Get Started on Your Multifamily Affordable Housing Preservation Strategy

What is Affordable Housing Preservation?

The U.S. Department of Housing and Urban Development (HUD) is partnering with owners of HUD Section 202 Direct Loan and Section 236 properties to preserve critically needed multifamily affordable housing assets across the county. When you preserve your property, you are successfully recapitalizing it in order to:

- **Safeguard** long-term rental assistance for your current and future tenants.
- **Improve** and **modernize** your property through capital repairs.
- **Stabilize** your property by placing it on solid financial footing.

Preservation Planning Process

In order to successfully design an effective preservation strategy, your ownership team needs to understand your property's current financing, rent structure, rent and other subsidies, and capital improvement needs. You will also need to determine the long-term goals for your property and residents; these will guide the decisions you and your team make pertaining to which preservation financing and rental assistance options to exercise. Working through this planning process can help you establish a preservation strategy to address the long-term stability and affordability of your property.

This guide provides information about the preservation of multifamily affordable rental properties originally financed with:

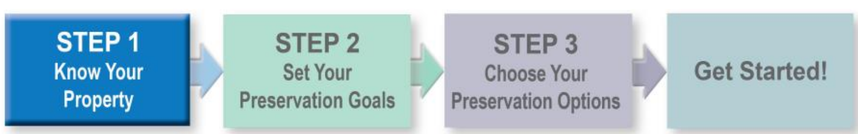
- HUD Section 202 Direct Loans or
- HUD Section 236 Insured or HUD-Held Loans or
- Section 236 Direct Loans from state Housing Finance Agencies (HFAs)

These properties could also have other HUD assistance, including:

- Section 8 Project-Based Rental Assistance (Section 8)
- Rental Assistance Payment Contract (RAP)
- Rent Supplement Contract (Rent Supp)
- Flexible Subsidy Loan (Flex Sub)

Preliminary Steps

Why start now? Some opportunities require that you act before your loan matures. Also, planning a preservation transaction takes time.



Know Your Property

Educate Your Board and Ownership

Before your property's ownership team develops a preservation strategy, you and your team will need to understand the property's current financing and operations, and gain a clear understanding of the issues and possibilities for the property's preservation.

Assemble Your Team of Experts: Gather a team of professionals who are familiar with and specialize in affordable housing preservation. Teams typically include a preservation consultant, lender, attorney, architect, property manager, and contractor.

Seek Guidance from HUD:

- Discuss with HUD how to pay for predevelopment costs with funds from your property's Reserve for Replacement account and residual receipts.
- If your property's mortgage is maturing in the next 12 months, or has already matured, you should contact HUD immediately for guidance.

> - For Section 202 properties, contact your local HUD Account Executive/Project Manager.
> - For Section 236 properties, email 236preservation@hud.gov.

Engage Residents: Residents may be under the impression that affordability is terminating and may think they need to find other housing. It is especially important to communicate early and often.

Understand Your Property's Current Financing

In order to design an effective preservation strategy, it is important to understand the provisions of any program agreements that your organization entered into at the time your property was originally financed, as well as any additional agreements that may have been executed subsequent to the property's initial occupancy. This step includes a thorough review of any/all of the following documents:

- Loan Agreement
- Mortgage Note
- Regulatory Agreement
- Section 236 Interest Reduction Payment (IRP) Amortization Schedule
- Flexible Subsidy Loan document
- Most recent 3 years of financial statements (audited if available), including notes and supporting schedules
- Information about any other financing and/or use restrictions on your property (such as an ELIHPA or LIHPRHA Plan of Action or Use Agreement)

During your review of the property's financing, you will need to confirm what type of HUD mortgage was originally used to finance development. Whether your property is a Section 202 or Section 236 will affect your regulatory options and which prepayment options are available for preserving your particular property.

Section 202 Direct Loan Program: HUD provided direct government loans or capital advances to nonprofits for the purpose of developing affordable rental housing for the elderly, and also for persons with disabilities under subsequent authorizations.

Section 236 Mortgage Program: Section 236 awards were made by HUD between the late 1960s and mid-1970s. HUD awarded interest subsidies (known as Interest Reduction Payments or IRP subsidies) to program mortgagees. These subsidies reduced the payments on loans that were made to private developers of low- and moderate-income multifamily housing. Most of these loans also received Federal Housing Administration (FHA) mortgage insurance. In return for a lower overall debt service, HUD required assisted property owners to lease their units to low- and moderate-income families at HUD-approved rents for the term of their 40-year mortgage.

Flexible Subsidy Loan (Flex Sub): This program was part of HUD's effort to preserve affordable housing originally developed under earlier HUD programs. It provided loans for repairs and other purposes to owners of troubled federally assisted low- and moderate-income multifamily rental projects. Operating Assistance loans are due as a balloon payment when the HUD loan matures or is prepaid, whereas Capital Improvement loans are amortized.

Flex Sub

- If you have an Operating Assistance loan, there may be an opportunity to defer the balloon payment; otherwise, you will need to make plans to pay off the loan balance.
- If you have a Capital Improvement loan, you will need to make plans to pay off the loan balance.

Prepayment Requirements: In order to refinance a property with a Section 202 or Section 236 loan or take advantage of HUD preservation incentives, you will need to prepay the remaining unpaid balance of your loan. All prepayments require HUD approval of a correctly prepared prepayment package and HUD's agreement that the owner properly delivered the required notice to tenants, state or local governments, and HUD. There is an exception:

for Section 236 loans from HFAs, the HFA approves the prepayment; however, HUD still determines whether proper notices were given.

- Know your property's loan maturity date. You should verify this date with your lender because certain loans may mature early as a result of unscheduled principal payments.
- For many properties, especially those developed by nonprofits, prepayment will require an additional discretionary approval from the HUD Secretary.

Understand Your Property's Rent Structure and Subsidies

Section 236 and Section 202 Direct Loan properties could have both unassisted and subsidized units. The earliest programs provided financing assistance to private developers of affordable housing with the idea that the reduced capital and/or debt service costs would allow owners to charge rents that would be affordable to low-income families. Over time, it became clear that the financing assistance was not sufficient to allow properties to be affordable to the poorest families while still maintaining the financial viability of the properties.

As a result, rental assistance was made available to subsidize rents for low-income families. The most common form of rental assistance is Section 8 project-based rental assistance. Typical Section 202 properties developed in 1974 or later have project-based Section 8 for 100% of the units. Earlier 202 and typical 236 properties have at least some project-based Section 8 and many have earlier forms of rental assistance (i.e., RAP or Rent Supp). It is important to understand exactly what type of rental assistance your property has, how many units are covered, when the contracts expire, and what your renewal options will be when each contract expires.

- Review your rental subsidy agreements and breakdown of subsidized and unsubsidized units (typically from the rent roll).
- Determine when each rental assistance contract expires.
- Determine how each rental assistance contract is renewed and rents are increased, and whether the current rents are under, at, or above market.
- For your unsubsidized units, determine which of the tenants are low-income and might benefit from a rental subsidy.

Understand Your Property's Long-Term Capital Needs and the Adequacy of its Reserves

Obtain a Capital Needs Assessment: Obtain a capital needs study to evaluate the property's current and upcoming capital replacement needs. As part of this process, you will estimate the level of upfront repairs and rehabilitation that are needed to ensure your property's long-term viability. This will help you determine if the property's current Reserves for Replacement account balance and schedule of funding the account are adequate to address the upcoming capital needs. Otherwise, you will need to seek new sources of funding for the property.

Understand Your REAC Score: Look at your property's recent HUD Real Estate Assessment Center (REAC) assessments and scores. REAC inspectors conduct physical inspections of properties that are owned, insured, or subsidized by HUD, including public housing and assisted multifamily rental housing. The REAC inspections are conducted to ensure that the housing is decent, safe, sanitary, and in good repair. Low REAC scores put your property's subsidy at risk and indicate that the property needs immediate repairs.

Set Your Preservation Goals

Long-Term Goals

Your property's board of directors and ownership team need to decide what its long-term preservation goals are for the property. While each property is faced with its own unique set of needs, these typically will include the need for capital improvements, affordability for low-income tenants, and achievement of stable operating income.

Financing Your Property's Capital Improvements

Sometimes, older properties are secure and stable assets without the need for large-scale capital improvements. However, when you evaluate your property's long-term capital needs, you are more likely to find the need for large-scale improvements to reduce utility costs, reduce operating costs, and improve living conditions for residents. In turn, your team's ability to successfully address these needs will rely on its ability to secure the necessary financing.

Ensure Low-Income Residents Can Remain in Their Homes with the Help of Rental Subsidies

In many circumstances, owners can renew their Section 8 contracts with lengthy terms. Upon mortgage prepayment (and under other conditions), Tenant Protection Vouchers may also be available for unsubsidized residents, allowing owners to raise rents without displacing existing tenants who would not be able to afford the new rents.

Provide Stable Project Income

Properties that are preserved as affordable housing are able to lock in long-term rental subsidies that provide a stable source of rental income, and typically a waiting list of potential tenants as well. Conceivably, the resulting increase in the property's income can be used to service additional debt in case the property needs to borrow money to address capital needs.

Choose Your Preservation Options

Which Preservations Options are Appropriate for Your Property?

Your team of experts and HUD will help you evaluate your preservation options for refinancing, rental assistance, and long-term financial stability.

Explore Financing Options and Prepayment Incentives

Typical preservation transactions require new funds to pay for large-scale capital improvements. One common source of funds is a refinancing (that is, a new larger first mortgage loan with new loan terms). Many preservation transactions are financed with an FHA-insured mortgage refinance. Other sources of financing products include State HFAs, conventional lenders, HUD's Home Investment Partnerships (HOME) and Community Development Block Grant (CDBG) programs, Low Income Housing Tax Credits, State housing trust funds, and other types of "soft debt" or grants. A preservation expert can help you evaluate the potential sources of funding and provide financial modeling that will help you choose an option that fits your preservation goals.

Should I refinance before the mortgage matures?
Yes! HUD incentives for the property and its residents are available only in connection with prepayment.

Determine Benefits of Prepaying your Section 236 or Section 202 Loan: Before you refinance the property's debt, you will need to prepay your Section 236 or Section 202 mortgage. HUD provides prepayment financing incentives to help owners retain affordability of their properties, which commonly include:

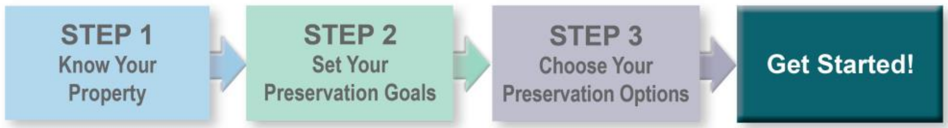
- **IRP Decoupling for Section 236 Properties:** IRP Decoupling is a preservation tool that retains the remaining monthly IRP payments when a Section 236 loan is prepaid and refinanced, and the interest reduction subsidy is attached to the new, fully amortizing loan. One key requirement is that the existing use and affordability restrictions are extended for five additional years.
- **Flexible Subsidy Loan Deferrals:** Some HUD-assisted properties with Flex Sub Loans do not have adequate resources in their refinance transactions to pay back the loan in full. To make it easier to prepay and refinance, HUD may allow you to defer repayment of the Flex Sub Loan and re-amortize it for the term of the new loan.

Understand HUD's Rental Assistance Options

Explore Tenant Protection Vouchers (TPVs) for Unsubsidized Tenants: TPVs are a valuable preservation tool. Your unassisted tenants may be eligible when there is a mortgage prepayment or under other certain scenarios. TPVs are issued through a local participating Public Housing Authority (PHA). The PHA may have the ability to project-base some or all of the TPVs.

Learn About Your Section 8 Renewal Options: Section 8 project-based rental assistance (PBRA) contracts typically renew for one, two, five, or twenty-year periods. However, HUD encourages owners to apply for twenty-year contracts upon renewal and lenders expect owners to get a new twenty-year contract for refinancing. There are several Section 8 contract renewal options for you to understand and consider in your preservation strategy.

Consider RAD 2 for Expiring RAP and Rent Supplement Contracts: When the RAP and Rent Supp contracts expire, so do the subsidy payments that property owners have relied on to support property rents. To help preserve these affordable rental housing assets for your low-income residents, you may apply for the Rental Assistance Demonstration (RAD) 2 program to convert your expiring RAP or Rent Supp to project-based Section 8 assistance. You may contact HUD directly for more information about this option at RAD2@hud.gov.



Get Started!

All preservation strategies take time to implement. Why start now?

- **HUD incentives are available.** You will likely be able to choose from a broader number of flexible options for additional or renewed rental assistance if you prepay the HUD mortgage instead of waiting until the loan has matured.
- **Take advantage of low interest rates.** Favorable financing means that more capital improvements can be undertaken with a new loan.
- **Address expiring rental assistance subsidies.** RAD 2nd Component can help your residents with long-term project based rental assistance.
- **Leverage your Section 8 income** to refinance the property and address capital improvement needs.
- **Make the necessary preparations to repay Flex Sub loans with balloon payments upon loan maturity.**

Resources for Getting Started

Resource Description	Webpage
Companion materials to this guide are the "Welcome to Preservation" webinar, which aired on December 2, 2014, and a glossary of preservation terms.	"Welcome to Preservation" webinar Preservation Glossary
Gateway to HUD preservation information on www.HUDExchange.info. Webpages include newly produced preservation guidance and webinar recordings.	HUD Exchange Housing Preservation Webpage
Subscribe to the Multifamily Preservation Mailing List to receive emails with news, events, training, and information about how to maintain housing affordability.	Multifamily Housing Preservation Mailing List
HUD's Office of Recapitalization, Office of Multifamily Housing Programs, administers **Section 236 preservation transactions.**	Office of Recapitalization Section 236 Preservation
Section 236 preservation information and resources are available via the Resource Desk portal, where property owners can apply for prepayment and other preservation transaction approvals.	Multifamily Preservation Resource Desk
HUD's Office of Recapitalization, Office of Multifamily Housing Programs, administers the **Rental Assistance Demonstration (RAD) 2** program, under which Rental Assistance Payment and Rent Supplement contracts can be converted to Section 8 project-based assistance. See Section III of the RAD Notice.	RAD Final Notice RAD Resource Desk RAD 2 Case Study
Tenant Protection Vouchers (TPVs) are available in some circumstances to tenants who do not receive Section 8 rental assistance (primarily, in connection with prepayment of the HUD mortgage).	Notice H-2012-03 Notice H-2014-04 Notice PIH-2001-41
HUD's Office of Asset Management and Portfolio Oversight (OAMPO), Office of Multifamily Housing Programs, is responsible for the portfolio of multifamily project assets after the development phase. It oversees **Section 202** preservation transactions.	Office of Asset Management and Property Oversight
HUD Notice H-2013-17 provides information about **Section 202** loan prepayment requirements.	Section 202 Prepayment Notice
HUD's **Section 8 Renewal Policy Guide** describes owners' options for renewing expiring Section 8 Project-Based Rental Assistance.	Section 8 Renewal Policy Guide
HUD's Office of Multifamily Housing Production provides **FHA mortgage insurance** through qualified private lenders.	Multifamily Hubs and Program Centers