides an incentive for operating efficiencies.
- 2. Underwriting. The incentive Performance Fee is *not* to be included as an "expense" in the underwriting pro forma, and *does not* reduce the NOI used in underwriting. However, the debt service coverage chosen by the PAE must be sufficient to provide for this payment in the calculation of the first year's operations.
- 3. Calculation Fee. The fee is a percentage, generally 3%, of annual effective gross income. The PAE may establish a higher percentage if necessary to generate an estimated first year fee of at least \$100 per unit. The PAE will establish a lower percentage if necessary to generate an estimated first year fee of no more than \$200 per unit.
- 4. Terms and Conditions of Payment. The owner may collect this payment, on an annual basis, only if:
 - a) all expenses are paid and there are no material accrued payables,
 - b) any first mortgage is current,
 - c) there are no unresolved HUD audit or management findings, including any finding that the owner is not in compliance with a Rehabilitation Escrow Deposit Agreement,
 - d) the property is in acceptable physical condition (the most recently issued REAC score is 60 or better or the Multifamily

Hub or Program Center has accepted the owner's proposal for curing a less favorable score), and

- e) funds are available after payment of the expenses, debt service on any first mortgage, and any Capital Recovery Payment. If funds are not available, payment will *not* accrue.

C. Distribution of Surplus Cash. After payment of all operating expenses, debt service on any first mortgage, any Capital Recovery Payment, and any Incentive Performance Fee, the owner will receive up to 25% of the remaining Surplus Cash annually. The remainder of the Surplus Cash will be paid toward the M2M second (or third) mortgage. OAHP will determine the specific percentage based on return to the owner and other factors in the underwriting.

D. Special Rules For Cooperatives

1. Processing for cooperatives requires an additional general operating reserve in the M2M underwriting. The annual escrow deposit amount is based on 3% of annual operating expenses plus P&I and MIP. The purpose of the reserve is to provide an additional measure of financial stability to the project. It may be used to meet deficiencies from time to time resulting from delinquent payments by individual cooperators, etc.

Refer to paragraph 3 of the project's existing HUD regulatory Agreement (FHA Form 3225 in the case of a 213 or 221(d) (3) co-op, or form HUD-93225A in case of a 236 coop).

2. Inasmuch as the MAHRA legislation provides that cooperatives are not required to make an owner contribution for rehabilitation, the Capital Recovery Payment provision of the Owner Return section does not apply.
3. An Incentive Performance Fee for operating the property efficiently and soundly will be made under the same terms as other properties.
4. The calculation for Surplus Cash (cash flow split) will be consistent with all other OAHP restructurings, i.e., the cooperative will receive up to 25% of the remaining Surplus Cash annually. The remainder of the Surplus Cash will be paid toward the M2M second (or third) mortgage.
5. OAHP will require that the funds the cooperative receives from the cash flow split and Incentive Performance Fee be deposited into a residual receipts account (separate from the operating reserve account noted in item 1 above). Withdrawals from the account will require the written approval of the Multifamily HUB or Program Center Director. Allowable uses of the funds will be based on the guidance in paragraph 25-9 of Handbook 4350.1REV-1.

Affordability and Use Restrictions

Section 3-6

- A. **Use Agreement Required.** Every project that has its mortgage debt restructured will be subject to affordability and use restrictions reflected in a recorded Use Agreement. The Use Agreement is a covenant running with the land and must be in effect at least 30 years.
- B. **Terms of Use Agreement.** A copy of the Use Agreement is posted on OAHP's Web site. The terms include:
1. **Residential Use.** The project must continue to be residential rental housing. HUD must approve in advance any reduction on the number of residential units.
 2. **Affordability Restrictions.** If fewer than 20 percent of a project's units receive project-based assistance, the project must comply with, and maintain records of, one of the following two rent and tenant income requirements used in the Low Income Housing Tax Credit Program.
 - a) At least 20 percent of the project's units must be leased to families whose adjusted income does not exceed 50 percent of the area household median income, as determined by HUD, with adjustments for household size. The rents for these units must be no greater than 30 percent of 50 percent of the area median income; or
 - b) At least 40 percent of the project's units must be leased to families whose adjusted income does not exceed 60 percent of the area median income, as determined by HUD, with adjustments for household size. Rents for these units may be no greater than 30 percent of 60 percent of the area median income; and
 - c) The type and size of units satisfying these requirements must be comparable to the unit configuration of the entire project.
 3. **Property Standards.** The owner must maintain the project in a decent and safe condition and in compliance with the following housing standards for the duration of the Use Agreement. If tenant-based assistance is provided, the applicable PIH standard will apply.
 - a) Uniform Physical Condition Standards (UPCS). As long as project-based assistance is provided, the UPCS in Section 5.703 of the regulations apply.

- b) **Local Housing Code.** At any other time, the applicable standards are those in the local housing code or the code adopted by the local public housing agency. These codes are only applicable if they equal or exceed the UPCS and do not severely restrict tenants' housing choices; otherwise, the UPCS continue to apply.
- 4. **Other Provisions.** The owner is required to accept offers from HUD to renew project-based Section 8 assistance (subject to funding availability) so long as the assistance is consistent with the terms and conditions of the Restructuring Commitment.

Sale or Transfer of Property

Section 3-7

- A. **Timing.** A Restructuring Plan may include a project's sale or transfer. An owner may request sale or transfer at any time during the restructuring process; however, given the length of time needed to arrange financing and to complete the transaction, and the twelve-month limitation on extension of HAP contracts at existing rents, this decision should be made as early as possible. If an owner intends, or is required, to sell property, notice should be provided to the tenants and to potential purchasers (see Forms 3.1 and 3.2).
- B. **OAHP Policy.** OAHP has no bias for or against transfers; in some cases, a sale to a new owner may be the best approach to restructuring. OAHP will consider PAE recommendations to structure transactions in such a way as to facilitate transfers whenever appropriate. If a sale to an independent, tenant-endorsed, community-based, non-profit organization (as defined in Appendix C) will enhance the project's operations, bring public funds to the transaction, or meet other public policy purposes, OAHP may forgive, assign, or modify the second or third mortgage.
- C. **Ineligible Owners.** If a project owner is ineligible for restructuring in accordance with Section 516 of MAHRA (see chapter 6, Section 6-6B.), then a Restructuring Plan should only be developed based on a request from the owner and a commitment to sell the property. If the owner requests a Restructuring Plan, for an initial 4-month period, the owner can only accept offers from tenant-endorsed "Priority Purchasers".
- D. **Transfers of Physical Assets.** All sales are subject to PAE recommendation and OAHP approval in accordance with the Transfer of Physical Asset (TPA) procedures described in Appendix D.

Tenant and Local Community Notice and Participation

Section 3-8

- A. **General.** Residents of properties participating in the M2M program, and interested community groups, must be provided the opportunity for meaningful participation in the restructuring process.
- B. **Participating Administrative Entities (PAEs).** PAEs are required to notify and consult with tenants, local government officials, and other interested parties after an owner submits an option to restructure and the asset has been assigned to the PAE, including providing these groups with the opportunity to commit on the actual Restructuring Plan.
- C. **First Tenant Consultation Meeting.** After a property has been assigned to a PAE, and the “kick off” meeting has been held with the owner, the PAE is responsible for assuring that a notice is provided to residents and other interested parties notifying them of the first Restructuring Plan and Consultation Meeting (see Form 3.3).
 1. **First Meeting.** The First Tenant Consultation Meeting must occur between 20 and 40 days after the date of the notice. This meeting provides residents with the opportunity to comment on such topics as the physical condition of the building, rehabilitation and repair needs, property management, whether the Restructuring Plan should provide project-based or tenant-based assistance, comparable market rents, and any proposed sale or transfer of the property.

At this meeting, the PAE should address tenant concerns about M2M and supply the tenants with information about the M2M process, for example, the difference between tenant-based and project-based assistance, the impact the different Restructuring Plan conclusions would have on the tenants, etc.
 2. **Notices.** Notices of the tenant meeting must be delivered directly or by mail to each tenant, the chief executive officer of the local unit of government, the executive director of the Public Housing Authority with jurisdiction over the property location, representatives of neighborhood residents or other affected parties, and Outreach and Training Grant (OTAG) or Intermediary Technical Assistance Grant (ITAG) recipients operating in the area, and any ITAG public entity grant recipient with jurisdiction. An additional notice should be sent to the owner if the owner is not otherwise assisting in sending out the notices.
 3. **Additional Notices.** Notices must also be delivered directly or by mail to any tenant organization at the property; posted in at least 3 conspicuous places within each structure or building on the

property where practicable; and be available at the management office during normal business hours for inspection and copying by tenants and by legal or other representatives acting for the tenants individually or as a group.

4. Information in the Notice. The PAE should use Form 3.3 for the notice. Each notice must include; the date, time, and place of the meeting; the name and FHA number of the property; the name, address, and phone number of the PAE responsible for the restructuring and a contact person at the PAE to whom comments and questions can be addressed; the restructuring option the owner has selected; the date project-based Section 8 assistance is due to end; the method by which residents and other interested parties can give comments; and HUD's M2M Tenant Brochure. The brochure may be ordered by calling (800) 685-8470.
5. Locating Of the Meeting. The PAE should arrange for the meeting to occur on site at the property, if feasible, or at a nearby public building convenient for the tenants, and at the time that maximizes tenant participation. The PAE should make a reasonable attempt to accommodate all interested attendees, either through a large enough space or by repeating the meeting. PAEs should also invite the owner, the PAE's physical inspector, the owner's physical inspector (if there is one), and other interested parties. If residents voice concern about the owner's participation, the PAE will make accommodations at the meeting to provide tenants the opportunity to speak confidentially with the PAE. Meetings can be held outside, providing the climate and conditions are conducive to an orderly, productive meeting and necessary seating is provided.
6. Foreign Language Materials. The PAE should provide materials in foreign languages where there is a sizable foreign language speaking population at the property. OAHP will reimburse reasonable costs for translation of material if necessary.

D. Second Tenant Meeting

1. General. The PAE should arrange a follow-up meeting with residents and other interested parties to provide them with the opportunity to offer comments on the draft Restructuring Plan. The formal submission of the Restructuring Plan should occur no sooner than 10 days after the second tenant meeting. The notice must be sent (using Form 3.4), and the material available for review, no less than 10 days prior to the second tenant meeting. All comments about the plan or recommendation will be
2. Comment Requirements. All tenant comments must be addressed in the restructuring plan by indicating how they were responded

to, or that they cannot be addressed, or that the concern was investigated and was without merit. Materials provided to the tenants and other stakeholders must have certain owner and financial information redacted (refer to the OPG, Appendix E, for guidance). Please refer to Resource Desk Broadcast of March 23, 2004, regarding incentive fee and use of Form 3.8. However, it should be noted, that Forms 3.6 and 3.7 referenced in those instructions are no longer used.

- E. **Notice of Completion of Restructuring Plan or Other Outcome.** Within 10 calendar days after closing of the restructuring or expiration of the appeal rights on the AOTC determination, the PAE must provide notice to the tenants and other interested parties (using Form 3.5) that either describes the closed transaction or indicates why the transaction will not be restructured. Where appropriate, the PAE will provide a copy of the “currently non-viable Restructuring Plan” (with appropriate material redacted) to the stakeholders. The OAHP Preservation Office staff or the PAE should contact OAHP Headquarters to determine what material should be redacted if the Restructuring Plan is being rejected because the property is owned by an entity or an affiliate with material adverse financial or managerial actions or omissions, or that did not cooperate with the Restructuring process.
- F. **Tenant and Community Access to Information.** Tenants and interested community groups must be given access to relevant documents in order to participate effectively in M2M restructurings. Some documents are withheld in order to protect the legitimate business interests of owners and to comply with the Trade Secrets Act and the Freedom of Information Act. These documents are detailed in Appendix E.
- G. **Tenant Protections if an Expiring Contract is not Renewed.** Tenants are entitled to certain protections, and owners are required to give certain notifications, when an owner decides not to renew or extend the Section 8 contract. Generally, owners are required to give a 12-month and a 120-day notice prior to opting out at the end of the contract period. In the event an owner does not give timely notice of non-renewal or termination, the owner must permit the tenants in assisted units to remain in their units for the required notice period with no increase in the tenant portion of their rent, and with no eviction due to inability to collect an increased tenant portion of rent. HUD will make tenant-based assistance available in certain circumstances subject to program policy. Refer to Housing and PIH’s instructions for further details.

Technical Assistance Funding

Section 3-9

A. Technical Assistance Funding.

1. The Multifamily Housing Reform and Affordability Act (MAHRA) authorized HUD to provide up to \$10 million annually, through fiscal year 2001, in technical assistance to help tenants create resident organizations that represent their interests and further the purposes of the M2M Program, including facilitating the transfer of properties to new owners when appropriate and necessary. Although no new grant money has been allocated, several grantees are still operating. Please refer to OAHP's Web Site for current information.
2. The annual technical assistance money funds the activities of Outreach and Training Grant (OTAG) and Intermediary Technical Assistance Grant (ITAG) grantees, and non-profit community-based housing groups that help residents organize and meaningfully participate in the M2M Program. A list of the three ITAG intermediaries and 32 OTAG grant recipients is posted on OAHP's Website.

Neighborhood Network Centers

Section 3-10

- A. **Neighborhood Networks Initiative.** The PAE and the owner may consider implementing a Neighborhood Network Center in an M2M transaction. For more information, consult: <http://www.NeighborhoodNetworks.org>.
- B. **Owner Request for Neighborhood Networks Funding.** An owner may request the PAE to include provisions for a Neighborhood Networks Center in the Restructuring Plan. Such a request should include:
 1. A business plan for staffing, technical support, and ongoing funding, and a strategy for achieving ongoing partnerships with other neighborhood, community, or educational groups.
 2. The local and size of the space to be used for the center.
 3. Estimated number and percentage of residents who will benefit directly from the center's services.
 4. A detailed estimate of the center's initial cost and ongoing operating expenses.
 5. Approval of the business plan by the Neighborhood Network Coordinator in the Multifamily Hub Program Center.

- C. **PAE Evaluation of Owner Request.** The PAE must evaluate an owner's request for Neighborhood Networks funding and assess its expected impact on the property and the neighborhood. An evaluation of the benefits compared to the costs of this option is particularly important when exception rents are requested. The evaluation must distinguish between capital costs to establish the facility, and ongoing operating and maintenance expenses. The PAE should consult with the Multifamily Hub or Program Center and should document its conclusions as to the benefits and costs of a Neighborhood Network Center during the underwriting process. For example, the PAE's evaluation may conclude that the operation of the Neighborhood Network Center will result in reduced operating and maintenance expenses for the project due to a decrease in vandalism and graffiti, or that the Network Center will result in an increase in tenant incomes due to improved job skills.
- D. **Financing.** If the PAE concludes that an owner's Neighborhood Network plan is viable, and if the owner has already obtained HUD's approval for this plan, the PAE may consider certain costs as rehabilitation and/or operating expenses for the property, as described below.
1. Certain up-front capital costs for the Center may be included in the rehabilitation escrow. These expenses are limited to the rehabilitation or build-out of the facility housing the Neighborhood Network Center and do not include furniture or the acquisition of computer hardware or software.
 2. Expenses such as utilities and facilities maintenance for the center and staffing can be considered operating expenses of the newly restructured property. However, computers and software are not eligible items and the PAE shall **not** consider the cost of computer equipment and software when determining the monthly deposits to the Reserves for Replacement. Operating expenses such as utilities and incremental maintenance expenses may be included in accordance with HUD Handbook 4381.5 Rev 2 Chg 2, chapters 8 and 9.

Davis-Bacon Act Requirements

Section 3-11

Unless otherwise required in connection with the new FHA mortgage insurance, such as the 221(d)(3) and 221(d)(4) programs, Davis-Bacon Act is not applicable.

Standard Form Legal Documents

Section 3-12

- A. OAHP requires the use of standard form legal documents. PAE or Owners may not modify these documents. Among other documents, Full debt restructuring transactions may require:
1. a modification to the existing Regulatory Agreement, and a M2M Regulatory Agreement;
 2. a M2M second (“Mortgage Restructuring”) and third (“Contingent Repayment”) Note and Mortgage;
 3. a Rehabilitation Escrow Deposit Agreement;
 4. a Use Agreement; and a Rider to the Section 8 Contract.

Blank copies of these documents should be provided to the owner at the kick-off meeting and are available on OAHP’s website. (See Section 7-8 for more details)

Business Forms

- 3.1 Notice of Intent to Sell
- 3.2 Notice to Potential Purchasers
- 3.3 Notice of 1st Restructure Plan Consultation/Tenant Meeting
- 3.4 Notice of 2nd Consultation/Tenant Meeting
- 3.5 Notice of Completed Restructuring Plan or Other Conclusion
- 3.6 No longer used
- 3.7 No longer used
- 3.8 PAE Certification for Outstanding Public Interest Survey Performance Incentive Fee