OMHAR: Office of Multifamily Housing Assistance Restructuring

Mark to Market

Preserving Affordable Housing
Today’s Discussion

- Program Advantages
- Owner Benefits
- Background
- M2M Process
- Case Study
- Program Results to Date
Program Advantages

- Preserves Dwindling Affordable Housing Stock
- Provides Funds & Tools for Challenged Properties
- Gives You a Voice in Restructuring
- Addresses Owner/Management Challenges
- And.....
Program Advantages (continued)

- Addresses Current and Future Physical Needs
- Increases Operating Efficiency
- Allows You to Participate in Significant Savings
- Contributes to Your Production Goals
What M2M Does for Your Owners
Owner Incentives

- Competitive Financial Return to Owner
- HUD Pays 80% of Rehab and Transaction Costs
- Equity Returned With Interest
- Financial Incentives Tied to Property Performance
- “Freeware” provides owner a preliminary look at before/after restructuring

and . . .

Mark to Market
OMHAR Slides from www.hud.gov/offices/omhar
Owner Incentives (continued)

- Owner Has a Voice in the Restructuring
- Owner Shares in Surplus Cash Flow
- Physical Property Conditions are Addressed
- Property Sale Can Be More Attractive
- First Mortgage is Reduced to a Level That Can Be Serviced by Market Rents

and.......
Contracts expiring 13+ months in the future

❑ Future Section 8 Rents ("Out Year Contracts) Can Be Recaptured

❑ Can be used to:
  ■ Lower Debt
  ■ Build Reserves
  ■ Finance Improvements

❑ Many owners already are coming in early
Background
When Congress created Section 8 twenty-five years ago, eligible properties were developed using above-market rents as a primary subsidy mechanism.

Current above-market contracts, if renewed, would soon exceed HUD’s total budget. So Congress mandated that as contracts expire, rents had to be reduced to market.

But reduction to market rents, without a reduction in debt service, potentially jeopardizes property operations and the FHA-insured mortgage.

Goals of the Mark to Market Program

- **Social:**
  - Preservation of the Affordable Housing Stock
  - Immediate & Long Term Physical Needs Addressed

- **Economic:**
  - Reduce Rents to Market (Congressional Mandate)
  - Restructured Debt (Ensure financial integrity)

- **Administrative:**
  - PAE Partnerships, including Public-Entity PAEs
  - Managerial Integrity of the Properties
  - Align Owner Incentives with HUD Interests
2001 Congressional Enhancements

- “Once Eligible Always Eligible”
  - Owners can take a rent reduction now, and debt restructuring later

- 223(a)(7) financing made available for HUD-Held mortgages

- Mark to Market Restructured mortgages can be amortized up to 30 years

- Owner’s contribution to Rehab Escrow as little as 3% for significant additions
  - Required contribution on other rehab is 20%
  - Significant additions include air conditioning, elevators, and community space
Mark to Market Process
Potential M2M Outcomes

- OMHAR-Lite
  - Rents marked to market without debt restructuring
  - Tier 1 (Rents Only) and Tier 2 (Rents and Expenses)

- Full Market Rent and Debt Restructure
  - Rents market to market and debt restructured
  - Exception Rents when warranted
M2M Process: Steps 1 - 2

Full Restructure Process:

- **STEP 1**
  - Approximately 120 days prior to HAP Contract expiration, Owner, PBCA or HUD Field Office determines rents above market (Out-year expirations can request a restructure at any time.)

- **STEP 2**
  - HUB/Program Center refers property to OMHAR Headquarters and OMHAR assigns to a Participating Administrative Entity (PAE)
M2M Process: Step 3

**STEP 3**
- PAE develops Draft Restructuring Plan
  - Objective third party appraisal/rent study
  - Physical Condition Assessment (PCA)
  - Tenant Meetings (Tenant Representatives)
  - Due Diligence/Underwriting
  - HUB/PC Project Manager Views
  - Other Stakeholders’ Input (Owners, Community)
  - Financial Model
M2M Process: Step 4-6

- **STEP 4**
  - PAE submits Restructuring Plan to OMHAR for review and approval

- **STEP 5**
  - Owner signs the Restructuring Commitment

- **STEP 6**
  - Transaction is closed or processing is discontinued
M2M Process: Step 7

**STEP 7**

OMHAR transfers responsibility back to the HUD Multifamily Field Office
Case Study
## Case Study: Property Status With Above Market Rents (“Before”)

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>Gross Potential Rent @Above Market</td>
<td>$700k</td>
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<tr>
<td>- Vacancy (@ 2.5%)</td>
<td>- 18k</td>
</tr>
<tr>
<td>- Operating Expenses</td>
<td>-475k</td>
</tr>
<tr>
<td>- Replacement Reserves (R4R)</td>
<td>- 20k</td>
</tr>
<tr>
<td>Adjusted Net Operating Income (ANOI)</td>
<td>187k</td>
</tr>
<tr>
<td>- First Mortgage Debt Service</td>
<td>- 160k</td>
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<tr>
<td>Surplus Cash Flow</td>
<td>27k</td>
</tr>
</tbody>
</table>

**OWNER ANNUAL RETURN (Totals) = $27k**  
(subject to limited distribution provisions)

Mark to Market

OMHAR Slides from www.hud.gov/offices/omhar
## Case Study: Comparing the Options – Cash Flow Pro Forma

<table>
<thead>
<tr>
<th></th>
<th>WITHOUT M2M</th>
<th>UNDERWRITTEN</th>
<th>ACTUAL</th>
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<tbody>
<tr>
<td><strong>Gross Potential Rent @ Market</strong></td>
<td>$625k</td>
<td>$625k</td>
<td>$625k</td>
</tr>
<tr>
<td>- Vacancy Loss (@ 2.5%)</td>
<td>- 16k</td>
<td>- 44k</td>
<td>- 16k</td>
</tr>
<tr>
<td>- Operating Expenses</td>
<td>- 475k</td>
<td>- 440k</td>
<td>- 409k</td>
</tr>
<tr>
<td>- Cap Recovery Pmt To Owner</td>
<td>0</td>
<td>-6k</td>
<td>-6k</td>
</tr>
<tr>
<td>- Replacement Reserves</td>
<td>- 20k</td>
<td>- 44k</td>
<td>- 44k</td>
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<tr>
<td><strong>Adjusted NOI</strong></td>
<td>114k</td>
<td>91k</td>
<td>150k</td>
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<tr>
<td>- First Mortgage Debt Service</td>
<td>- 160k</td>
<td>- 70k</td>
<td>- 70k</td>
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<tr>
<td>- Incentive Perf. Fee to Owner</td>
<td>0</td>
<td>-17k</td>
<td>-18k</td>
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<tr>
<td><strong>Surplus Cash Flow</strong></td>
<td>- 46k</td>
<td>4k</td>
<td>62k</td>
</tr>
<tr>
<td>- 75% to Second Mortgage</td>
<td>0</td>
<td>-3k</td>
<td>-47k</td>
</tr>
<tr>
<td>- 25% to Owner</td>
<td>0</td>
<td>-1k</td>
<td>-15k</td>
</tr>
<tr>
<td><strong>TOTAL TO OWNER</strong></td>
<td>- $46k</td>
<td>24k</td>
<td>39k</td>
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<tr>
<td><em>(CRP+IPF+25%CF)</em></td>
<td></td>
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</tr>
</tbody>
</table>

**Mark to Market**

OMHAR Slides from www.hud.gov/offices/omhar
Case Study: Why to Restructure

Operating Expenses: NO RESTRUCTURE vs. WITH RESTRUCTURE
Replacement Reserves: NO RESTRUCTURE vs. WITH RESTRUCTURE
First Mortgage Debt Service: NO RESTRUCTURE vs. WITH RESTRUCTURE
Case Study: Comparing the Options – Owner’s Annual Return

**NO Restructuring**

- $0
- ($20)
- ($40)
- ($60)
- ($80)
- ($100)

**WITH Restructuring**

- $30K

$30K includes CRP, IPF, and Owner’s Share of Surplus Cash
Owner Incentive Package

- **Capital Recovery Payment (CRP)**
  - Owner contribution towards closing and rehab costs repaid with interest (350BP over like-term Treasuries) over 7-10 years
  - Underwritten as an expense; accrues if cash flow is insufficient to pay

- **Incentive Performance Fee (IPF)**
  - Payment to Owners equal to 3% of Effective Gross Income
  - First priority from Surplus Cash annually while subordinate debt is outstanding

- **Cash Flow Split** - Owner shares up to 25% of cash flow
What’s In It for HUD?
(What’s the Catch?)
What’s In It for HUD? (What’s the Catch?)

- New 30-Year Use Agreement
M2M Update (09/30/02)

- 573 Full Debt Restructures closed
- 623 OMHAR-Lites completed
- 353 Additional transactions completed
- 2234 Completed or Active Properties
Mark to Market . . .
Puts Property on Solid Footing

Comparison of Pre-Restructure to Post Restructure Characteristics
For Transactions Closed Through June 2002

Percentage change from pre- to post-M2M for 510 Closed Fulls

<table>
<thead>
<tr>
<th></th>
<th>Avg Pre-M2M</th>
<th>Avg Post-M2M</th>
<th>% Change</th>
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</thead>
<tbody>
<tr>
<td>1st Loan Amount</td>
<td>$1,649,804</td>
<td>$919,896</td>
<td>(44%)</td>
</tr>
<tr>
<td>Operating Expense (PUPA)</td>
<td>$4,258</td>
<td>$4,165</td>
<td>(2%)</td>
</tr>
<tr>
<td>Replacement Reserve Deposit (PUPA)</td>
<td>$284</td>
<td>$429</td>
<td>51%</td>
</tr>
<tr>
<td>Operating Expenses + R4R (PUPA)</td>
<td>$4,542</td>
<td>$4,593</td>
<td>1%</td>
</tr>
<tr>
<td>Replacement Reserve Balance</td>
<td>$105,154</td>
<td>$173,136</td>
<td>65%</td>
</tr>
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Mark to Market . . .
Processes Transactions Timely

Processing Times have improved dramatically since the beginning of the M2M Program:

- For Lites assigned prior to 2001, processing time averaged 7 months. Since 2001, OMHAR has been processing Lites in under 5 months, on average.

- For Fulls assigned prior to 2001, processing time averaged almost 15 months. Since 2001, OMHAR has been processing Fulls in approximately 11 months, on average.
Mark to Market . . . Saves Taxpayers’ Money

Taxpayer Savings Approaching $1 Billion

<table>
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<tr>
<th></th>
<th>Dec-99</th>
<th>Mar-00</th>
<th>Jun-00</th>
<th>Sep-00</th>
<th>Dec-00</th>
<th>Mar-01</th>
<th>Jun-01</th>
<th>Sep-01</th>
<th>Dec-01</th>
<th>Mar-02</th>
<th>Jun-02</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings (in Millions)</td>
<td>$6</td>
<td>$80</td>
<td>$165</td>
<td>$281</td>
<td>$341</td>
<td>$436</td>
<td>$585</td>
<td>$697</td>
<td>$781</td>
<td>$825</td>
<td>$903</td>
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</tbody>
</table>
For More Information
Mark to Market “Freeware”

- **What?** - Easy to use analytical tool for stakeholders to review how a property will work under M2M

- **How?** - Minimal data entry required - 17 numbers from audited financials, unit mix, estimated market rents, and estimated post-M2M Reserve deposit

- **Where?** - Excel based format on the web at [www.hud.gov/offices/omhar](http://www.hud.gov/offices/omhar)
Office of Multifamily Housing Assistance Restructuring (OMHAR)

Headquarters: 888-291-4650

General Information: www.hud.gov/omhar

Technical Information: www.omhar.com

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