COLORADO RURAL HOUSING PRESERVATION ACADEMY

Session 2, Topic 1: The 515 Transfer Process and 538 Financing

VIRTUAL CONVENING
AUGUST 5, 2020
This webinar is being recorded, and all audience members are muted as they log in

Please use the **Chat Feature** to submit questions **during** the presentation

**After** the presentation, we will open up the lines for Q&A by using the **Raise Hand Feature**

All participants will receive a copy of today’s webinar recording and PowerPoint slides

Please be patient with technical difficulties
AGENDA

10:00  Welcome and Introductions

10:15  The 515 Transfer Application

10:00  Break

10:05  538 Guaranteed Loans

10:45  Questions and Wrap up
ONE DAY every person will have an affordable home in a vibrant community, filled with promise and the opportunity for a good life.

OUR MISSION is to create opportunity for low- and moderate-income people through affordable housing in diverse, thriving communities.
What is the Rural Preservation Academy?

- A series of no-cost training and peer learning sessions designed to help rural housing providers and nonprofits acquire and/or preserve affordable housing in rural Colorado.

- Ultimate goal is to preserve affordable housing options for low-income rural populations in the state.

- Overview & Introduction to Rural Rental Housing and Preservation
- USDA Rural Development Transfer Process and Development Rehabilitation
- Preservation Financing and Deal Structuring
- Supportive Policy
- Buyer/Seller Conference
- Financing and Deal Structuring Part 2
- Property Management
OUR PARTNERS

The Colorado Health Foundation

Fannie Mae

A Health Equity Foundation
Colorado Rural Housing Preservation Academy

Overview of USDA RD’s MFH Transfer Process.
Deeper Dive 8-5-2020

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Looking for deals that work:

- **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

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When you have found a deal that might work – Make a data request directly to RD after a letter of intent has been signed by a seller

- You have found a potential RD MFH to purchase and you want to get to the point where you can make a well-informed offer. A good strategy is to ask RD for their information so that you and RD will be working with the same data.

- The following screen contains information that a purchaser should have the seller request directly from RD. It offers a good preliminary review of project status and operations. The potential purchaser may prepare the letter for the seller, but the seller must sign and authorize RD to release the information.

- The second screen contains operational and financial information a purchaser should understand well after performing an initial analysis using this data.
Specific Property Data request from owner to RD

- Form RD 3560-7 from the audited financial statements from MINC for the last three years on FIN 1700. The FIN 1700 should be in excel format for conversion into the RD underwriting template (PAT).
- Proposed Budget on FIN 1000
- Form RD 3560-10 from the audited financial statements from MINC for the last three years.
- Copy of the initial and any subsequent loan agreements and notes.
- Most recent project worksheet on PRJ 2000.
- Copy of the current interest credit and rental assistance agreement.
- AMAS M1FI Screen including the current remaining unpaid balance.
- A copy of any restrictive use agreement or covenant.
- Project Reserve Balance FIN 2000.
- Rent History PRJ 3050.
- Quick Check Report.
- Occupancy history for 5 years on PRJ 4200.
- Copy of the original loan agreement and note.
General advice on a preservation data review strategy:

- Next Level – review status and project performance by looking at:
  - RTO
  - Management fee
  - Reserves
  - Current and historical occupancy
  - Eligible for LIHTC
  - Cash flow
  - RD classification and findings
- If it looks good - Make an offer and get a purchase and sales agreement
  - PSA should always be subject to RD approval
RD MFH Transfer Application Requirements HB-3-3560, Attachment 7-B-1

**Proposed Transaction**

- **Executive Summary** - narrative draft
- **Required written statements and certifications** - 12 statements in 3 docs
  - seller statements - signed doc
  - buyer statements - signed doc
  - joint statements - signed doc
- **Application supplement** - Attachment 7-B-2
- **Contact list** - Attachment 7-B-3
- **Application for partial release, subordination or consent** - Form RD 3560-1
- **Purchase and sales agreement** - signed doc
- **Current Preliminary Title Report** - signed doc
- **Legal Services Agreement** - signed doc
RD MFH Transfer Application Requirements
HB-3-3560, Attachment 7-B-1

◊ The Project and proposed repairs
  ◊ Capital Needs Assessment - Final report
  ◊ Repair Agreement - word doc
  ◊ Cost estimate - Form RD 1924-13

◊ Documentation of Market Rents and Value
  ◊ Appraisal for USDA Security Value - report
  ◊ Appraisal As-Is Unrestricted - same report
  ◊ Rent Comparability Study - may not be needed
  ◊ Purchaser’s best available evidence to support CRCU - if no appraisal
RD MFH Transfer Application Requirements

HB-3-3560, Attachment 7-B-1

◦ Financial Aspects of the Transaction
  ◦ Application for Federal Assistance - Form SF 424 & attachments
  ◦ Proposed Project Budget - Form RD 3560-7
  ◦ Sources and Uses of Funds statement – PAT Template

◦ Third Party Funding
  ◦ Applications(s) for funding from each source - doc or templates
  ◦ Financial Pro Forma information – PAT template
  ◦ Environmental information - report
  ◦ Commitment letters or equivalent - signed letter
  ◦ Regulation requirements for third party funding - word doc
  ◦ Interim Financing - word doc
RD MFH Transfer Application Requirements
HB-3-3560, Attachment 7-B-1

◊ The Proposed Purchaser
  ◇ Purchaser's Resume (for principals) - doc
  ◇ Previous participation certification - Form HUD 2530
  ◇ Identity of interest certification - Form RD 3560-30 or 3560-31
  ◇ Debarment/Suspension Certification - Form AD 1047 or AD 1048
  ◇ Purchaser's Financial Statements w/Attachment 7 B-4 - doc and Attachment 7 B-4
  ◇ Credit Report Fees - checks for principals
  ◇ Proof of citizenship - Fed Tax ID or SS #

◊ Proposed Management
  ◇ Complete management plan - Per RD 3560
  ◇ Attorney Opinion Re: Proposed Lease and Compliance - Per RD 3560
  ◇ Management Certification - Form RD 3560-13
  ◇ Affirmative Fair Housing Marketing Plan - Form HUD 935.2A
RD MFH Transfer Application Requirements
HB-3-3560, Attachment 7-B-1

◊ Proposed Organizational Documents for Purchaser
  ◊ Purchaser’s Organizational documents - doc
  ◊ Attorney certification certifying legal sufficiency - doc

◊ Other
  ◊ Assurance agreement - Form RD 400-4
  ◊ Equal Opportunity agreement - Form RD 400-1
  ◊ Lobbying Certification – Attachment 7 B-5 & SF-LLL if applicable
  ◊ Certification Regarding Drug-Free Workplace Req - Form AD 1049 or AD 1050
  ◊ Letter from HUD concurring in transfer of HAP Contract - letter
  ◊ Request for Rental Assistance - Form RD 3560-25
Common RD Areas of Concern – Transfer Apps

(per Dean Greenwalt presentation – 2015)

1. Incomplete information
2. Inadequate CNAs and Scope of Work Statements
3. Unacceptable Appraisals
4. Unreasonable/Unjustified O&M expenses
5. 3rd Party Business terms
6. Projected Rents, rent loss, vacancies and market data not rationalized
7. Unrealistic expectations
RD MFH Transfer Application Requirements
HB-3-3560, Attachment 7-B-1

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Successful strategies to coordinate and cooperate

- 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
Successful strategies to coordinate and cooperate

Establish realistic underwriting expectations

- Equity and RTO increase must fit within CRCU
- The gap between current rents and CRCU is a pivotal feasibility measure
- Some projects may not have the market position to satisfy all expectations

Is an HQ underwriter available for fast tracked help advice and solutions?

Big Deals need big time teamwork

- Coordinate developer, financial and RD resources (loan/servicing and technical)
- Focus on critical times – application, underwriting, obligation, closing, and construction
Some basic advice on a 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.
Advice from the school of hard knocks: Communicate!

What's the plan?
Developer, seller, buyer, lender, LIHTC Agency, other financing, mortgage broker, syndicator, credit enhancer, bond issuer

Who are the key players?

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, 3rd party requirements, scope of work, post rehab CNA
Advice from the school of hard knocks: Communicate!

- When and what appraised values?
- What is the impact of key RD underwriting issues?
  - CRCU/equity/reserves/RA/Tenant impact
- What are the limitations of specific loans?
  - Pre-92/post-89/RUPS
- What are subordination expectations?
- For portfolio transactions – Run a trial one through first
RD Preliminary Assessment Tool (PAT)

- Standard underwriting format used for all RD MFH transactions (other funders have their versions) includes:
- General Information – Size and location of project, number of units, original funding, current account and loan balances
- Sources and Uses – Sources for all transactional funding and detailed projected hard and soft uses and contingencies
- Reserve Sizing – Based on a CNA, 20 years of capital spending and funding to track long term capital uses and funding availability
- Rents and Operations – Current and projected rents and incomes as well as operational expenses, based on most recent 3 years
- Pro Forma - 15 year trending examines inflation’s effect on project income and expenses and project’s ability to maintain NOI and DCR
- Review Tool – Quick look to see if underwriting standards are met.
New Underwriting Principles (Chpt 7 Handbook 3)

- Project is needed in community
- Post transaction owner is eligible
- Capital and accessibility needs addressed
- Post transaction rents will not displace current tenants
- Rents don’t exceed the lesser of CRCU or restricted rents
- RD recognized equity must be supported by an appraisal and underwriting

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New Underwriting Principles (Chpt 7 Handbook 3)

- Equity defined by market value RD approved appraisal
- If no equity an “exit incentive” (IE) may be paid under certain conditions
- Either Seller Equity or EI – not both
- RD MFH HQ approves any equity amounts and RTO

- Third party loans and guarantees encouraged
- Rents don’t exceed the lesser of CRCU or restricted rents
- New RTO to be calculated at the time of transfer
<table>
<thead>
<tr>
<th>Category</th>
<th>Requirement</th>
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<tbody>
<tr>
<td>Post transfer rents</td>
<td>Lesser of HOME (if used), LIHTC or CRCU</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>No more than 10% reduction from 3 year avg.</td>
</tr>
<tr>
<td>Rents must cash flow in proposed operations</td>
<td>Vacancy and contingency at 5%, NOI to meet 1.15 DSCR or higher 3rd party DSCR</td>
</tr>
<tr>
<td>General operating account minimum requirement</td>
<td>20% of operations</td>
</tr>
<tr>
<td>Vacancy/Bad debt loss</td>
<td>Max 10% for &gt; 16 units, 15% for &lt; 16, and should be most recent 3 year plus 2%</td>
</tr>
<tr>
<td>Tenant protection</td>
<td>Owner must protect all non-RA tenants from rent increase caused by transaction</td>
</tr>
<tr>
<td>Category</td>
<td>Description</td>
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<td>--------------------------------</td>
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<tr>
<td>CNA funding and reserve deposit</td>
<td>Greater of CNA or third party lender required deposits. Positive at end of 20 years</td>
</tr>
<tr>
<td>New loans for RD Section 515</td>
<td>RRH - eligible purposes (not developer fee or equity)</td>
</tr>
<tr>
<td>Debt service coverage ratio</td>
<td>Trend 2% for revenue, 3% for expenses, DSCR 1.15 for years 1-3, 1.1 for 4-5, and 1.0 &gt;5.</td>
</tr>
<tr>
<td>Loan to Value</td>
<td>All rehab must be within “prospective as-improved Security value including favorable financing</td>
</tr>
<tr>
<td>Loan Terms of third party debt</td>
<td>No balloons of 3rd party debt before RD loans, unless 3rd party agrees to keep rents affordable</td>
</tr>
<tr>
<td>Sources and uses balance</td>
<td>Includes health, safety, accessibility</td>
</tr>
<tr>
<td>Development shortfalls</td>
<td>Must be from non-project sources.</td>
</tr>
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Why the MPR is a good idea for the Program

Cheapest way to revitalize a project
- Deferral, soft money, grants and zero percent loans are cost effective tools
- Early MPR rents went down by 2% or $17 PUPM

May be the only feasible way to address existing capital needs
- Early results – rehab plus 20-years CNA needs over $29K per unit
- Typical project could not afford rehab or higher reserves within CRCU without MPR
- Without MPR tools the cost is carried by RA
- Without MPR tool rehab is limited and may leave the job half done

Many owners have no ability to sell or pay off
- The gap between current rents and CRCU is a pivotal feasibility measure
- Many projects don’t have the market position to satisfy all expectations
- Bring in 3rd party funds through a transfer not an option – project starts a death spiral

Mechanism for stay in owner to recapitalize
- Over 50% of MPR transactions with stay in owners last year
- Government funds not used for equity payout or huge developer fees

Magnet for third party funding
- Early results $100 Million leveraged by $30 Million in MPR BA
- Provides additional funds to get the transaction to work

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Free TA and Pilot Program to help NP or PB Preservation

NOSA funding for Free Technical Assistance (TA) for Non Profits (NP) in Second year

- 4 TA providers can help in a variety of ways to preserve RD funded Section 515s
- For properties RD anticipates exiting before 2036
- TA providers provide free TA as needed – big or small issues
- Contacts and more information on upcoming slides

June 14, 2019 Unnumbered letter encourages NP to participate in Preservation

- Allows a NP to earn an ROI based on investment or an Asset Management Fee up to $7,500, “investment may include:
  - Developer loan
  - Hard cost contingency
  - Grants
  - Loan to Security value
- Allows a “two step” transfer process
  - Step one - Purchase the property
  - Step two - Perform the rehabilitation
Get RD Done Right!
Contact: Larry Anderson 571-296-4746 or landerson32@cox.net

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Questions?

Use Chat Feature to submit Questions to the panel.
THANK YOU