Multi-Family Housing Preservation

Pacific Northwest Preservation Academy

April 14, 2021

USDA Rural Development
U.S. DEPARTMENT OF AGRICULTURE

USDA Rural Development

We are committed to helping improve the economy and quality of life in rural America. Through our programs, we help rural Americans in many ways.

We offer loans, grants and loan guarantees to help create jobs and support economic development and essential services such as housing; health care; first responder services and equipment; and water, electric and communications infrastructure.

We promote economic development by supporting loans to businesses through banks, credit unions and community-managed lending pools. We offer technical assistance and information to help agricultural producers and cooperatives get started and improve the effectiveness of their operations.

We provide technical assistance to help communities undertake community empowerment programs.

We help rural residents buy or rent safe, affordable housing and make health and safety repairs to their homes.

USDA Rural Development Multi-Family Housing Programs

Over the past 40+ years USDA Rural Development through its direct funding program has financed thousands of affordable housing properties across Rural America.

Section 515 - Family and Elderly/Disabled Housing

- Direct loans, with varying terms, from 30-50 years in length, properties have income restrictions. Additionally, the properties are eligible for interest credit subsidy which effectively reduces the interest rate to 1%.
- Elderly/Disabled properties are restricted to those households 62 and older or disabled.

Section 514/516 - Domestic Farm Labor Housing

- Direct loans and grants, 33-year term with a 1% interest rate, properties have income restrictions, one household member must meet the Domestic Farm Labor definition as defined by the Agency.

USDA Rural Development Multi-Family Housing Programs

Section 521 - Rental Assistance

- In addition to funding the development of housing the Agency also provides Section 521 Rental Assistance. The Section 521 RA program is project based and ensures the tenant pays only 30% of their adjusted income. For a property to be eligible for the Section 521 program they must have an active Section 514 or 515 direct loan with the Agency. Many properties have partial RA (not all units are assisted).

Section 538 – Guaranteed Loans

The Agency provides loan guarantees to approved private-sector lenders to provide financing to qualified borrowers to increase the supply of affordable rental housing in eligible rural areas. Tenant incomes cannot exceed 115% of AMI. Can be used for new construction or rehabilitation.

USDA Rural Development Multi-Family Housing Programs

Multi-Family Preservation and Revitalization Demonstration Program (MPR)

- Available to existing 515 and 514/516 properties to support rehabilitation. Selected properties execute a new Restrictive Use Covenant. Previous funding rounds included several MPR tools: 20-year debt deferrals, 0% loans, soft seconds and grants. There are currently 170 approved applications in the MPR pipeline ($200MM program dollars/$100MM budget authority). The pipeline has been closed since last year, with an aim to clear out the existing applications before accepting new applications. We plan to issue a no-cost deferral NOSA later this summer. This will apply only to loans originated after the Credit Reform Act date of October 1, 1991. The only tool available will be 20-year debt deferrals. After the pipeline has been funded, we expect future MPR rounds to include additional funding tools.

Multifamily Production and Preservation Funding

Loan Program	Funding Utilized in FY2020	
Section 515 Direct Loans	Subsequent Loans	$29MM
	Persistent Poverty Loans	$4MM
	Prepayment Prevention Equity /Non-Profit Transfer Incentives	$5.9MM
	Rural Economic Area Partnership (REAP)	$1MM
	Total	**$40MM**
MPR Demonstration	0% Loans	$4.2MM
	Soft Second Loans	$37MM
	Grants	$192,028
	Deferrals	$16.4
	Total	**$56.4MM**
Section 538 Guaranteed Loans	**Total**	**$228MM**
Farm Labor Housing	Section 514 Loans	$12.9MM
	Section 516 Grants	$4.7MM
	Total	**$17.7MM**

Importance of RD MFH Preservation

- RD properties are a significant source of affordable housing in WA, OR, ID and AK—almost 20,000 units in the four states and 413,000 units nationwide.
- Many RD properties are in communities where it's not feasible to build new affordable housing, making it even more important to preserve what we have.
- Average age of properties in the RD portfolio nationwide is 33 years old. Properties of this age often require rehabilitation to remain viable.
- Preserving federally-subsidized units provides affordable housing that can serve the lowest-income households. Average annual household income of tenants receiving RA in the four states is less than $13,000.

AK, ID, OR and WA RD MFH Portfolio – Physical Attributes

	Total Number Units	Average Number of Units Per Property	Number of 1 Bedroom Units	Number of 2 Bedroom Units	Number of 3 Bedroom Units	Number of 4 Bedroom Units
Section 515						
Alaska	840	25	368	411	54	7
Idaho	3,729	25	1,728	1,839	162	-
Oregon	5,410	35	2,951	2,183	276	-
Washington	7,987	30	4,375	2,782	783	47
Section 514/516						
Alaska	-	-	-	-	-	-
Idaho	159	27	-	72	69	18
Oregon	951	34	70	379	380	122
Washington	711	34	120	282	247	50
AK, ID, OR & WA Total	**19,787**	**30**	**9,612**	**7,948**	**1,971**	**244**
National Total	**413,885**	**31**	**207,985**	**172,793**	**29,792**	**3,263**

Source: [2020 MFH Annual Fair Housing Occupancy Report](), USDA Rural Development, November 21, 2020

AK, ID, OR and WA RD MFH Portfolio – Tenant Income

	Number of Properties	Number of Households	Number of Tenants/ Cotenants	Average Adjusted Income		Households with Rental Assitance	Precent of Households with Rental Assitance	Average Adjusted Income with Rental Assitance
Section 515								
Alaska	33	752	815	$ 18,549		727	97%	$ 18,418
Idaho	151	3,616	4,146	$ 12,468		3,436	95%	$ 11,690
Oregon	153	5,208	6,022	$ 13,659		4,212	81%	$ 12,170
Washington	263	7,654	8,740	$ 14,644		5,597	73%	$ 12,567
Section 514/516								
Alaska	-	-	-	$ -		-	-	$ -
Idaho	6	146	214	$ 23,694		86	59%	$ 10,992
Oregon	28	854	1,361	$ 28,718		526	62%	$ 17,917
Washington	21	524	772	$ 24,782		380	73%	$ 18,259
AK, ID, OR & WA Total	**655**	**18,754**	**22,070**	**$ 15,102**		**14,964**	**80%**	**$ 12,865**
National Total	**13,348**	**385,180**	**435,773**	**$ 14,131**		**268,916**	**70%**	**$ 11,669**

Source: 2020 MFH Annual Fair Housing Occupancy Report,
USDA Rural Development, November 21, 2020

Preservation Challenges

- Mission risk/loss of properties due to program exit
  - Maturing mortgages
  - Prepayments
- Property and portfolio risks
  - Poor physical condition
  - Failing ownership and/or management
  - Financial weakness
  - Poor community/market viability
- Properties can be subject to multiple types of risks

Mission Risk: Loss of Properties Due to Program Exit

- The mission of RD MFH is to provide quality affordable housing to low-income households in rural areas. Loss of viable properties caused by owners exiting RD MFH programs creates a mission risk. There are two primary ways that owners can voluntarily exit RD MFH programs:

    - Mortgage maturity: When the project loan reaches its natural maturity date, the owner makes a final payment and exits the MFH program. Tenants no longer receive rental assistance. RD offers owners the option to extend the loan term to remain in the program but it is voluntary.
    - Prepayment: Certain properties are eligible for prepayment. RD assesses the potential impacts of a prepayment based on the need for the housing and civil rights analysis. Depending on the outcome of this analysis, the owner may be allowed to exit the program without restrictions, with restrictions, or may be required to offer the property for sale to a nonprofit.

Mission Risk: Maturing Mortgages

Overview:

- RD MFH properties began reaching mortgage maturity in 2015, but the number of properties to date nationwide has been small.
- In the Western region, maturities begin to increase starting in 2025 and increase significantly beginning in 2030.

USDA Rural Development MFH Maturing Loans 2021-30										
	2021	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
Section 515										
Alaska							1	1	2	1
Idaho		1	2	1	1	2	3	7	5	7
Oregon	1	1		3	1	1	2	5	6	7
Washington	1	2	2	2	8	5	8	6	3	8
Section 514/516										
Alaska										
Idaho								1	1	
Oregon			2	1			2	1	1	1
Washington		1					1			1
AK, ID, OR & WA Total	**2**	**5**	**6**	**7**	**10**	**8**	**17**	**21**	**18**	**25**

Mission Risk: Maturing Mortgages

Preservation considerations:

- Owner motivation is a critical factor in willingness to preserve
  - Does the owner (either non-profit or for-profit) have a mission/community motivation to keep the property as affordable housing? If so, they are typically more willing to stay in the program or go through the effort to find a preservation buyer.
- Market conditions play an important role
  - Owners in strong markets are more likely to exit the RD program in order to convert to market-rate housing and/or sell the property. However, these properties may also attract third-party funding and preservation buyers. Owners in weaker markets may seek to stay in the MFH program because they don't have better options in the market and/or they need RA to maintain occupancy.
- Not all properties can or should be preserved
  - In some cases, the combination of mission and project risk factors makes a property not feasible for preservation. In these cases, it's important to ensure that tenants understand their options, including taking their RA to another RD property or applying for other types of housing assistance.

Mission Risk: Prepayment-Eligible Properties

Overview:

- Projects built in 1989 or earlier may be eligible for loan prepayment. Certain properties that would be eligible for prepayment based on a pre-1990 financing date are ineligible to prepay because they participated in a settlement with the government that requires them to remain in the program until mortgage maturity.
- Properties built in 1990 or later have RD loans that cannot be prepaid.
- Restrictions placed on a property by third-party funders may limit the ability to prepay.
- Upon application by an owner to prepay, RD reviews eligibility for prepayment and impact on tenants and the community if the prepayment is approved. Depending on the outcome of this analysis, properties may be subject to certain restrictions or the owner may be required to offer the property for sale to a nonprofit for 180 days.
- Upon approval of prepayment the property exits the RD program. Tenants are eligible for RD vouchers.

Mission Risk: Prepayment-Eligible Properties

Preservation considerations:

- It is difficult to assess the amount of mission risk posed by prepayments. Owners decide if they want to apply for prepayment and the agency responds. The amount of prepayment activity varies widely from state to state. Preservation buyers need to be ready to respond.
- Prepayment risk will decrease over time as more pre-1990 properties exit the MFH program and the remaining properties are not prepayment eligible. In addition, properties that have been recapitalized and/or transferred are subject to new restrictive-use agreements that require them to stay in the program.
- Properties that are at risk of loss due to prepayment are often a high priority for third-party funders, especially HFAs, that are seeking to preserve federally-subsidized housing.
- If you are a potential preservation buyer, it’s important to know if a property is eligible to prepay because it has a significant impact on valuation. Properties that are ineligible to prepay will be appraised subject to the existing restrictions. Properties that are eligible to prepay (meaning they don’t have agency or other restrictions) are generally appraised at market unrestricted value.

Project/Portfolio Risk: RD MFH Risk Assessment Tool

- RD has created an internal risk assessment tool to better assess and monitor portfolio status and challenges.
- The tools creates a score for each property in the following categories:
  - Financial Health
  - Physical Condition
  - Owner/Agent Capacity
  - Community Health
- Properties are classified and assigned for servicing based on a combined risk score
  - Critical
  - Troubled
  - Watch
  - Performing

Project/Portfolio Risk: RD MFH Risk Assessment Tool

- The risk assessment tool is an internal monitoring system to assess portfolio performance. It is also used to compile portfolio summary information to share with stakeholders.
- Because it is a new tool, RD has not determined how to incorporate the results of the tool into its preservation policies. RD does not provide property scores/ratings to owners or prospective buyers.
- Properties that are not performing well will be carefully assessed when determining feasibility for transfer. However, there could be many cases where sale to a preservation buyer would address the risk factor causing the property to be classified below performing (e.g. failing ownership resolved by sale to a competent owner).

Project/Portfolio Risk: Poor Physical Condition

Overview:

- Physical condition risk is a relatively common concern given the age of the portfolio.
- The condition of MFH properties varies widely. The Agency is using its risk assessment tool to develop a more standardized assessment of property condition.
- Many properties that are 30+ years old are well-maintained but haven't received any significant rehabilitation.
- Some properties have low reserve account balances that haven't kept pace with property needs.
- Due to limited MPR funding, most MFH rehab has been funded by third parties, including through the low-income housing tax credit program.

Preservation considerations:

- Determine if the physical condition is at a level where preservation makes sense. Is there functional obsolescence?
- Get a capital needs assessment (CNA) to determine the upfront and ongoing rehab and replacement needs. What is the financing/funding/operating strategy for addressing these needs?

Project/Portfolio Risk: Failing Ownership and/or Management

Overview:

- There are many different types of RD owners from sole proprietors to large companies. It is similar with management agents, varying from single-property owner/managers to large national management companies.
- Common issues and challenges:
  - Owner/manager non-compliance with Agency requirements
  - For-profit owners/partners seeking to retire and exit program
  - Non-profit boards with difficulty retaining members and lack of organizational capacity
  - Deceased borrower and heirs not interested in acquiring ownership

Preservation considerations:

- Generally this is the easiest issue for a preservation buyer to address, since the failing owner and/or manager is replaced at the time of transfer.
- Caution: Working with owners engaged in partner disputes (legal, etc) can be challenging for preservation buyers.

Project/Portfolio Risk: Financial Weakness

Overview:

- The owner and manager are responsible for the operations and financial health of the property. The Agency approves the proposed property budget and reviews the annual financial statements.
- Less than 2% of agency loans are currently delinquent.
- Common causes of financial weakness:
  - Ongoing high vacancy rates, often due to market weakness
  - Inadequate rents to cover operating costs and inability to raise rents due to market conditions
  - Management problems that affect operations, occupancy, etc

Preservation considerations:

- Be cautious: Assess what is causing the financial problems and if they can be fixed. If the problem is primarily caused by market conditions, it will be difficult to address.
- If rents need to be raised, can they be supported in the market?

Project/Portfolio Risk: Poor Community/Market Viability

Overview:

- Poor market conditions and lack of community viability create a big preservation challenge.
- Unused RA is a red flag: consider carefully why units are not rented despite being subsidized.
- Common problems:
  - Declining population and lack of employment opportunities
  - Overbuilt/oversupply of income-restricted housing
  - Community lacks amenities/not desirable to tenants

Preservation considerations:

- A common myth is that rehabbing a property in a weak market will improve occupancy. Although it might improve it marginally, it is generally not enough to address the underlying market problems.
- Properties in weak markets often have financial weakness and physical condition issues. Some have been "limping along" for years.
- Many of the properties that are not considered "preservation-worthy" will be due to this issue.

Strategies to Improve Preservation Outcomes

- More training and education for preservation buyers (why you are here today!)
- Better and timely matching of potential buyers and sellers, especially for prepayment and maturing mortgage properties
- Improvements to the RD transfer process
- Continue to work with partners to identify rehab funding sources and help owners and preservation buyers to access them
- Recognize that we can't preserve everything, especially if condition is very poor and/or market is weak. Focus time and resources on properties that make sense to preserve.
- Where preservation isn't feasible, ensure that tenants are aware of all options to maintain access to affordable housing.

Questions?

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USDA RD
Preservation Process

Pacific Northwest Preservation Academy 2021

Office of Rural & Farmworker Housing

10-Step Process

1. Identify and Secure Property
2. Assess Regulatory Restrictions
3. Determine Feasibility
4. Scope of Work
5. Identify Capital Sources
6. Submit Applications
7. Submit USDA Transfer Application
8. Closing & Transfer
9. Construction/Rehabilitation
10. Placed In Service (PIS)

1. Identify and Secure Property

- USDA sends notifications for loans in **Prepayment** and has a dashboard of expiring loans
- Some properties may be available even if they are not in pre-payment nor have an expiring mortgage
- **Purchase and Sale Agreement (PSA)** must be negotiated with current owner

2. Assess Regulatory Restrictions

- Buyer **must** be a housing nonprofit
- Review **RD Handbook(s)**
- Concept meeting with RD staff
- Other financing or deed restrictions on property?

3. Determine Feasibility

- **Unit Conditions:**
  - Must conduct **Capital Needs Assessment (C.N.A.)**
  - Safety and Accessibility are top priority
- **Current availability of Rental Assistance**
  - Potential to subsidize all units
- **Appraisal**

4. Scope of Work

- **Determined by CNA**
  - Repairs from years 1-5 must be included
  - Accessibility Plan **("504 Plan")** must be updated
- **Written by project architect**
- **Total Construction Cost estimate**

5. Identify Capital Sources

- Existing USDA Debt
- Current equity
- Capacity for 3rd party debt
- Soft debt
- Grants

6. Submit Application(s)

- Determine operating budget and management entity
- Complete USDA **Preliminary Assessment Tool**
- Timing of commitments between funding sources

7. Submit USDA RD Transfer Application

- USDA provides **Transfer Checklist**
- USDA transfers **must** be approved by their National Office **(Office of the General Counsel/"OGC")**

8. Closing & Ownership Transfer

- USDA in **first lien position**
- Operating and Reserve accounts transferred to new owner

9. Construction/Rehabilitation

- Can be completed up to 24 months after transfer
- Contracts **must** be approved by USDA **regardless of funding**
- Relocate current tenants

10. Placed in Service

10~Step Process

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Pacific Northwest Rural Preservation Academy

Overview of USDA RD's MFH

Preservation Process

RD's Basic Preservation Strategy

Components of all deals

- Project is needed in market
- Post transaction owner is eligible

Basic Feasibility Thresholds

- CNA to determine capital needs, timing and funding
- Underwriting to determine feasibility and tools
  - SUSTAINABLE RENTS = SUSTAINABLE PROPERTIES!
  - CNA needs - O&M - operating cushion – vacancy - accounts current

RD's Basic Preservation Strategy

Basic Feasibility Thresholds (continued)

- Seller payments and increased RTO is market based
  - Market value for equity when hard loan part of deal
  - CRCU limit for equity payment and increased RTO
  - CRCU test with any MPR tools
- Consider impact on tenants

Long Term Commitment – RD's RA funding/Owner's RUP

Overview of Access to Preservation Resources

Stay or sell with the MPR

(MFH Preservation and Revitalization Demo)

(NOSA)

- Access RD rehab funds – key tool: deferrals (also 515, 0% or soft loans, NP grants)
- No RA
- Simple (stay in owners)/Complex (transfers)Portfolio (transfers and stay in owners)

Transfer

(Handbook 3 – Chapter 7)

- Access 3rd party funding – only source of seller payment outside prepayment - Complicated
- Apply thru RD Office
- Low rents = tight deals and "Pie split" issues common

Prepayment Process

(Handbook 3 – Chapter 15)

- Access RA, RTO and equity loan incentives (stay in owners or transfers)
- Apply thru RD Office – Process strictly regulated by Statute
- Waiting list and no more access to Sales to Non-profits resources

Overview of Access to Preservation Resources

Substitution of GP' s or LP's for a "no-rehab" transfer (Handbook 3 - Chapter 5)

- Access to project control - no new resources available (existing RA helps)
- Notify RD Office for concurrence and white knights beware – you own the good and bad now!

Stay-in rehabilitation including energy efficiency upgrades

- Funding from reserves, non-RD funds, rent savings or higher rents supported by RA

Access to RA

- Prepayment Incentive
- Transfer in RA for a tenant with a LOPE letter
- Unused RA via the UNL for the tenant with the greatest need
- Unused RA via the UNL for a preservation project – prepare to demonstrate
  - Owner contribution to preservation effort
  - Continued need in the community
  - Leverage from other sources

Advice to developers on a preservation strategy:

Look for deals that work – the four "R" analysis

- RENTS - What's the gap between current basic rents, Fair Market Rents (FMR's) and 60% LIHTC Rents?
- RA - How many RA units and %? Can RD loans be deferred, soft funds be used to reduce RA increase?
- RUPS – Find out about RUPs and prepayment restrictions (pre or post 89) as they affect value and options.
- REHAB – How much (CNA & Statement of Work (SOW))? Rehab or Transfer/Rehab? RD must know to approve.

Next Level – RTO, management fee, reserves, current occupancy & eligible for LIHTC, cash flow, RD classification and findings

Advice from the school of hard knocks: Communicate!

What's the plan?

Who are the key players?

- Developer, seller, buyer, lender, LIHTC Agency, other financing, mortgage broker, syndicator, credit enhancer, bond issuer

What are the deadlines?

Important goal – one CNA and one appraisal – your provider must work with RD

How will capital needs be determined?

- Full CNA, 3^{rd} party requirements, scope of work, post rehab CNA

Successful strategies to coordinate and cooperate

Agree to a Scope of Work

- First CNA – full review of needs
- Add third party requirements – to get tax credits what must you do
- Agree to a Scope of Work
- Revised CNA to reflect post rehab per Scope of Work

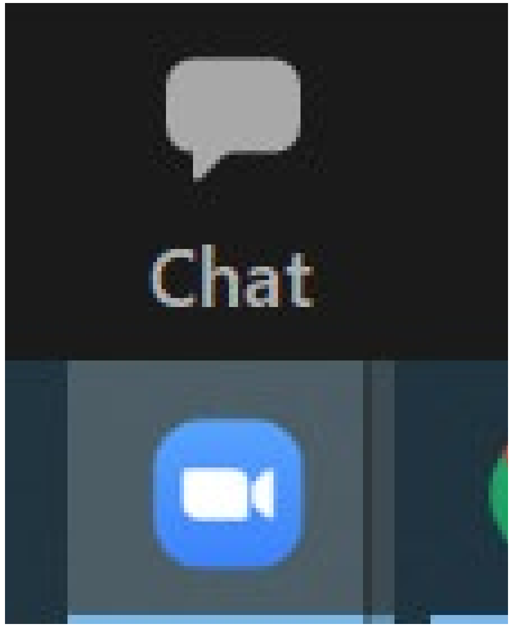
Expect and schedule a series of meetings with all parties

- Issues will rise throughout the process
- Establish a positive effective working relationship

Some basic advice on a Multi-Funder preservation strategy:

- Working with Multi-Funder MFH Transfers
  - Extremely tight or conflicting funding deadlines require significant coordination among funding partners.
  - The traditional developer led models where the transaction is independently presented to various funding entities at different times in different formats is difficult to pull off.
  - RD as the holder of the original note and mortgage and provider of RA and setter of rents can not be the last one in the mix.

Get RD Done Right!
Contact: Larry Anderson 571-296-4746 or landerson32@cox.net



Questions?

Please use the chat feature in Zoom to submit questions to the panel

Thank you