

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

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Program Advantages

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

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Program Advantages (continued)

- ❑ Addresses Current and Future Physical Needs
- ❑ Increases Operating Efficiency
- ❑ Allows You to Participate in Significant Savings
- ❑ Contributes to Your Production Goals

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What M2M Does for Your Owners

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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 . . .

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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.....

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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

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Background

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Section 8 and M2M

- ❑ 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.
- ❑ Accordingly, the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA) created OMHAR, and the Mark to Market Extension Act of 2001 continues the agency through September 2004, and the restructuring tools through September 2006.

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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**

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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

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Mark to Market Process

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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

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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)

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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

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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

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M2M Process: Step 7

□ STEP 7

- OMHAR transfers responsibility back to the HUD Multifamily Field Office

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Case Study

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Case Study: Property Status With Above Market Rents (“Before”)

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

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

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Case Study: Comparing the Options – Cash Flow Pro Forma

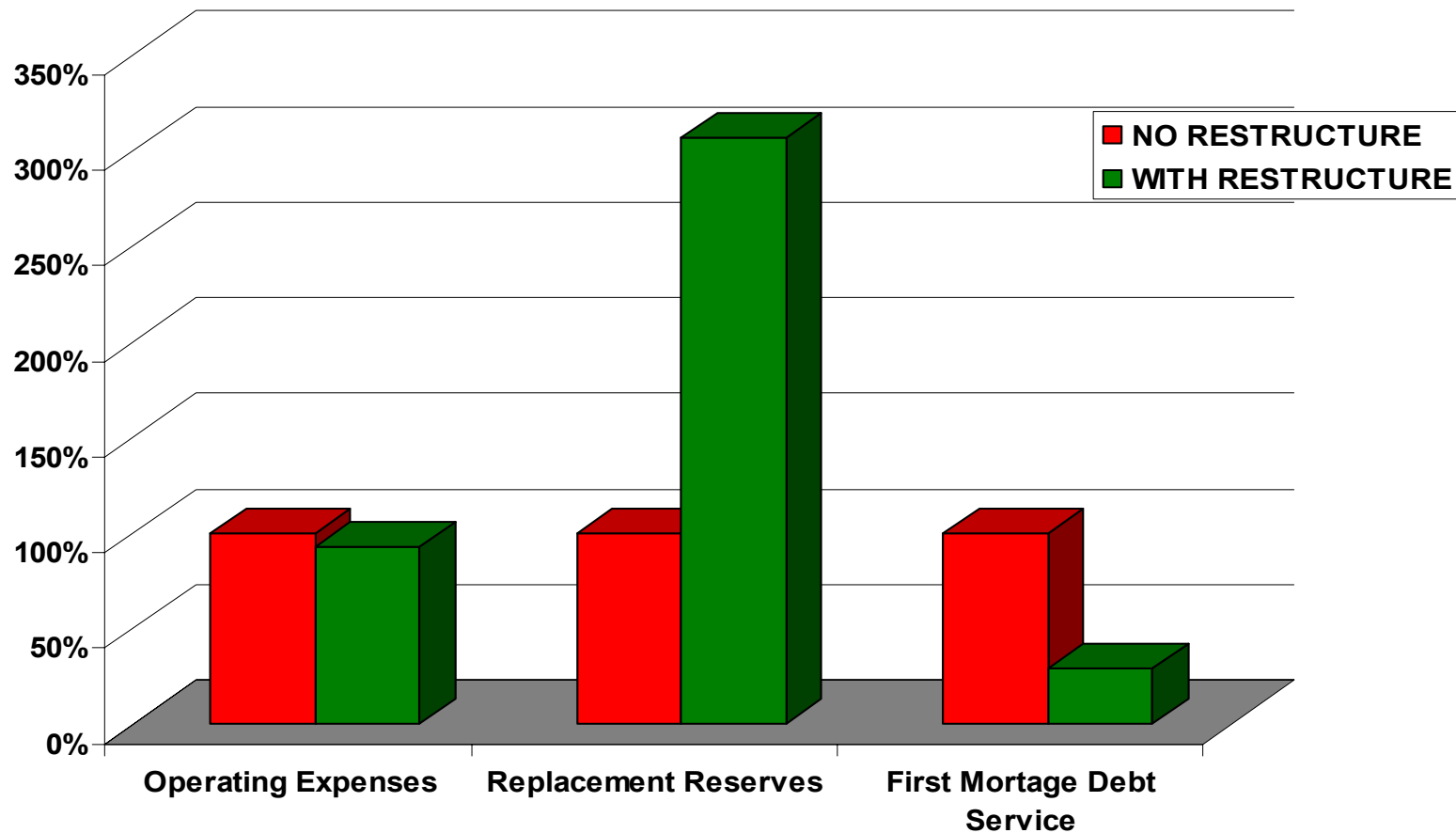
	<u>WITHOUT M2M</u>	<u>UNDERWRITTEN</u>	<u>ACTUAL</u>
Gross Potential Rent @ Market	\$625k	\$625k	\$625k
- Vacancy Loss (@ 2.5%)	- 16k	- 44k	- 16k
- Operating Expenses	- 475k	- 440k	- 409k
- Cap Recovery Pmt To Owner	0	-6k	-6k
- Replacement Reserves	- 20k	- 44k	- 44k
Adjusted NOI	114k	91k	150k
- First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

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Case Study: Why to Restructure

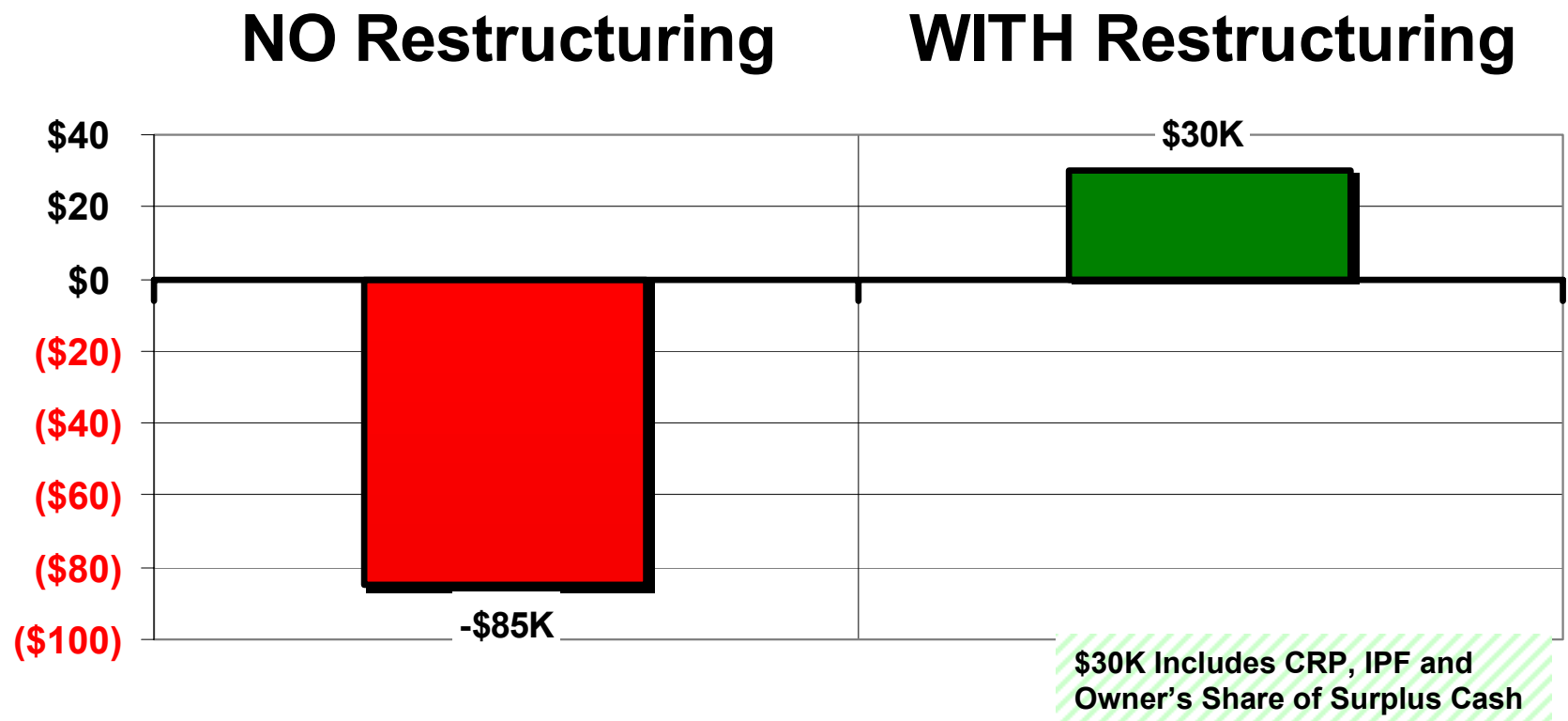


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Case Study: Comparing the Options – Owner's Annual Return



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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

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What's In It for HUD?

(What's the Catch?)

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What's In It for HUD?

(What's the Catch?)

□ New 30-Year Use Agreement

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Program Results to Date

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M2M Update (09/30/02)

- ❑ 573 Full Debt Restructures closed
- ❑ 623 OMHAR-Lites completed
- ❑ 353 Additional transactions completed
- ❑ 2234 Completed or Active Properties

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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

	Avg Pre-M2M	Avg Post-M2M	% Change
1st Loan Amount	\$1,649,804	\$919,896	(44%)
Operating Expense (PUPA)	\$4,258	\$4,165	(2%)
Replacement Reserve Deposit (PUPA)	\$284	\$429	51%
Operating Expenses + R4R (PUPA)	\$4,542	\$4,593	1%
Replacement Reserve Balance	\$105,154	\$173,136	65%

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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.

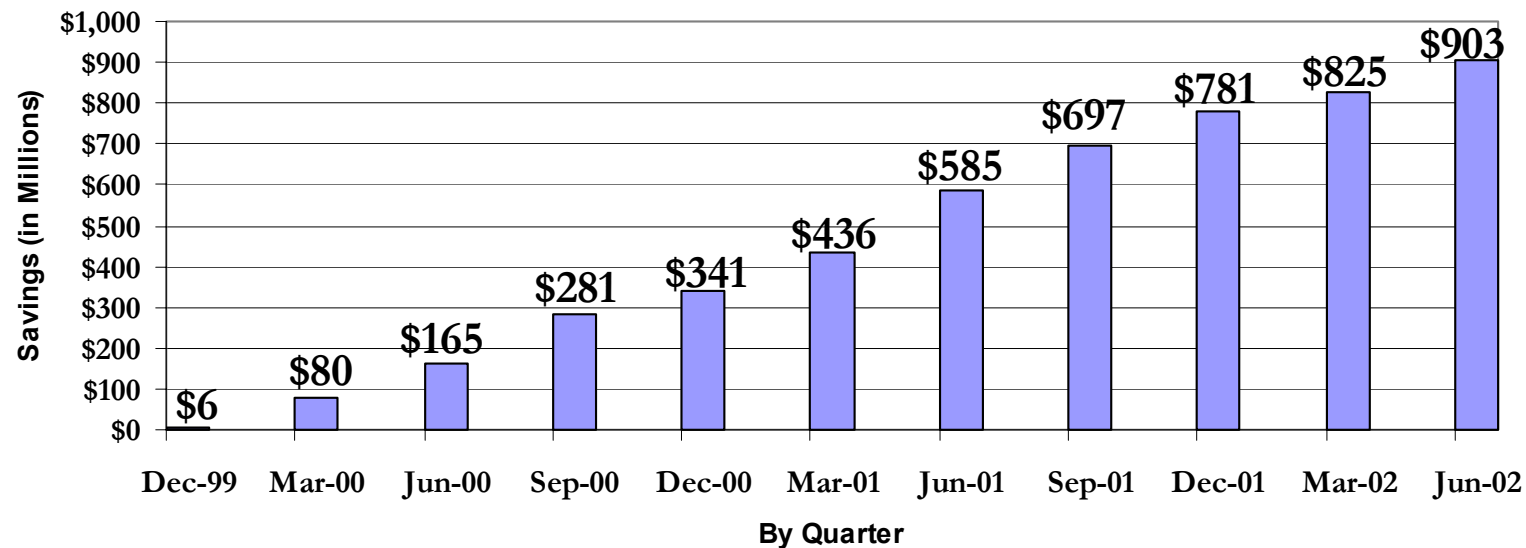
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Mark to Market . . . Saves Taxpayers' Money

Taxpayer Savings Approaching \$1 Billion



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For More Information

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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

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