Advance Training on
Section 202 Preservation/Refinancing

HAND Training

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Speakers

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State of HUD Elderly Housing Programs and Needs

• No Appropriations for New Section 202 Programs from FY 2015 to Present
• There are between 1.5 to 2.6 Million “extremely low-income” Seniors.
• 3.5 Million elderly live below the poverty line.
• Senior population is expected to double by 2030.
• Section 202 Program created approx. 400,000 units of elderly housing serving very low-income seniors.
• There are 10 seniors on the waiting list for every Section 202 unit that becomes available.
202 Preservation/Refinance Options

Recent statutory provisions allow nonprofit owners to prepay 202 Direct Loans and for 202 Direct Loans to be subordinated or assumed (if Property transferred) to new financing to facilitate Property’s preservation.

The general authority for prepayment of the 202 Loan is provided under the Supportive Housing for the Elderly Act of 2010 (the “Law”) and 24 CFR Section 891.530 (the “Regulation”). The Law states that:

Upon request of the project sponsor of a project assisted with a [Section 202 loan], the Secretary shall approve the prepayment ... [of such loan] ... as part of a prepayment plan under which the project sponsor agrees to operate the project until at least 20 years following the maturity date of the original loan **under terms at least as advantageous to existing and future tenants** as the terms required by the original loan agreement or any project-based rental assistance payments contract, or any successor project-based rental assistance program relating to the project.

- **only applies to 202 Direct Loans for projects from 1959 to 1990.**

Such 202 projects can be recapitalized using a variety of financing sources, including LIHTCs, tax-exempt bonds, FHA-insured financing, conventional financing as well as other financing means.
SECTION 202 DIRECT LOAN KEY CONCEPTS

Multifamily Office of Asset Management and Portfolio Oversight
Section 202 Direct Loan
Program Overview

The Section 202 Direct Loan program ran from 1959-1990.

- Projects financed from 1959 to 1974 had below market
  · interest rates (6% or less), little or no rental subsidy and
  · rented to low and moderate income tenants.

- Projects financed from 1975 to 1990 had market
  · interest rates (some very high – above 10%), most had
  · Section 8 assistance on some or all units, and rented to
  · low and very low income tenants.

Owners were single purpose nonprofit entities.
Section 202 Direct Loan

Program Overview

- 202 Capital Advance Grants were awarded beginning in 1990, through yearly NOFA’s,
- 40 year terms of use; non-profit owner; assisted through PRAC, budget-based rents; no distribution to owner (currently no new awards)
- To successfully position a Section 202 project that may be aging, an owner may prepay and refinance the loan, or may choose to partner with another nonprofit organization, or form a tax credit limited partnership to syndicate tax credits and raise equity.
- Other owners may choose to sell the project to a qualified purchaser who will maintain affordability.
Section 202 Direct Loan
Program Overview (continued)

· If a Section 202 owner wishes to refinance the project, the proceeds from the new financing may be used for project purposes or for the benefit of residents of the project or residents of other HUD assisted senior housing.

· If the owner chooses to sell the project, the owner may use the net proceeds from the sale for project purposes or for other charitable purposes of the nonprofit.
Q: Why prepay your Section 202 Direct Loan?

A: To enable refinancing of a property for capital improvements or to lower the interest rate.
Types of Section 202 Prepayments

1. **Prepay and refinance to reduce interest rate**: For projects financed between 1975 & 1991 (except for project noted below):
   - HUD permission to prepay is required.
   - Owners may prepay and refinance if the owner can
     - demonstrate **debt service savings** for the project.
   - Notice H 2013-17 provides guidance on these prepayments.

2. **Prepayments which do not require HUD approval**: A small subset of Section 202 projects approved from 1977 to 1982 do not require HUD permission to prepay.
   - Owners of properties in this category may also opt to
     - prepay under the Notice 2013-17 in order to receive an incentive
       - of retaining above-market Section 8 rents.
Types of Section 202 Prepayments (continued)

3. Refinance to address the physical needs of the project:

- Projects financed prior to 1975 had low-interest loans (below 6%). Even with today’s historically low interest rates, these projects are not likely to result in a lower debt service if they refinance.

- HUD will approve a prepayment or refinance of these Section 202 projects that will result in an increased debt service only if the transaction will address the physical needs of the project as outlined in Notice 2013-17.
Prepayment/Refinance

Owner may use the proceeds of a Section 202 refinancing for the benefit of existing project residents, to provide supportive services, to convert units to reduce vacancies, to pay a developer fee, or for the benefit of elderly residents of other HUD-assisted senior housing.
Prepayment/Refinance (continued)

- Owners authorized to receive a Mark-Up-To-Market or Mark-up-to-Budget for the Section 8 units.
- Under Notice H 2013-17, in the event of a sale of a Section 202 project, as opposed to a refinance, there will be no restrictions on the use of sale proceeds from the transaction that flow to the selling Owner, provided that the transaction meets the requirements of the Notice. Any new loan proceeds obtained by the purchaser must be used for the project in accordance with the Notice.
Key Provisions for Pre-1975 Properties

The law makes special provisions for pre-1975 properties with Direct Loan interest rates of 6% or less:

∙ The Act specifies that no unassisted elderly residents may be displaced or face rent increases.
∙ To prevent displacement of these unassisted tenants, the
  ∙ Act authorized new project-based rental assistance for non-
  ∙ assisted units – SPRAC. However, SPRAC funds were only available for one year.
∙ HUD may provide tenant protection vouchers to the unassisted residents, subject to appropriations, in accordance with Notice H 2012-3.
Prepayment Approval Process

- The Owner applies directly to the local Regional Center or Satellite Office.

- Approval will go more smoothly if the Owner discusses the prepayment application in detail with HUD prior to submission to make sure you understand the required information.

- Often a prepayment request is in conjunction with other approvals – deferrals of flexible subsidies, for example. Let your HUD account executive know what you are planning.
Prepayment Approval Process (continued)

- The final approval is done at HUD Headquarters.

- Often the prepayment is in conjunction with other financing, so it is important to time the prepayment request accordingly – the process may take several weeks.
SECTION 202 DIRECT LOAN SUBORDINATION

Q: Why subordinate your Section 202 Direct Loan?

A: Because of its low interest rate, or because there are not enough funds to pay it off.
Subordination of Section 202 Direct Loan

- Owners of project with Section 202 Direct loans that have immediate needs for rehabilitation, significant or emergency repairs and cannot be paid off using outstanding Section 202 refinance procedures, may propose a transaction to fund rehabilitation in which the existing Section 202 debt (or portion of the debt) is subordinated to a new mortgage.
Requirements for Subordination of Section 202 Direct Loans

- Must be necessary to achieve long term preservation.
- Must demonstrate Section 202 loan can be repaid.
- Owner (or buyer) must be in compliance with HUD 2530 requirements.
- Meet ownership requirements of Section 202 program.
- **No equity take-out permitted.**
- Rent increases allowed to cover project costs only.
- New Use Agreement for 20 years beyond the original mortgage maturity date.
- Section 202 loan repayment under flexible terms.
Requirements for Subordination of Section 202 Direct Loans (continued)

• To apply for subordination of a Section 202 Direct Loan, apply to the Regional Center/Satellite Office following guidance in Notice H 2010-26.

• The Regional Center/Satellite Office will review and recommend approval to HUD Headquarters for final approval.
Flexible Subsidy Deferments

- Flexible Subsidy Loans become due in full when the 202 Direct Loan is prepaid.
- If there are insufficient funds in the transaction to repay the Flex loan, a deferment may be requested in accordance with the requirements of Notice 2011-05.

HUD CAN GUIDE YOU THROUGH THE PROCESS!
Opportunities / Advantages

- Perform much-needed rehabilitation/modernization of aging Section 202 properties
- Replace high interest debt with lower-interest debt
- Attract new equity investment (e.g., LIHTC) to fund repairs and services
- Protect the Option 4 HAP Contracts and extend the 202 Use Restrictions
- Obtain potential rent increases to fund repairs and services -- “post-rehab” market rent levels (or preservation of existing above-market rents)
- Increase distributions to project owner
- Subordinate Section 202 when there are insufficient proceeds to pay-off the 202 Direct Loan
- Use project equity, residual receipts and reserves
- Sell the 202 project and retain the proceeds
Considerations to Preservation

- What is extent of renovations needed?
- Will refinancing provide sufficient funds to reposition project well into the future?
- Nonprofit may lose control of project or its operations with LIHTC investor.
  - Numerous 202s were developed by small local nonprofits that may not understand or want to go through the tax credit and syndication process, or don’t have the wherewithal on their own to manage a major rehab.
- Is nonprofit tired of running property and desires to sell it to another owner to operate?
  - Priorities of nonprofit owner may have changed and want to use sales proceeds for purposes other than this project.
HUD Notice H 2013-17 is HUD’s guidance on approval and processing of prepayment requests.

Supersedes all other previous HUD guidance

There is no preservation program in place for post-1990 Capital Advance Projects with PRACs.

(This should be the next area of HUD preservation activities.)
Structuring the Preservation Transaction

Proceeds from Sale of 202 Project that flow to Selling Owner have no restrictions on their use. This includes LIHTC transactions and Identity-of Interest transactions.

New Owner can be:

- Nonprofit Entity (501(c)(3) or (c)(4))
- For-profit limited partnership or limited liability company, whose general partner/managing member is:
  - For-profit corporation wholly-owned and controlled by one or more nonprofits
  - Limited liability company wholly-owned or controlled by one or more nonprofits
For profit developers can work with nonprofit owners to aid them for guarantees required with LIHTC Acq-Rehab transactions.

Pleasant Acres Elderly Housing LP
New Owner

GP LLC
General Partner
0.005%

Happy Investor Corp.
Investor LP
99.99% Interest

Developer Friend LLC
Special Limited Partner
0.005% Interest
Guarantor

Friendly Developer Manager
0.00 % Member

The Acres Nonprofit, Inc.
100% Member
Developer Fees allowed from refinance proceeds.
- If LIHTC, up to amount allowed by State Tax Credit Agency.
- If per FHA financing, allowed for 221(d)(4), only from 223(f) with LIHTC or excess proceeds with 80% LTV, not allowed for 223(a)(7)
- Otherwise, up to 15% of development costs.
- HUD will not monitor use of Developer Fees

LIHTC Compliance Fees allowed as Project expenses
- i.e., syndicator asset management fee, state tax credit agency compliance and asset monitoring fees,
- Deferred developer fees may be included in operating budget, but only paid from surplus cash, with interest accruing at up to AFR and deferred no more than 12 years.

Distributions allowed for for-profit limited partnership.
- 6% annual distribution limit, if limitation imposed by Section 8 HAP Contract
- Otherwise, no percentage cap if not limited in Section 8 HAP Contract, or if no other limitation.
Other 202 Prepay Requirements

Environmental Review Required under 24 CFR Part 50, see MAP Guide for guidance.

Tenants must be given notices and provided with opportunity to comment on Owner’s request for prepayment, rehab work and refinancing.

- Follow 24 CFR Part 245
- Notices provided to tenants at least 30 days before Prepayment submission to HUD

Owner must at a minimum use “Energy Star” appliances or explain to HUD why such use is economically infeasible.
1959 to 1974 Direct Loans

Refinancing is to Address Physical Needs of Project for Long-Term Viability

- Normally determined by meeting “Substantial Rehabilitation” threshold in MAP Guide.
- Substantial Rehabilitation Threshold met by either:
  - PCNA and Repair Plan to address needs in PCNA, or
  - Architectural plans and specification.
- Comply with Section 504 Accessibility Standards

HUD will consider waiver of substantial rehab threshold if owner submits PCNA that demonstrates project does not require substantial rehab to ensure long-term viability.
Debt service can increase with Direct Loans initially at or below 6%, but the proposed transaction cannot result in higher rents for unassisted residents.

If the transaction is not feasible without rent increases for unassisted residents, owner has 2 options:

1. **Senior Preservation Assistance Contracts (SPRAC)** –
   - SPRAC funding was awarded to 1,700 units at 12 properties in 2013
   - No additional funding has been made available in recent years

2. **Tenant Protection Vouchers**, pursuant to *HUD Notice H 2012-03, Guidance on Eligibility for Tenant Protection Vouchers Following Certain Housing Conversion Actions*
Unit Conversions and 202 Preservations

Conversion of Efficiencies to 1 bedroom units can occur at same time as long as done in conformity with

HUD Notice H 2011-03, “Policies and Procedures for the Conversion of Efficiency Units to One-Bedroom Units”

Owner demonstrates conversion warranted by:
• local market demands
  – Evidence of marketing efforts
  – Aver. Vacancy rates for efficiency at least 25% for 24 months.
• Results in long-term financial and physical repositioning
  – 1.1 DSCR
  – No increase in budget authority through conversions
Section VII.A of the Notice provides that “[for] Projects with Direct Loan interest rates above 6 percent, Owners must show in pro forma numbers that there is a lower interest rate and/or a lower loan payment . . . ”. (Emphasis added.)
Proceeds from Refi Loan that Exceed Direct Loan Payoff can be used for:

- Provision of Social Services (up to 15% of cost of increasing availability or provision),
- Rehabilitation, modernization or retrofitting of structures, common areas or individual dwelling units, including reconfiguring units in accordance with HUD H 2011-03, without required PCNA or “Substantial Rehab” Threshold,
- Construction of an addition or other facility in or adjacent to the project, including assisted living facilities,
- Payment of project owner, sponsor or 3rd party developer of developer fee,
- Payment of transaction costs related to LIHTCs or secondary financing,
- Other HUD-assisted senior housing properties, or
- Rent reduction of unassisted tenants residing in the project being refinanced.
Where Proceeds will be used for “Substantial Rehabilitation” of the project in accordance with pre-1975 202 Direct Loan requirements, debt service savings are not required as long as no resident is required to pay more for rent.

HUD must approve use of Proceeds from Refi. Excess proceeds are to be deposited into segregated account and included in Project’s Annual Financial Statements.

Construction / Rehab must be completed within 5 years of prepayment.
Use of Project Resources in 202 Prepayments

Residual Receipts:
• In excess of $500/unit can be used to increase availability of supportive services.

Replacement Reserves (RfR):
• In excess of $1,000/unit can be used to:
  ❖ increase availability of supportive services,
  ❖ Rehabilitation, modernization or retrofitting of structures, common areas or individual dwelling units, or
  ❖ Construction of an addition or other facility in project, including assisted living facilities.

With FHA-insured financing, RfR up to $20,000 can be used to fund 3rd party reports.
Section 202 Elderly projects are “exception” projects under the Section 8 Renewal Guide (Option 4), meaning that they are not subject to Mark-to-Market Restructuring (Option 3).

In 202 Prepays, new Owner is required to renew the HAP contract for 20 years under the options available to the owner in the Renewal Guide.

Owner may renew under Option 4 and keep the Section 8 based upon budget-based rent or can renew under Option 2 and receive a yearly OCAF adjustment.

However, Owner may also chose to renew the existing HAP Contract under Option 1-B (Discretionary Mark-up-to-Market) and obtain a rent increase up to 150% of the fair market rent. Alternatively, Owner can renew under Chapter 15 (Preservation) and Option 1-B of the Renewal Guide and obtain post-rehab rents at the time of prepayment or when rehab is completed.

Both Option 1-B and Chapter 15 require that the current rents be below market rents and that a rent comparability study be performed. All options other than option 4 require rent comparability studies to adjust rent to market rent over 5 years, which means that rents may decrease or increase over 5 years.
Timing and Coordination is important between the FHA financing process and the 202 Prepayment process.

- Submission of HAP Contract Renewal
- Need to match rents and expenses submitted to the Project-based Contract Administrator to those used for FHA loan underwriting.

Use an experienced FHA MAP lender who has financed 202 Prepayment Projects
Volunteers of America Housing Programs

- Approximately 500 properties with 20,000 units in 42 states and Puerto Rico
- Headquartered in Alexandria, VA
- Portfolio (property type) consists of:
  - 60% Senior
  - 31% Special Needs
  - 9% Family
- Majority of Senior properties are HUD 202 or formerly 202s converted to LIHTC
- Portfolio includes 112 PRAC 202s

Helping America’s most vulnerable®
Senior Housing Resident Demographics

- Gender – 67% Female
- Race – 61% White, 20% African American, 5% Asian, 14% no unknown
- Ethnicity – 67% Non-Hispanic, 17% Hispanic/Latino, 16% unknown
- Income - 37% report incomes of less than $12,000/per annum
- Functional Impairments – 57% meet HUD definition of “at risk” (unable to perform one or more activities of daily living) or “frail” (unable to perform three or more ADLs)
- Health Insurance - Over 80% are on some type of publicly funded health insurance (Medicaid, Medicare, dual eligible, or VA/other/SCHIP)
- Participation in VOA Service Coordination – 97% with average using service coordination 22 times per year.

Source: 9/12/2016 VOA Service Coordination Study
Westgate Towers – Denver, CO

Helping America’s most vulnerable®

Volunteers of America®
Westgate Towers – Transaction Highlights

- 50 unit mid-rise in downtown Denver. Constructed 1991. HUD 202 with 100% HAP
- Recapitalized using:
  - $4,875,000 Tax Exempt Loan
  - $3,973,575 LIHTC Equity
  - $4,945,639 seller note financing
  - $387,124 deferred developer fee
- Total Development cost of $14,370,105 or $287,402 per unit
- Construction was $71,020 per unit. Acquisition was $144,973 per unit
- Considered 223f/PILOT but rehab scope exceeded 40K per unit
- Closing timeframe did not allow 221d4
- Perm Mortgage Rate decreased to 4.35% from 9.25%
- Used Option 2 Renewal – Budget Based Rent Increase, new 20 year HAP, chapter 15
- Rent increased not to exceed market, per Rent Comp Study
Las Palmas – Miami, FL

NORTHEAST VIEW OF SUBJECT BUILDINGS FROM N.W. 7TH STREET

AERIAL VIEW OF SUBJECT PROPERTY (FACING SOUTH)

Helping America’s most vulnerable®
Las Palmas – Transaction Highlights

• Two Phases in Little Havana neighborhood of Miami. Phase I, built in 1991 – 100 units. Phase II, built 1993 – 96 units. All units with 100% HAP contract

• Recapitalized into one project using:
  ➢ $13,275,000 Tax Exempt Loan
  ➢ $8,862,816 LIHTC Equity
  ➢ $9,962,106 seller note financing
  ➢ $248,202 deferred developer fee
  ➢ $658,906 acquired reserves

• Total development cost of $33,432,352 or $170,573 per unit
• Construction was $27,517 per unit. Acquisition was $92,857 per unit
• Used Option 1B Mark up to Market, new 20 year HAP. Rents increased as much as $210 pupm
• Needed HUD approval for prepayment, merger of projects, MU2M and merged HAP
• Project approved “pre-election”. Post election closing saw debt interest increase of 92 bps and 9 cent decrease in LIHTC price. Project lost approximately $2.5MM in sources.
References

- Section 202 of the Housing Act of 1959 (12 U.S.C. 1701q)
- Section 811 of the American Homeownership and Economic Opportunity Act of 2000
- Section 202 Supportive Housing for the Elderly Act of 2010
- 24 CFR Part 891.530
- HUD Notice H 2013-17, issued May 30, 2013, *Updated Requirements for Prepayment and Refinance of Section 202 Direct Loans*
- HUD Notice H2010-26, issued December 20, 2011, *Subordination of Section 202 Direct Loans*
- HUD Notice H 2011-03, issued February 1, 2011, *Policies and Procedures for the Conversion of Efficiency Units to One-Bedroom Units*
- HUD Notice H 2012-3, issued February 24, 2012, *Guidance on Eligibility for Tenant Protection Vouchers Following Certain Housing Conversion Actions*