

Documentation and Analysis; Financing Alternatives

Executive Summary

Section 4-1

This chapter describes the responsibilities of the PAE and owner from the acceptance of the asset by the PAE through the collection of data and completion of some non-financial conclusions. The topics are presented sequentially, though many items may occur simultaneously. The chapter addresses:

- A. the PAE's Kick-off Meeting with the owner to describe the M2M program and process and to start the collection of documents from the owner.
- B. the PAE's ordering of the required third party contract reports, namely the Physical Condition Assessment, including environmental information, and the Limited Scope Appraisal.
- C. the PAE's collection of other information for underwriting, including information from the Multifamily Hub or Program Center.
- D. development of the PAE's conclusion on ownership and management.
- E. development of the PAE's conclusion on physical condition.
- F. PAE's decisions on any Repair Escrow.
- G. completion of the Rental Assistance Assessment Plan (RAAP).
- H. completion of any Transfer of Physical Assets.
- I. financing options.
- J. collection of information on bond financed properties.
- K. collection of documents regarding the existing mortgagee, servicer, and unpaid principal balance on the existing mortgage, for review with the Preservation Office Closing Coordinator and comparison to HUD's F47 system.

Kick-Off Meeting

Section 4-2

- A. **Schedule the Kick-off Meeting.** The PAE should contact the owner and schedule a Kick-off Meeting. The meeting should generally be held within 15 days of the acceptance of the asset. Face-to-face meetings are preferable but teleconferences are also acceptable. The PAE should encourage the owner to involve the current lender, and any new lender who has been identified, either in person or by phone. The PAE should maintain a record of the meeting in its files.
- B. **Send the Owner's Package.** As soon as possible after the Kick-off Meeting is scheduled, the PAE should send the owner the complete Owner's Package, in Appendix G, including Form 4.1, Owner's Data Release Authorization Letter Form 4.2 Checklist of Related Party Agreements Form 4.3, Loan History Statement and Form 4.10 Certification of Ownership Entity.
- C. **Hold the Kick-off Meeting.** At this meeting, the PAE should
1. **Explain the restructuring process**, including a review of the items in the Owner's Package and document collection.
 2. **Strongly encourage the owner to obtain tax advice** and begin working immediately with any limited partners, or any others whose consent for restructuring would be required, to make them aware of any upcoming issues. Neither OAHP nor the PAE may provide tax advice and neither has any responsibility for the tax consequences of the transaction. However, the PAE should request general information from the owner regarding the tax impact of their restructuring transactions, principally to ensure that the owner is considering the issue. The PAE may call the owner's attention to Revenue Ruling 98-34 from the IRS which may be accessed from OAHP's Web site;
 3. **Strongly encourage the owner to identify a lender** for take-out financing;
 4. Advise the owner of the requirement to verify the loan balance on the existing mortgage with the existing mortgagee and servicer, and to ensure that the unpaid principal balance, the name of the mortgagee, and the name of the servicer match up to HUD's records, which are maintained in HUD's F47 system. Establish point of contact for discussion of any mortgage modifications (including interest rate reductions and principal paydowns) that have occurred over the life of the existing mortgage.
 5. **Discuss the requirement (Form 4.10) for early due diligence concerning ownership issues**, including obtaining the current partnership agreement (or other governing documents) with all

amendments, obtaining a current list of partners and their respective ownership interests, establishing who has authority to act on behalf of the ownership entity, and identifying the term of the existing ownership entity. (Note that neither FHA insurance, nor a M2M 2nd / 3rd mortgage, may extend beyond the remaining term of the ownership entity and a 30 year mortgage term is normally required.) This early coordination is necessary in order to identify any ownership-related issues early in the restructuring process

6. **Explain that the PAE will order a title bring-down early in the restructuring process**, and ask the owner for information on any easements, liens and other issues that may affect title and that have occurred subsequent to the start of ownership;
7. **Review the requirements** for tenant notifications and meetings (See Chapter 3, Section 3-98);
8. **Provide the owner** with copies of the appropriate closing documents (including the FHA State Form Note and mortgage from the HUD Regional Counsel's Office with jurisdiction); and
9. **Obtain information from the owner** regarding current or past bond financing, if any.
10. **Note** that both the PAE and owner are responsible for notifying OAHP of any potential conflicts of interest that may exist for either party regarding the restructuring process.

Ordering Third Party Reports

Section 4-3

- A. **Third-party Reports.** The PAE is responsible for ordering each of the following, in accordance with the requirements of the PRA:
 1. Limited Scope Appraisal in accordance with Appendix H.
 2. Physical Conditions Assessment (PCA), including the Environmental Checklist, Form 4.4, in accordance with Appendix I.
 3. Preliminary Title Report (Title Bring-Down). PAEs are required to obtain and review a title bring-down (sometimes called a "Report on Title") on the property from the time the current owner acquired the property to the time of the title bring-down. This title bring-down should reveal loan modifications, major liens, the presence of a leasehold, and other useful information which should suggest further investigation. The PAE may incur costs of up to \$500 per transaction to cover both obtaining the bring down and reviewing the report.

- a) When ordering and reviewing the title report, the PAE should consider the requirements contained in Appendix F, Attachment 1, Title Insurance Policy Instructions.
 - b) If the preliminary title report identifies liens or encumbrances that would, in the PAE's judgment, materially or adversely affect the property and/or that might pose a barrier to restructuring, the PAE will immediately advise the OAHP Preservation Office in writing (and copy the Multifamily Hub or Program Center). The debt restructure transaction cannot close until the issues have been resolved. If the issues involve potentially improper action by the owner and/or manager, the PAE must consider whether to recommend that OAHP determine the owner ineligible (see Chapter 6).
 - c) All non-HUD subordinate debt is required to be approved by Multifamily. If subordinate debt is noted during a review of the preliminary title report, verify with Multifamily whether the debt has been approved. If not, the PAE must provide the Multifamily office with the information obtained for Multifamily's consideration.
- B. **Timing.** The reports should be ordered as soon as practicable after the asset is assigned and should provide for as short a turn-around as can be reasonably obtained.
- C. **Qualifications.** The PAE should assure that the appraiser and the PCA inspector meet the qualifications specified in the applicable appendices.
- D. **Obtaining Drafts.** The PAE is strongly encouraged to obtain and review draft reports. In this way, the PAE may complete its review and often obtain any necessary corrections before the final product is complete. This will reduce the amount of time needed to make adjustments or address issues in the narrative submission to OAHP. The PAE should discuss the results and provide the owner with copies of the third-party reports.
- E. **Tenant Comments.** The PAE must assure that any applicable comments made by the tenants at the First Tenant Meeting are provided to, and addressed as necessary by, the third-party contractors.

Collection of Data – General Use of Forms

Section 4-4

- A. **Underwriting Documentation Needed.** The best underwriting can be achieved if all of the underwriting documents or information cited in the Guide can be obtained. In some cases, however, owners may be unable or unwilling to submit a document, a visit to the HUD Hub

or Program Center may not appear appropriate, a local government entity may be unresponsive, or other circumstances may prevent the PAE from proceeding in a manner recommended by this Chapter. Except for the items cited in Section 4-4 B and C below, if the PAE, in its judgment, believes that it can complete an adequately-supported Restructuring Plan without the specific document or without obtaining certain specific information cited in this Chapter, the PAE may proceed.

- B. Exceptional Documentation.** The PAE must not proceed without:
1. Form 4.1, (Owner's) Data Release Authorization Letter (executed).
 2. Form 4.10, Certification of Ownership Entity (executed).
 3. The most recent three years of audited financial statements available at the time of document collection. In the rare case where these cannot be obtained from any source, the PAE should discuss the circumstances with the OAH Preservation Office and agree on how to proceed.
 4. The third-party reports in Section 4-3 above.
 5. The evaluation of ownership described in Section 4-8 B below.
- C. Closing Documentation Not Included.** The authorization to proceed without certain required documents applies only to underwriting documents and does not apply to documents required for closing.
- D. Use of Guide Provided Forms.** The PAE need not follow precisely the Forms and Formats provided in the Guide so long as the same applicable information is provided in all cases.

Collection of Data from the Owner

Section 4-5

- A. Owner's Documentation.** The owner is requested to submit the documents listed below. However, the PAE may proceed without one or more elements of this documentation if the requirements of Section 4-4 A and B are met.
1. (At or before the kickoff meeting) The most recent three years' audited financial statements.
 2. (Within 45 days after the kickoff meeting).
 - a) The minimum documentation listed on the Data Checklist in the Owner's package. See Appendix G, Attachment 3.
 - b) Any Supplemental Information the PAE may have checked off. See Appendix G, Attachment 3, Supplemental

Information.

3. (Within 45 days after the kickoff meeting) Form 4.10, Certification of Ownership Entity. This certification requires the following attachments:
 - a) For partnership (or LLC) ownership entities, a complete list of partners (or LLC members) including the percentage ownership interest of each.
 - b) The names and social security or tax identification numbers of all principals in the ownership entity. See Appendix A for a definition of “principal.”
 - c) The partnership agreement (or other governing documents) including all amendments.
 - d) A description of the formal consent process, if any, that is required under the ownership entity’s governing documents to extend the term of the ownership entity.
 - e) A description of the formal consent process, if any, that is required in order for the ownership entity to close a restructuring transaction (e.g., if a vote of partners is required, what percentage of the ownership interests must vote in favor).
 - f) Identification of the persons who are authorized to sign a Restructuring Commitment on behalf of the ownership entity and the persons who are authorized to sign the Closing Documents.
 4. PAEs are required to obtain and review existing Notes and Mortgages, and any modifications to them, if at all possible. The PAE should attempt to obtain these from the owner; and, if the owner will not supply them, the PAE must maintain a record of the efforts made to obtain the documents. The Note and Mortgage should be reviewed as part of due diligence to determine if there is any lock-out period (i.e. prepayment prohibitions or conditions) and/or whether the transaction has been bond financed, which may require special review and/or approval, and special restructuring commitment language.
 5. (When requested by the PAE) Any other information the PAE may reasonably need for completion of its review.
- B. Owner Failure to Submit Documentation.** If, after the 45 days have passed, the owner still has not submitted information that the PAE requires to complete its review, the PAE should so notify the owner using Form 4.5 by certified mail with a return receipt. The notification should identify the missing information and allow the owner 10 business days to submit the information. The notification

will also indicate that an owner's failure to comply with the PAE's notice may cause the PAE to stop developing a Restructuring Plan (See Chapter 6).

Affordability and Use Restrictions

Section 4-6

- A. **Coordination with the Multifamily Hub or Program Center.** The PAE must request the Multifamily Hub or Program Center to advise of any issues of which the PAE needs to be aware. The PAE should use the Form 4.6, which may be sent by e-mail with a copy to the Multifamily Hub or Program Center Director, to make this request. The response from the Multifamily Hub or Program Center may be made by phone. In this case, the PAE must briefly document the call in the Restructuring Plan Package and provide a copy of that record by e-mail to the HUD staff person with whom the call was held with a copy to the Multifamily Hub or Program Center Director. Significant input should be noted to support PAE conclusions.
- B. **Specific Concerns.** The PAE should specifically attempt to obtain information regarding any violations of the Regulatory Agreement, the results of any REAC inspections, any sanctions which may have been imposed, any tenant complaints, workouts, opt out notices, results of management reviews, Capital Needs Assessments, and similar issues.
- C. **HUD Asset Management Records.** The asset management files in the Multifamily Hub or Program Center may contain valuable information that can assist the PAE in its underwriting and other analyses. A list of the information that should be in these files is included in Appendix J. However, for some PAEs, the travel and time to review the files is substantial and the significant information that would be obtained from these files can be obtained by other means. The PAE should discuss the files with the HUD Project Manager, or supervisor, and determine whether an on-site visit to obtain information from the files is warranted.
- D. **Annual Financial Statements.** The PAE should obtain the audited financial statements from the owner. If this is not feasible, the PAE may request the documents from the Hub or Program Center, or, lastly, request OAHQ Headquarters to obtain the documents from REAC's database.

Collection of Other Data

Section 4-7

- A. **Code Compliance.** The PAE should contact the owner to determine whether there are outstanding code compliance issues. The PAE should also obtain code compliance information from the jurisdiction if the information is readily available from the jurisdiction without causing a new inspection. The PAE should be alert to the possibility that local codes may require items of significant cost such as window guards or sprinkler systems and should discuss the issue with the owner and/or jurisdiction. Any identified code compliance issues must be corrected in the Restructuring Plan.
- B. **Expense Data.** In addition to the information in the appraisal, the PAE should endeavor to obtain appropriate information on expenses of similar properties in the area. This information may come from the PAE's own sources, such as properties in its own portfolio, from HUD, from local apartment owners' associations, local lenders or appraisers, or other published sources. The PAE should contact all applicable utility suppliers, taxing bodies, and insurance carriers to determine recent past rate changes and/or future rate changes that would impact underwriting. See Section 5-5 for further details.
- C. **Community Development Block Grant Consolidated Plan.** The PAE should obtain this document or similar plans addressing affordable housing from the applicable jurisdiction if needed to complete the RAAP (see Section 4-13). The jurisdiction may also be able to provide additional useful information to the PAE.
- D. **HUD's F47 System Reconciliation and Forms 4.11 and 4.12.** The PAE should obtain the name and identification number of the existing mortgagee and the existing servicer, and the unpaid principal balance of the existing mortgage in order to reconcile the mortgage information maintained in HUD's F47 System. This reconciliation must be completed prior to the approval of any M2M restructuring plan. Detailed instructions appear on the OAHF Resource Desk (www.oahf.net).
- E. **Independent Review of the Property, Neighborhood, and Comparables.** At a time determined appropriate by the PAE, the PAE should conduct an independent review of :
 - 1. The Property. The PAE should inspect the grounds and common areas and a sample of occupied and vacant units. This review should assist the PAE in its review of the PCA and its determination of the acceptability of ownership and management.
 - 2. The Neighborhood. The PAE should generally drive the neighborhood and determine the availability of comparables, the

impact of nearby uses, accessibility and visibility of the property, public amenities, and similar issues. This review should assist the PAE in its review of the Limited Scope Appraisal and other analyses.

3. The Comparables. The PAE should generally visit all comparables selected by both the PAE's appraiser and the owner's appraiser if the owner submitted a market assessment. In addition, the PAE should visit any other comparables that are heavily weighted in its rent conclusion.

Evaluation of Ownership and Management

Section 4-8

A. Determination of Ownership, Term, and Consent Requirements.

As early in the restructuring process as practicable, the PAE should establish the following key information concerning the ownership entity (using the information provided by the owner in Form 4.10, Certification of Ownership Entity).

1. Owner Of Record. The current owner must be the same as the HUD-approved owner.
 - a) The PAE must identify the entity that owns the property according to the local land records and the entity that owns the property according to HUD's Asset Management records and determine whether these are the same as the current ownership entity.
 - b) If not, ownership may have been transferred without HUD approval of a Transfer of Physical Assets, in violation of HUD requirements. The PAE will immediately advise the OAHP Preservation Office in writing (and copy the Multifamily Hub or Program Center). If an unauthorized TPA has occurred, the debt restructure transaction cannot close until the issue has been resolved, and the PAE must consider whether to recommend that OAHP determine the owner ineligible (see Chapter 6).
2. Term of Ownership Entity. If the ownership entity has a limited life¹, the PAE must determine whether the current limit is sufficient to permit restructuring. Neither FHA insurance nor the term of an M2M 2nd or 3rd mortgage may extend past the remaining term of the ownership entity. Unless the remaining term is clearly sufficient (i.e., extends beyond the term of the new mortgage loans and M2M Use Agreement), the PAE should notify the ownership entity of the need to extend the term. The

¹ Corporations generally have perpetual life. Partnerships and LLCs generally have a fixed term.

PAE should not schedule the closing date, or submit a Partial Payment of Claim package, until the PAE has verified that the remaining term of the ownership entity is sufficient to permit restructuring. Generally the minimum remaining term is 30 years.

3. Consent to Restructure. The PAE should notify the owner that the PAE will not schedule the closing date, or submit the Partial Payment of Claim package, until the ownership entity has executed the Restructuring Commitment and completed any formal consent processes that are required in order for the owner to close the transaction.

B. Evaluation of Ownership History.

1. The PAE will provide the information on principals of the ownership entity (see Section 4-5.A.3.b) to the local HUD office for a check through the “2530 system” (“Red Flag Check”). (The PAE will need to check with its Debt Restructuring Specialist or each individual Multifamily office to determine the appropriate staff person in the Multifamily Hub or Program Center to handle this request.)
2. The local HUD office will provide a print out of any name matches to the PAE, reason for the flag, and Field Office that created the flag. The PAE should contact the appropriate Hub/Program Center of the flagging office for information on the reasons for the flag and any corrective actions the owners took.
3. If, in the PAE’s judgment, the flags may result in a finding of ineligibility of the ownership, the PAE should advise the OAHP Preservation Office who will obtain information on the problem from Multifamily Headquarters. With this information and any other information the PAE has collected, the PAE will determine whether or not to make a recommendation to OAHP that the ownership be found ineligible and that the request for a full restructuring be rejected (see Section 6-7).

Formal 2530 clearance, including submission of completed Forms HUD-2530 from all principals, is not required unless required in connection with new FHA financing (other than 223(a)(7)), a TPA, or a change in management entities.

4. **Eligibility issues.** If the eligibility of the owner or the project is in question, the PAE should make a recommendation to OAHP, and OAHP will make the final determination. If the owner is determined ineligible (see Chapter 6), the Multifamily Hub or Program Center will make the determination whether to renew project-based Section 8 (at market rents) or provide tenants with vouchers, if the request for restructuring is rejected.

- a) **Issues Already Identified within HUD.** The PAE should note any issues found in any available REAC or Asset Management records. All such issues should be addressed in the Restructuring Plan.
 - b) **Issues Discovered by PAE.** As the PAE develops the Restructuring Plan, the PAE may uncover information or circumstances that the PAE concludes may call the owner's or property's eligibility into question. All such issues should be addressed in the Restructuring Plan.
- C. **Evaluation of Management.** In underwriting, the PAE is required to evaluate the current or proposed management agent in accordance with standards the PAE develops. The PAE may adopt the standards in Appendix K and the elements noted below. The PAE should also assure that the management standards are in accordance with any guidelines established by HUD and industry standards governing conflicts of interest between owners, managers and contractors.
- 1. Management is Property-Specific. Properties differ. Specific property factors should be considered in evaluating management experience and competence. For example:
 - a. project-based or tenant-based assistance following restructuring;
 - b. resident profile;
 - c. any anti-crime initiatives that the PAE has approved;
 - d. any non-housing services that the PAE has approved;
 - e. the relative proximity of the property to the agent's supervisory office (and to other properties managed by the agent); and
 - f. other factors, such as use agreements, influencing the ease or difficulty of managing the property after restructuring.
 - 2. Demonstrated Competence. The best evidence of capacity is demonstrated competence in the tasks required to manage the property after restructuring. Indicators of competence may include:
 - a) favorable references from non-affiliated owners of similar properties under the same management;
 - b) positive comments from the Multifamily Hub or Program Center;
 - c) favorable comments from residents;
 - d) the length of time over which the agent has managed such properties successfully;

- e) favorable references or evaluations from regulatory agencies with jurisdiction over such properties; and
 - f) positive experience with such tasks as anti-crime measures, or non-housing services such as Neighborhood Networks, where these are recommended by the PAE.
3. Current Experience with the property. Competence is indicated if the agent is currently managing the property successfully, and the operating expenses and management approach are reasonable, competitive with the market, and not expected to change dramatically after restructuring. As noted above, the PAE must obtain input from the appropriate Hub or Program Center on the performance of management. The underwriter should assess the adequacy of property management through a review of tenant and local community comments and through a review of any concerns identified above.
4. For Properties Converting to Tenant-Based Assistance. The underwriter should look for evidence of competence in managing market-rate apartments, with a particular focus on marketing, leasing, resident retention and “curb appeal.”
- D. **Conclusion on Ownership and Management.** The PAE will review all of the available information and conclude whether the ownership entity is acceptable and the current or proposed management is acceptable. If management is determined “not acceptable”, the PAE will discuss the replacement of the current manager with the owner and Multifamily. The PAE will include a brief justification of its conclusions in the Restructuring Plan Package.

Evaluation of Physical Condition

Section 4-9

- A. **General.** In general, the property should be able to compete for and attract non-subsidized tenants on the basis of rent rather than amenities. The PAE will review the property and information related to physical condition with the goal of restoring the project to a non-luxury standard appropriate to its original rental market. If the standard has changed, the repair/rehabilitation may include improvements to meet the updated standard. For example, if the property lacks central air conditioning and similar units currently serving the same market provide central air conditioning, air conditioning would be an appropriate improvement.
- B. **Review of the Physical Condition Assessment (PCA), SHPO Requirements.** The PAE will review the PCA for consistency with the PAE’s review of the property, any information received from the

owner or HUD, internal consistency, and acceptable compliance with the requirements in the Statement of Work in Appendix I. (It is preferable and more efficient for any problems in the PCA to be identified at the draft stage, discussed and corrected before final submission. The PAE must:

1. Finalize the list of items to be included in the Rehab Escrow (any repairs to be completed in the next 12-months or earlier and including any substantial rehabilitation needed). Generally, all broken items should be included in the Rehab Escrow.
 - a) The PAE must assure that the repair list is sufficiently clear that the Rehab Escrow administrator can determine completion.
 - b) **The PAE must also assure that needed repairs are all included in the Rehab Escrow and not inappropriately moved to the Reserve for Replacements.** Inclusion of an item in the Reserve for Replacements does not assure that the item will be completed and may result in further deterioration of one or more elements of the property with problems resulting in both maintenance and reserves and the general performance of the property;
2. Finalize the list of items and costs in the Reserves for Replacements;
3. Assure that any market comparable improvements on which the rents are based are included in the Rehab Escrow;
4. Address any accessibility requirements;
5. Assure the plan addresses any appropriate/applicable concerns raised by tenants;
6. Determine whether any operating deficit escrow may be necessary as a result of substantial repair or rehabilitation work. If the PAE determines that an operating deficit is needed, the PAE must determine the amount and form of the escrow and how the escrow will be administered;
7. Assure the repair and reserve requirements do not include maintenance items; and
8. If the property is at least 50 years old **and** the planned rehabilitation under M2M involves exterior renovations, obtain an opinion from the State Historic Preservation Office (SHPO) as to whether any historic properties will be adversely affected by the planned rehabilitation.

C. Owner Input.

1. Owners are required to evaluate the rehabilitation needs of the

project. The owner may meet this requirement by adopting the PAE's conclusions (Rehab Escrow and Reserve for Replacement information) based on the PCA. This choice must be evidenced by the owner's signature on Form 4.7; or, if the owner does not sign Form 7, the owner must adopt the PAE's conclusions through signature of a Restructuring Commitment that contains a special condition addressing this issue.

2. In any case, PAE discussion with the owner or manager is an integral part of the review process. In particular, the owner or manager may supply evidence of replacements already completed (which may reduce reserve needs) or provide information on typical costs of recurring items.
- D. **PAE Adjustment of the PCA.** If there are problems remaining in the final draft of the PCA or if optional adjustments are appropriate that will not negatively impact the condition of the property over time, the PAE may make appropriate adjustments to the list of items in the Rehab Escrow or to the schedule of long-term physical needs. Such adjustments should be noted and briefly justified in the Narrative. The PAE should generally have the PCA inspector indicate that any significant changes are acceptable.
- E. **Critical Repairs.** The PAE should assure that any life threatening repair needs identified in the PCA or in the PAE's inspection are immediately reported to management and Multifamily and corrected before closing. The owner's failure to make these critical repairs in a timely manner will result in the PAE re-evaluating the project's eligibility (see Chapter 6).
- F. **Conclusion on Physical Condition.** If the physical condition of the property is acceptable, or will be made acceptable with the completion of the items on the repair list and the benefit of adequate reserves, the PAE may proceed with the transaction. If the property is not physically sound and cannot economically be made sound, the PAE may consider the property ineligible and proceed as discussed in Chapter 6.
- G. **Conclusion on Environmental Concerns.** The PAE will review the information submitted by the inspector on Form 4.4. If there are concerns in the area of PCBs, lead based-paint, or asbestos containing materials, the PAE should advise the owner of any requirements using Form 4.8. (See the OAHP web page for the most recent guidance on environmental matters.)

PAE's Decision Regarding any Rehab Escrow

Section 4-10

- A. **Applicability.** M2M debt restructure transactions will fall into one of the following categories for purposes of rehabilitation escrow administration:
1. This Section Is Not Applicable where there is no rehabilitation escrow or in certain Additional Funds Transactions. For Additional Funds transactions, see OPG Appendix R.
 2. This Section Is Fully Applicable, and the standard form "Rehabilitation Escrow Deposit Agreement" will be used, where there is a Rehabilitation Escrow and either:
 - a) FHA 223(a)(7) financing; or
 - b) the M2M Mortgage Restructuring Note ("second mortgage") will be in first lien position.
 3. This Section Is Partially Applicable where there is a:
 - a) **Rehabilitation escrow and FHA 221(d)(4) or 223(f) financing.** In these cases, the standard form Rehabilitation Escrow Deposit Agreement will not be used. The multifamily Hub or Program Center determines the form of rehab escrow agreement, procedures for inspection / draws / evidence of completion / release of funds, and the amount of the escrow. Standard FHA legal documents will be used. The balance of this Section does not apply. PAEs should contact the Hub or Program Center to obtain the final escrow amount (including contingency and any inspection fees).
 - b) **Rehabilitation escrow and non-FHA financing.**
 - i. The PAE will require the lender to use the standard form legal document Rehabilitation Escrow Deposit Agreement (REDA) and to establish administration fees and procedures in accordance with the balance of this Section. If the lender agrees, the balance of this section applies.
 - ii. If the lender does not agree, another escrow administrator must be designated.
 - iii. For Additional Funds transactions, see OPG Appendix R.
- B. **General.** The PAE selects the party(ies) who will administer the escrow, and proposes fair and reasonable compensation for OAHP's approval. The standard form Rehabilitation Escrow Deposit Agreement (REDA) will be used to document the terms and conditions of the escrow administration, define the rights and responsibilities of the parties, and establish the scope, budget and timeline for completion of the rehabilitation work.

1. The PAE is a party to the REDA and remains available to the escrow administrator to provide advice and consultation.
2. The PAE must make several determinations addressed in this section, in order to complete the REDA. It is recommended that the PAE begin consideration of these issues as soon as possible after determining that a REDA is necessary so that closing is not delayed.
3. See also Section 9-5

C. Selection of Rehabilitation Escrow Administrator.

1. The PAE will engage a single entity to administer the escrow and hold/disburse the funds (the “Rehabilitation Escrow Administrator”, or REA). The REA will engage the inspector and pay for the inspection(s) required prior to payment of any reimbursement request. With OAHF’s advance written permission, the REA may engage and pay other third parties to assist in administering the escrow.
2. In any case, the REA must be acceptable to the PAE and OAHF.

D. Bonding. FHA-approved multifamily lenders are considered qualified to hold, invest, and disburse escrow funds. If a party, other than an FHA-approved multifamily lender, will hold, invest, or disburse escrow funds, the PAE must assure that such party is a suitably qualified fiduciary; and, at a minimum, such party must carry a fidelity bond in an amount not less than the entire amount of the escrow.

E. Compensation. The PAE will determine an appropriate fee for escrow administration. The fee includes the cost of any inspections (and any other third party costs of administration). The PAE needs to indicate how much of this amount is for administration and how much is for inspection fees and how these fees were determined. The fee must be reasonable based on the complexity of the administrative work required and the duration of the escrow and may not exceed typical escrow administration fees for comparable services in the market area in which the property is located. The amount of the compensation will be included in the financing as a transaction cost. The cost of administration must be addressed by the PAE in the Restructuring Plan and approved by OAHF.

F. Amount of the Escrow. The PAE must size the escrow based on the estimated cost (as determined by the PAE) to complete the required repairs. The PAE should work closely with the owner in developing the rehabilitation escrow scope, budget and timeline.

1. Amount Must Be Adequate. If the PAE considers a work element to have a significant cost or to represent a significant percentage of the overall escrow, the PAE should require the

owner to obtain fixed-price bids and/or increase the amount of the escrow so that the escrow amount will be adequate.

2. Less Than Sub Rehab. If less than substantial rehabilitation is involved, a cash escrow must be established equal to 100% of the cost plus at least a 10% contingency.
3. Substantial Rehabilitation. (If substantial rehabilitation is involved, Section 223(a)(7) financing cannot be used.) HUD procedures for Section 221(d)(4) financing require that the Escrow consist of cash or a forward commitment for financing in the amount of 100% of repairs plus contingencies. Additionally, a 100% performance/payment bond or a cash escrow of at least 15% is also required. If the building is an elevator structure of four or more stories, the cash escrow must be at least 25%. The bond or cash escrow must be maintained until the escrow administrator has completed any cost certification review.

Note: For this purpose, “substantial rehabilitation” is defined as: required repairs, replacements and improvements involving (1) the replacement of 2 or more major building systems or (2) costs which exceed either 15 percent of the property’s replacement cost as reasonably determined by the PAE or \$6,500 per unit times the area high cost factor.

G. Evidence of Completion. The standard form legal document REDA contains certain minimum documentation requirements for processing releases from the rehabilitation escrow. The PAE must ensure that the REA fully discloses to the owner its reimbursement procedures and what specific evidence of completion will be required to release funds from the escrow.

H. Approval. The REA approves the release of funds. The REA need not seek OAHP approval of releases unless the REA has been notified in writing that one or more particular repairs will require advance approval by OAHP, the REA is seeking guidance for final escrow balance disposition, or in the event of a dispute with the owner. REAs should use Form 9.10 as a transmittal when seeking guidance in rehab related matters.

I. Timing.

1. Generally, repairs must be completed within 12 months. The PAE must determine whether certain repairs must be completed earlier (to avoid deterioration, for example) in the escrow period or whether, in the case of substantial rehabilitation, more than 12 months should be allowed. Whenever completion dates of less than 12 months are established by the PAE, owner agreement must be obtained and the special completion date(s) should be made a condition of the Restructuring Commitment.

2. PAEs should make owners and REA aware that, if repair costs have not been reimbursed prior to fiscal year end, it is likely the project will have negative Surplus Cash which, in turn, will prevent payment of Capital Recovery Payments and will result in loss of any Incentive Performance Fee for the fiscal year.
3. If the underwriting assumes operating efficiencies (or reductions in rent loss) that will occur only after completion of repairs, an Operating Deficit Escrow may be needed to cover any additional operating costs and rent loss while repairs are being made. See also Section 4-9.B.

J. Special Considerations for More Complex Repairs. For more complex repairs, the PAE must consider whether the work requires:

1. Periodic inspection for work that should be reviewed in progress, as well as upon completion;
2. Partial release of funds, often called progress payments, where incremental disbursements to the contractor based on the amount of work completed and inspected is appropriate (coupled with periodic inspections and appropriate lien releases);
3. Latent Defects Escrow, where the quality of the work cannot be adequately ascertained at the time of completion and the potential costs for additional repair or remediation are large; or
4. Plans and Specifications detailing the work, its quality and quantity. The cost of preparing such documents may be included in the mortgage as a transaction cost.

Deposits to the Reserve for Replacements

Section 4-11

- A. Initial Estimate of Annual Deposits to the Reserve.** The PAE will determine the deposits to the replacement reserve that are needed to maintain the property in acceptable physical condition over the term of the mortgage. PAE will make an initial determination of the annual deposit needed using:
1. The model worksheet showing the long-term needs identified in the PCA and possibly adjusted by the PAE;
 2. PAE's reasonable estimate of the Initial Deposit to the Replacement Reserve (the initial balance in the reserve immediately after closing considering use of any of these funds for repairs made prior to closing);
 3. Reasonable rate of inflation (generally 2.5% per annum) applied to the total cost of replacement items in a given year;
 4. A minimum end-of-the-year balance that is generally no less

than the lesser of the amount being deposited on an annual basis prior to the asset being submitted to M2M or the M2M determined annual deposit;

5. At the PAE's option, a modest rate of interest income on deposits held in the reserve (no more than a typical pass book rate); and
6. An annual increase in the amount of the deposit to the reserve. The deposit will be increased annually by the OCAF.

B. Final Determination of the Annual Deposit and any Initial Deposit to the Replacement Reserve. The PAE should establish the best balance available between the estimates of the annual deposit and any IDRR. In determining the optimum combination, the PAE will consider the physical needs of the property, the NOI after reserves, impact on exception rents, the available funds both from any new mortgage and from the other sources, and actual funding to, and disbursements from, the Reserve for Replacement account during processing. The final determination will be included in the Restructuring Plan.

PAE's Review of the Appraisal; Determination of Market Rents

Section 4.12

- A. **Review.** The PAE must review the Limited Scope Appraisal for consistency with the PAE's review of the property and market, any information received from Multifamily, internal consistency, and acceptable compliance with the requirements in the Statement of Work (See Appendix H). It is preferable and more efficient for problems to be identified at the draft stage, discussed and corrected before final submission. OAHF encourages the PAE to obtain consultation, if possible, between their appraiser and the owner's appraiser where there are material differences in the conclusions.
- B. **Determine Comparable Market Rents.** The PAE must determine market rents (defined as those rents the property would command in the open market, absent project-based Section 8 assistance) and support its conclusion. The PAE must:
 1. Compare the Limited Scope Appraisal to any rent study submitted by the owner as well as its own independent review conclusions (see Section 4-7-E).
 2. Assume that the owner will repair the project in accordance with the repair/rehabilitation escrow.
 3. Prepare a grid showing its conclusions on rents and adjustments.
 4. Support its conclusions including a brief justification for its adjustments and for differences with the owner and appraiser.

- C. **Poor Quality.** If the final Limited Scope Appraisal is of very poor quality, it should be submitted to OAHP Headquarters for review and possible referral to the Appraisal Institute or a State licensing entity.

Rental Assistance Assessment Plan (RAAP)

Section 4-13

- A. When the PAE has sufficient information, it is required to complete the Rental Assistance Assessment Plan (RAAP) in Appendix M. Note that if any of the categories in Section A of the RAAP are answered “Yes”, the PAE need not complete the remainder of the form.
- B. All of the items in Section B of the RAAP must be addressed; however, the responses should be brief, especially where one or more factors will effectively dictate the conclusions. For example, if the vacancy in the local sub-market for affordable housing is 2%, or the PHA advises that there is a low success rate in the voucher program, the option of tenant-based assistance is likely precluded. Appendix M includes a sample RAAP and detailed instructions.
- C. PAEs must provide a report on a semi annual basis of any properties in which a Restructuring Plan results in tenant based assistance or any properties in which project based assistance was provided notwithstanding tenant support for tenant based assistance.

Transfers of Physical Assets

Section 4-14

- A. **General Overview.** The PAE will work with the owner/seller to obtain OAHP’s approval of a TPA that is a part of the Restructuring Plan. TPAs will be processed by PAEs and submitted to OAHP Preservation Directors for approval when there is a sale or transfer and either
 1. new debt financed by FHA mortgage insurance under 223(a)(7) or
 2. a mortgage modification.

The Multifamily Hub or Program Center will continue to process TPAs for Lites. In addition, Multifamily’s processing of new financing under 223(f), 221(d)(3) or (4), Section 542(c) HFA Risk-Sharing or Section 542(b) GSE Risk-Sharing will incorporate any TPA processing.

- B. **Special TPA Requirements.** The TPA Handbook (HUD Handbook 4350.1, Chapter 13, available in HUDClips) provides general

guidance on TPAs. However, the PAE's standard processing of a Full Debt Restructuring will generally meet all TPA requirements except: 1) analyzing the Purchase and Sale Agreement and 2) review of the Purchaser's Resume and Organizational Documents.

C. **Sequential transactions.** In some cases, there are sequential transactions with respect to a single project that might be construed to require multiple TPA Reviews. However, the PAE may choose to treat all transactions as one event and require only one approval. In these instances, PAEs should consider the guidance in TPA Handbook Appendix G, Section III, Paragraph F (other legal issues).

D. **Two types of review.**

1. **“Full” TPA Review.** Required when a property is sold or conveyed to a new mortgagor.
2. **“Modified” TPA Review.** Required when a property undergoes a change of control of the current mortgagor (such as substitution of general partner, transfer of a 50 percent or greater interest in the project, or any other transaction resulting in a change of control).

E. **Process.** Detailed requirements for the TPA application package and PAE processing are discussed in Appendix D. The following is an overview of the process:

1. When the negotiations on the sale or transfer are substantively complete, the proposed new owner/proposed new controlling parties submit a TPA application package to the PAE for review.
2. The PAE and its attorney review the package to determine acceptability of the transfer and incorporate conclusions in the Restructuring Plan.
3. The PAE submits its conclusions and recommendation on the TPA to the OAHP Preservation Office.
4. OAHP approves the TPA and grants Preliminary Approval concurrently with the Restructuring Commitment.
5. The deed, mortgage, note, and regulatory agreement must be assigned to the new mortgagor in the case of a Full review.
6. The actual TPA transaction must occur after Preliminary Approval by OAHP and prior to the M2M closing.
7. After recording the TPA transfer documents and closing of the transaction, the new owner submits an application package for Final Approval to the PAE.
8. The PAE and its attorney certify that all conditions of the Preliminary Approval have been met and recommend that OAHP grant Final Approval.

9. OAHP grants Final Approval.
10. The PAE distributes the complete TPA package in accordance with Chapter 8 of the OPG.

Financing Options: Coordination with Lenders and HUD

Section 4-15

- A. **General.** Any owner contemplating a first mortgage as part of the Restructuring Plan will need to identify a source of financing. Regardless of the financing option selected, the PAE should encourage the owner to begin the process of identifying a financing method and selecting a lender as early in the process as possible. Financing options are discussed below.
- B. **FHA Insured Mortgage under Section 223 (a)(7).** Processing and approval under Section 223(a)(7) are available directly through OAHP. Guidance on the processing of applications (for M2M properties only) under Section 223 (a)(7) are contained in Appendix N.
- C. **Loan Modification.**
 1. Loan modification cannot be used to finance rehabilitation or transaction costs because a loan modification holder cannot or will not modify the loan (e.g., because of inability to obtain investor consent for securitized loans), the owner must restructure by refinancing the current loan.
 2. Modification of FHA-insured loan. The owner must obtain the approval of the existing FHA-insured mortgagee for a loan modification. Loan modification can include any combination of the following:
 - a) **Interest rate** adjustment to market rate,
 - b) **Principal** write-down, and/or
 - c) **Re-amortization** over a term not to exceed the remaining term of the insured loan.
 3. Modification of HUD-Held loan. Modifications of HUD-held mortgage loans in M2M full restructuring transactions can be handled directly with OAHP. The PAE may recommend modifications with:
 - a) **Interest rate** adjusted to the Applicable Federal Rate published by the Internal Revenue Service,
 - b) **Principal reduced** (but never increased) to the amount of supportable debt determined by the PAE (pay-off balances for HUD-held loans can be obtained from the OAHP Headquarters closing manager); and

- c) **Reamortization** over a term not to exceed 30 years (provided that the expected long term physical and economic life of the property justifies the extended amortization period and any necessary Partnership Agreement extension is obtained).
- D. **Other FHA Mortgage Insurance.**
 - 1. Section 221(d)(4) or Section 223(f) programs require processing and approval using the Multifamily Accelerated Processing (MAP) system. The PAE will need to coordinate closely with the Multifamily Hub or Program Center and the MAP Lender.
 - 2. Section 542(c) HFA Risk-Sharing or Section 542(b) GSE Risk-Sharing Programs require processing and approval by Multifamily.
- E. **Conventional Financing.** If conventional financing is proposed, the owner should obtain evidence of a loan commitment from the new lenders early as possible.
- F. **Financing Through PAE.** Where the PAE provides financing for a M2M transaction, the transaction will be considered non-conforming for purposes of the PRA and subject to particular review by OAHP.
- G. **Loan Rates.** OAHP requires that the overall rate (including fees) used in a M2M transaction be “competitive”. PAEs should be alert to pricing that seems excessive. If the PAE receives a transaction that reflects an interest rate the PAE considers may be excessive, the PAE should discuss the transaction with the Preservation Office.

Additional Requirements for Bond Financed Properties

Section 4-16

- A. **General.** Bond financed properties contain an added level of complexity because the bond documents can and often do affect OAHP’s ability to restructure a property and often impose additional closing requirements when the property can be restructured. Because of this, the relevant bond documents must be collected and analyzed by the PAE. When circumstances prevent the PAE from collecting all of the required bond documents, the PAE should not proceed without first obtaining the consent of the OAHP Headquarters
- B. **Required Documentation.** The PAE must not proceed without:
 - 1. Note or Mortgage Note;
 - 2. Any Prepayment Riders to the Note or Mortgage Note;
 - 3. Any Allonges/Modifications to the Note or Mortgage Note.;

4. Regulatory Agreement (other than the FHA Regulatory Agreement);
 5. Indenture or Trust Indenture;
 6. Debenture Lock Agreement (if any);
 7. Refunding Agreement or FAF Refunding Agreement (if any);
and
 8. HAP Contract.
- C. **Other Documents.** Additional documents can and should be collected if those documents would affect the eligibility of the property for M2M. However, documents that lack any relevance for an eligibility determination should not be submitted. For example, OAHP does not need the Mortgage or a bond resolution that merely authorizes the issuance of bonds.
- D. **Lite Transactions.** In Lite Transactions, where the rents can be marked down to market without a full restructuring, the PAE collects the documents in Section 4-16(B), above, but does not submit an Executive Summary.
- E. **Executive Summary.** For Full Restructurings, OAHP makes a formal determination of eligibility for each bond-financed property. To assist this process, in all cases, the PAE must collect the documents identified in Section 4-16(B) and submit an Executive Summary that analyzes these documents.
- F. **Defeasance.** If the PAE believes that defeasance may be a potential option, the PAE must request permission from the OAHP Headquarters to perform a Defeasance Analysis. A Defeasance Analysis will not be authorized until a formal determination of eligibility has been made for M2M restructuring.

Business Forms

Section 4-17

- 4.1 Data Release Authorization Letter
- 4.2 Checklist of Related Party Agreements
- 4.3 Loan History Statement
- 4.4 Environmental Restrictions Checklist
- 4.5 PAE's Request to Owner for Missing Documentation
- 4.6 PAE's Request to Multifamily Hub or Program Center for Project Information
- 4.7 Owner's Adoption of the PAE's PCA/Findings
- 4.8 PAE's Notice to Owner of Environmental Issues

4.9 Reserved.

4.10 Certification of Ownership Entity

4.11 F47 Clearance Certification

4.12 F47 Reconciliation Form

Additional Forms

HUD Form 92080 - Mortgage Record Change