

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR-4162-N-01]

Fiscal Year 1997 Portfolio Reengineering Demonstration Program Guidelines

AGENCY: Office of Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Notice of Demonstration Program and Initial Guidelines.

SUMMARY: This Notice provides initial guidelines to implement a Demonstration Program authorized by the Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act, 1997 (Pub. L. No 104-204, 110 Stat. 2874, approved September 26, 1996) ("HUD FY 1997 Appropriations Act"). The Demonstration Program is directed at FHA-insured multifamily projects that have project-based Section 8 contracts with above market rents. The Demonstration Program is intended to explore various approaches for restructuring mortgages and taking other related actions in order to reduce the risk to the FHA insurance fund and lower subsidy costs while preserving housing affordability and availability.

FOR FURTHER INFORMATION CONTACT: George C. Dipman, Demonstration Program Coordinator, Office of Multifamily Housing, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-4000; Room 6106; Telephone (202) 708-3321. (This is not a toll-free number.) Hearing or speech-impaired individuals may call 1-800-877-8399 (Federal Information Relay Service TTY). Internet address: PRE@hud.gov.

SUPPLEMENTARY INFORMATION:

I. Paperwork Reduction Act Statement

The proposed information collection requirements contained in this notice have been submitted to the Office of Management and Budget (OMB) for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a valid control number. The Department has requested emergency clearance of the collection of information described below:

(1) *Title of the Information collection proposal:* Fiscal Year 1997 Portfolio Reengineering Demonstration Program.

(2) *Summary of the collection of information:* Each owner would submit to HUD, the owner's request to participate. An owner that is not within the jurisdiction of a Designee also may submit a request to HUD to proceed under the alternative processing in Section VIII.

Thereafter, each owner would submit to HUD, a Designee, or a lender (under alternative processing), as appropriate, the following information: documents necessary to perform the underwriting; modifications to proposed Restructuring Commitments, and information relating to any appeal of a Restructuring Commitment, and evidence of having sent appropriate notices. The owner's must notify tenants, units of general local government, and, in certain cases, lenders at key points in the process.

Under Designee Processing, each prospective Designee would submit to HUD a letter of interest together with evidence of its ability to meet the selection criteria (see Section VII.A.). If selected the Designee would submit a

management plan detailing how it will carry out restructurings. If the Designee operates under the fee for service approach, it must submit to HUD, for each project, a detailed Business Plan containing the information specified in Section VII.B.1.a.(1) STAGE I. For a Designee operating under the joint venture approach, submissions to HUD on specific projects, in general, will be certifications and representations.

Under Alternative Processing, each lender/servicer would submit to HUD a Business Plan detailing the terms of the restructuring proposal.

(3) *Description of the need for the information and its proposed use:* The owner's request to participate is needed to initiate processing and to provide information necessary to ensure that the project meets statutory eligibility requirements to participate in the Demonstration Program. Notices to tenants, to units of general local government, and to lenders are intended to comply with statutory requirement for such notification and to obtain information that may provide for more informed decision making.

(4) *Description of the likely respondents, and proposed frequency of the response to the collection of information:* Respondents will be (1) certain owners of FHA-insured projects that have expiring project-based Section 8 contracts; (2) State housing finance agencies, housing agencies and nonprofits; and (3) FHA-approved lenders and servicers. The estimated number of respondents and frequency of the response is set out in the table in paragraph (5), below.

(5) *Estimate of the total reporting and recordkeeping burden that will result from the collection of information:*

Information Collection	Number of respondents	Responses per respondent	Total Annual responses	Hours per response	Total hours	Guideline reference
Owner's request to participate	275	1	275	.5	137	VI.A.
Owner's notice to tenants, local governments, and lenders of intent to participate.	275	3	725	1.0	725	VI.D.
Owner-supplied information relating to underwriting	275	3	725	2.0	1,450	VI.F.
Owner's summary to tenants, local governments, and lenders of Restructuring Commitment.	275	3	725	1.5	1,088	V.H.
Owner's request to modify Restructuring Commitment	100	1	100	1.0	100	VI.I.
Owner's summary to tenants, local governments, and lenders of substantial modifications to Restructuring Commitment.	100	3	300	2.75	825	VI.K.
Owner's notice to HUD of appeal of Restructuring Commitment.	100	1	100	1.0	100	V.L.
Owner's summary to tenants, local governments, and lenders of the appeal of Restructuring Commitment.	100	3	300	1.0	300	V.L.
Letter of interest to participate as a Designee	25	1	25	1.0	25	V.II.A.
Information to demonstrate qualification as Designee	25	1	25	2.0	50	V.II.A.
Designee Management Plan	25	1	25	8.0	200	VII.A.
Designee Business Plan	25	1	25	40.0	1,000	VII.B.I.
Lender/Servicer Business Plan	75	1	75	40.0	3,000	VIII.

Information Collection	Number of respondents	Responses per respondent	Total Annual responses	Hours per response	Total hours	Guideline reference
Total annual burden	9,000	

In accordance with 5 CFR 1320.8(d)(1), the Department is soliciting comments from members of the public and affected agencies concerning the proposed collection of information to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

(2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those who are to respond; including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this proposal. Comments must be received within seven (7) days from the date of this proposal. Comments must refer to the proposal by name and docket number (FR-4162) and must be sent to: Joseph F. Lackey, Jr., HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503.

II. Introduction

A. Background

Over 800,000 housing units in approximately 8,500 projects have been financed with FHA-insured loans and supported by project-based Section 8 housing assistance payment (HAP) contracts. In many cases, these HAP contracts currently provide for rents which substantially exceed the rents received by comparable unassisted units in the local market. Starting in Fiscal Year ("FY") 1996, those Section 8 contracts began to expire, and Congress and the Administration provided one-year extensions of expiring contracts at a cost of over \$200 million. While annual HAP contract extensions for these projects maintain an important housing resource, they come at great expense. Every year more contracts expire, compounding the cost of annual extensions. In ten years, the annual cost

of renewing Section 8 contracts rises to approximately \$7 billion, about one-third of HUD's current budget. If, however, the Section 8 assistance is reduced or eliminated, there is an increased likelihood that these projects will be unable to continue to meet their financial obligations including operating expenses, debt service payments, current and future capital needs.

The FY 1997 renewal authority limits renewals of most Section 8 project-based assistance contracts expiring in FY 1997 to 120% of Fair Market Rents and authorizes participation in an optional Demonstration Program by owners with properties that have FHA-insured mortgages whose rents are subject to the required reduction. The Demonstration Program will explore approaches to restructuring the debt secured by these properties while minimizing adverse impacts on tenants, owners and communities.

These Program Guidelines describe the authority given to HUD under the Demonstration Program and explain how HUD plans to implement the Program. As the Department works with owners on restructuring project loans and as questions arise from affected parties, HUD may periodically provide additions and clarifications to these Guidelines.

B. Legislative Authority

The Section 8 Contract Renewal Authority and this Portfolio Reengineering Demonstration Program are authorized by sections 211 and 212, respectively, of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1997 (Pub. L. 104-204, 110 Stat. 2874, approved September 26, 1996) ("HUD FY 1997 Appropriations Act").

Section 212 also repealed the demonstration program authorized by section 210 of Departments of Veteran Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1996 (110 Stat. 1321) ("HUD FY 96 Appropriations Act"). Amounts made available under section 210, however, remain available through FY 1997 and the FY 1997 Demonstration Program does not nullify any agreements or proposals that have been considered under the FY 1996 Demonstration Program. Proposals

submitted under the FY 1996 Demonstration Program that were received by the Department prior to September 25, 1996 will continue to be processed by HUD. The Department is implementing the FY 1996 Demonstration Program under notices published at 61 FR 34664, July 2, 1996 and 61 FR 28757, July 25, 1996.

C. Outline of Notice

The remaining sections of the Guidelines provide the following information:

Section III. explains section 211 of the HUD FY 1997 Appropriations Act regarding renewals of up to one year for Section 8 contracts expiring during FY 1997 as they relate to the Demonstration Program.

Section IV. provides an overview of the goals of the Demonstration Program provided for in section 212 of the HUD FY 1997 Appropriations Act, clarifies eligible and ineligible projects and gives specific substantive guidance on restructuring.

Section V. discusses additional Demonstration Matters, such as, required consents, additional restructuring tools, and others.

Section VI. sets forth the procedures which owners seeking to participate in the Demonstration Program will be required to follow and explains HUD processing.

Section VII. provides guidance relating to the anticipated use of Designees in the Demonstration Program.

Section VIII. provides guidance on Alternative Processing by lenders making new loans and by mortgagees or loan servicers where the existing FHA-insured loan is retained.

Section IX. addresses other provisions of the Demonstration Program legislation such as participation of projects with post-FY 1997 expirations and sunshine provisions.

Section X. contains HUD's findings and certifications.

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III. Section 8 Renewal Authority

A. Summary of Section 211 as It Relates to the Demonstration Program

The Section 8 renewal authority and its implementation are fully described in Housing Notice H 96-89, dated October 15, 1996. The renewal authority, as it relates to the Demonstration Program, is summarized below.

The FY 1997 renewal authority limits HAP contract renewals of most Section 8 project-based assistance contracts expiring in FY 1997 to 120% of Fair Market Rents and authorizes participation in an optional Demonstration Program by owners with properties that have FHA-insured mortgages whose rents are subject to the required reduction. The Demonstration Program will explore approaches to restructuring the debt secured by these properties while creating the least disruption to tenants, owners and communities.

B. Renewals of Section 8 Contracts With Rents Currently Above 120% of Fair Market Rents (FMR)

In general, owners of FHA-insured multifamily projects with Section 8 contracts that expire in FY 1997 and whose rents in the aggregate exceed 120% of FMR, have two options for continuing in the Section 8 program:

(1) They can request that the contract be renewed for one year at gross rents, in the aggregate, not to exceed 120% of FMR; or

(2) They can participate in the Demonstration Program.

"FMR" are the Fair Market Rents (FMR) for the Section 8 Housing Assistance Payments Program. They are provided for specific geographic areas of the country, for dwelling units of varying sizes and are published in the Federal Register at least annually.

"In the aggregate" means that the comparison of Section 8 rent to FMR is examined not unit-by-unit but for the Section 8-assisted units for the project as a whole. Specifically, the total rent revenue at 100% occupancy for the Section 8-assisted units in the project using current gross rents (contract rents plus the utility allowance, if applicable) must exceed the total rent revenue at 100% occupancy for the Section 8-assisted units in the project using 120% of the FMR for each unit.

Owners who choose Option (1) should refer to Housing Notice H 96-89 dated October 15, 1996, which describes in detail the terms under which HUD will provide one-year extensions for expiring Section 8 contracts and to the memorandum from Assistant Secretary

for Housing—Federal Housing Commissioner dated November 1, 1996, entitled “Clarifications of Procedures for Project-Based Section 8 Contracts Expiring in Fiscal Year 1997.”

Owners who select Option (2) should refer to the discussion in Sections IV. to IX. for further guidance.

IV. Demonstration Program

A. Purpose/Goals

The purpose of the Demonstration Program is to test approaches that retain the critical affordable housing resource represented by the supply of FHA-insured Section 8 assisted housing and maintain it in good physical and financial condition, while at the same time reducing the cost of the ongoing Federal subsidy. In carrying out the Demonstration Program, HUD will work with willing owners and lenders to reduce both Section 8 rents and operating expenses to true market levels, and also provide for the project's capital improvement needs.

The Demonstration Program will attempt to minimize involuntary displacement of tenants, adverse tax consequences to owners, and adverse effects on neighborhoods and communities, to maintain existing affordable housing stock in a decent, safe, and sanitary condition, and to encourage responsible ownership and management of property, in the least costly fashion. In determining how best to restructure a project, HUD and the owner will look for ways to balance these competing goals.

B. Eligible Projects

1. General Eligibility

For a project to be eligible for the Demonstration Program, the owners must agree to participate. The projects must be subject to an FHA-insured mortgage and supported by project-based Section 8 HAP contracts with rent levels which, in the aggregate, exceed 120% of FMR. Preference will be given to projects with contracts expiring in FY 1997.

2. Projects with Mix of Assisted and Unassisted Units

A project will be eligible for the Demonstration Program regardless of whether all or only some of the units in the project are covered by a project-based Section 8 HAP contract.

3. Projects with Multiple Section 8 Contracts

A project with multiple Section 8 contracts, one or more of which expires in FY 1997 and meets the requirements for the Demonstration Program, is

eligible to participate in the Demonstration Program, and will also be given preference over other projects whose contracts expire after FY 1997.

4. Projects with Public Financing

A project with primary financing that was provided by a public agency and is FHA-insured and that has a HAP contract expiring in FY 1997 is eligible to participate in the Demonstration Program with the consent of the appropriate Housing Finance Agency and the owner.

C. Ineligible Projects

1. Projects without FHA-Insured Loans

A project that does not have an FHA-insured loan will not be eligible to participate in the Demonstration Program. Some examples include: (i) A project whose FHA-insured loan has been assigned to HUD (ii) a project that is HUD-owned, (iii) a project financed solely with conventional financing, or (iv) a project with a direct HUD loan.

2. Projects that Fail to Meet HQS Standards

A project that is otherwise eligible to participate in the Demonstration Program will be deemed ineligible if the project contains units which fail to meet Housing Quality Standards (HQS) at contract expiration and the owner has received adequate notice thereof and has been given the opportunity to cure HQS deficiencies in accordance with Chapter 6 of HUD Handbook 4350.1, Multifamily Asset Management and Project Servicing.

3. Disqualified Owners

HUD also will not permit the owner to participate in the Demonstration Program if HUD determines that the owner of the multifamily housing project has engaged in materially adverse financial or managerial actions or omissions with regard to the project (or with regard to other similar projects if HUD determines that such actions or omissions constitute a pattern of mismanagement that would warrant suspension or debarment by HUD). Material adverse financial actions or omissions are any action or omission which lead to either owner default (monetary or technical), or a violation of one or more of the contractual obligations under the project's Regulatory Agreement or Section 8 HAP Contract. Violations may include, but are not limited to, submission of false statements or certifications to HUD, diversion of project funds, unauthorized distributions, and documented project mismanagement. HUD may renew the

contract of a disqualified owner if the project is sold to a qualified purchaser.

D. Transfer of Projects Disqualified From the Demonstration Program

When an owner or purchaser that is ineligible for the Demonstration Program for reasons described in Section IV.C. 2. and 3. wishes to voluntarily sell or transfer the property, the procedures that should be followed to facilitate the voluntary sale or transfer are described in Section V.H. To facilitate a transfer to a qualified purchaser, HUD may renew and transfer assistance that has not been renewed in the case of disqualified projects.

E. Demonstration Approaches/Underwriting

This section sets forth the approaches by which projects in the Demonstration Program will be restructured and describes the underwriting procedures to be employed.

1. Mandatory Demonstration Approaches

Under the Demonstration Program, HUD must utilize one or more of the following demonstration approaches (the “Mandatory Demonstration Approaches”) with respect to each eligible project: (a) Mortgage Restructuring, (b) Debt Forgiveness, or (c) Budget-Based Rents. Other demonstration actions may be used with one or more of the Mandatory Demonstration Approaches.

HUD will determine which of the Mandatory Demonstration Approaches is appropriate based upon, among other things, a calculation of the adjusted, i.e., market-based, net operating income (“NOI”) generated by the applicable project. In those cases in which the NOI is positive, the Mortgage Restructuring or Debt Forgiveness approaches generally will be used. If the NOI is negative, the Budget-Based Rents approach generally will be used.

Further, HUD will determine what constitutes the Supportable Debt by applying a 1.10 or greater debt service coverage ratio, at the interest rate and term approved by HUD, to the adjusted NOI. HUD may require that the term and/or interest rate on the first mortgage loan be modified, subject to the consent of the mortgagee.

The Supportable Debt may be adjusted, as necessary, to provide the minimum Owner's Distribution, as described in Sections IV.E.1.a.(3) and IV.E.1.b.(2), and/or to accommodate the payment of debt service on a rehabilitation loan. The Supportable Debt may, at HUD's option, also be adjusted if the security for the existing

FHA-insured loan includes vacant land or other non-income producing assets with additional market value.

a. Mortgage Restructuring. Under the Mortgage Restructuring approach, the existing FHA-insured mortgage loan is divided into two parts: (i) A performing first mortgage loan, and (ii) a second mortgage loan payable out of Net Cash Flow.

In most instances, the Mortgage Restructuring shall be accomplished by a partial or full prepayment of the existing FHA-insured mortgage loan.

(1) *Supportable First Mortgage Loan.* The amount of the unpaid principal balance ("UPB") of the supportable first mortgage loan after restructuring shall equal the Supportable Debt. The term Restructured First Mortgage as defined in this section is meant to be used only as a means of sizing the Second Mortgage Loan. It is not to be confused with the Supportable Debt, which is the amount of the adjusted, performing first mortgage loan. The Restructured First Mortgage Loan shall equal the Supportable Debt *plus* (i) All contributions made by the owner (and the owner's partners/investors) in connection with the restructuring, as determined by HUD, and (ii) all excess funds in the project's reserve for replacement account, and (iii) all funds in the project's residual receipts account and any other escrows and reserves, as determined by HUD, *minus* (ii) the rehabilitation costs approved by HUD, and (iii) the transaction costs approved by HUD.

(2) *Second Mortgage Loan.* Unless otherwise required by HUD, the initial unpaid principal balance of the second mortgage loan will equal:

(a) The outstanding balance of the existing FHA-insured mortgage loan(s); *minus*

(b) The amount of the Restructured First Mortgage. Unless otherwise required by HUD, the second mortgage loan will bear interest at a rate not to exceed the long term applicable Federal rate, as set forth pursuant to section 1274(d) of the Internal Revenue Code of 1986 (26 U.S.C. 1274(d)). Principal and interest on the second mortgage loan will be payable out of Net Cash Flow (discussed below), and unpaid interest will accrue. The second mortgage loan will be due upon the sale of the project or the refinancing of the first mortgage loan. Other terms and conditions of the second mortgage loan will be established in the restructuring process. HUD may, at its option, forgive, extend, or allow the assumption of all or a part of the second mortgage loan.

(3) *Use of Net Cash Flow.* For purposes of the Mortgage Restructuring

approach, "Net Cash Flow" means that portion of the NOI that remains after the payment of all required debt service payments on the first mortgage loan. Net Cash Flow shall be applied as follows:

First, to payment to the holder of the first mortgage loan of any past due principal or interest, and required escrows and reserves, on such mortgage loan; *second*, to the extent of the remaining Net Cash Flow and after the owner has met the maintenance standards required by HUD, to payment to the owner of an annual owner's distribution of up to \$25 per unit per month (the "Owner's Distribution") and, if applicable, to payment of an additional equity distribution to the owner equal to a cumulative 10% on any new cash equity invested by the owner in the project (the "New Equity Distribution") (Note: the proceeds from the sale of low-income housing tax credits ("LIHTCs"), and the balances of any residual receipts accounts and capital reserves, are excluded from consideration for purposes of determining the amount of the New Equity Distribution); and *third*, to the extent of the remaining Net Cash Flow, to be distributed equally between the owner and HUD. In the event of new equity investment by the owner in connection with a restructuring, HUD may waive some or all of the distribution of cash flow to HUD.

(4) *Funding Rehabilitation Costs.* Rehabilitation costs will be financed with funds available in the project's residual receipts account and excess funds in the project's reserve for replacements account, as of the date of the Mortgage Restructuring. (Use of excess funds in the reserve account will be determined by the Demonstration Manager and will be net of funds required for the initial deposit to that account.) If rehabilitation costs exceed the amount of such available funds, the rehabilitation costs may be funded by (1) a contribution of cash equity from the owner's partners/investors, (2) the proceeds of a non-FHA-insured rehabilitation loan, and/or (3) to the extent that other sources of funds are unavailable, through a loan or grant from HUD.

b. Debt Forgiveness. The Debt Forgiveness approach will be used, for good cause and upon request by the owner, to forgive a certain portion of the outstanding balance of an existing FHA-insured loan. This approach shall be accomplished through a partial or full prepayment of the existing FHA-insured mortgage loan. Under this approach, the owner may choose to keep the reduced FHA-insured mortgage loan in place, or refinance such loan with new debt and/

or new equity. HUD will consider the owner's proposals that address how the forgiven debt shall be treated.

(1) Amount of Debt Forgiveness. The amount of the debt that will be forgiven pursuant to the Debt Forgiveness Approach is equal to the *lesser* of (a) the maximum amount of debt forgiveness authorized under the 1997 Appropriations Act, as described in Section IV.E.1.b.(1) (a), and (b) the amount of debt forgiveness computed under the formula described in paragraph (b), below, of this Section IV.E.1.b.(1).

(a) *Statutory Maximum Amount of Debt Forgiveness.* Under the HUD FY 1997 Appropriations Act, the maximum amount of debt forgiveness is limited to that portion of the existing FHA-insured debt that exceeds the "market value" of the applicable project. The project's "market value" will be determined based upon an appraisal of the project's as-is value prepared in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP). The appraisal will take into consideration, among other factors, the current market rents for unsubsidized units in the local market area, the project's current operating expenses, any necessary reserves for long term capital replacements, any necessary rehabilitation costs (see Section IV.E.2.b.(1)(c)), and any anticipated costs relating to the transition of the project to market rents.

(b) *Formula for Computation of Debt Forgiveness Subject to Statutory Maximum.* (i) *If the FHA-insured mortgage loan will be refinanced with non-FHA-insured financing,* the amount of debt forgiveness under this formula, unless otherwise required by HUD, will be:

(1) The sum of (a) the outstanding balance of the existing FHA-insured mortgage loan(s), (b) the rehabilitation costs approved by HUD, and (c) the transaction costs approved by HUD; *minus*.

(2) The sum of (a) the UPB of any new financing(s) approved by HUD, (b) all contributions made by the owner (and the owner's partners/investors) in connection with the restructuring, as determined by HUD, and (c) all excess funds in the project's reserve for replacement account, all funds in the project's residual receipts account, and any other escrows and reserves, as determined by HUD.

(ii) *If the FHA-insured mortgage loan is retained or refinanced with another FHA-insured loan,* the amount of debt forgiveness under this formula, unless otherwise required by HUD, will equal:

(1) The sum of (a) the outstanding balance of the existing FHA-insured mortgage loan(s), (b) the rehabilitation costs approved by HUD, and (c) the transaction costs approved by HUD; *minus*

(2) The sum of (a) the Supportable Debt (if the existing FHA-insured loan is retained) or the UPB of the new FHA-insured financing(s), (b) all contributions made by the owner (and the owner's partners/investors) in connection with the restructuring, as determined by HUD, and (c) all excess funds in the project's reserve for replacement account, all funds in the project's residual receipts account, and any other escrows and reserves, as determined by HUD.

The formula for computing the amount of debt forgiveness may be further adjusted, at HUD's option, if the security for the existing FHA-insured loan includes vacant land or other non-income producing assets with additional market value.

(2) Use of Net Cash Flow. For purposes of the Debt Forgiveness approach, "Net Cash Flow" means that portion of the NOI that remains after the payment of all required debt service payments on the first mortgage loan and on the subordinate loan(s), if any. Net Cash Flow shall be applied as follows: *First*, to payment to the holder of the first mortgage loan and of any subordinate loans of any past due principal or interest, and required escrows and reserves, on such mortgage loan; *second*, to the extent of the remaining Net Cash Flow and after the owner has met the maintenance standards required by HUD, to payment to the owner of an annual owner's distribution of up to \$25 per unit per month (the "Owner's Distribution") and, if applicable, to payment of an additional equity distribution to the owner equal to a cumulative 10% on any new cash equity invested by the owner in the project (the "New Equity Distribution") (Note: the proceeds from the sale of low-income housing tax credits ("LIHTCs"), and the balances of any residual receipts accounts and capital reserves, are excluded from consideration for purposes of determining the amount of the New Equity Distribution); and *third*, to the extent of the remaining Net Cash Flow, to be distributed equally between the owner and HUD. In the event of new equity investment by the owner in connection with a restructuring, HUD may waive some or all of the distribution of cash flow to HUD.

(3) Funding of Rehabilitation Costs. *If the FHA-insured mortgage loan will be refinanced with non-FHA-insured*

financing, the HUD approved rehabilitation costs will be financed with funds available in the project's residual receipts account and excess funds in the project's reserve for replacements account, as of the date of the Debt Forgiveness. If the rehabilitation costs exceed the amount of such funds, the rehabilitation costs may be funded by (a) a contribution of cash equity from the owner's partners/investors, and/or (b) the proceeds of the non-FHA-insured refinancing loan, and (c) to the extent that other sources of funds are unavailable, through a loan or grant from HUD.

If the FHA-insured mortgage loan is retained or refinanced with another FHA-insured loan, the HUD approved rehabilitation costs will be financed with funds available in the project's residual receipts account and excess funds in the project's reserve for replacements account, as of the date of the Debt Forgiveness. If the rehabilitation costs exceed the amount of such funds, the rehabilitation costs may be funded by (1) a contribution of cash equity from the owner's partners/investors, (2) the proceeds of a non-FHA-insured rehabilitation loan, (3) the proceeds of an FHA-insured rehabilitation loan, and/or (4) to the extent that other sources of funds are unavailable, through a loan or grant from HUD.

For owners who want to refinance the original FHA-insured loan, mortgage insurance from the following FHA programs may be provided:

(a) Section 223(f), acquisition and refinance with limited renovations—loan to value limit of 85 percent; or
(b) Section 223(a)(7), refinance of an insured loan to lower the interest rate and to fund rehabilitation costs—loan limit is up to the original insured principal amount.

c. Budget-Based Rents. The Budget-Based Rents approach will be used, in limited circumstances, to renew HAP contracts expiring in FY 1997 for a period of up to one year at budget-based rents not to exceed the rent levels in the expiring HAP contract.

(1) Application of Budget-Basing. The Budget-Based Rents approach is intended for projects in which the application of Mortgage Restructuring or Debt Forgiveness alone is infeasible. It is anticipated that the Budget-Based Rents approach will be used for the following types of projects:

(a) If the project has a negative adjusted NOI, that is, the adjustment of rents to market levels would not enable the project to pay its reasonable and necessary operating expenses. Reasonable operating expenses, for

these purposes, will not include the Owner's Distribution or New Equity Distribution.

(b) If the project's market rents are higher than both 120% of the applicable FMRs and the gross rents (HAP contract rents plus any applicable utility allowance amounts), and restructuring may result in the displacement of tenants.

(2) Preference for Unique Projects. HUD may give a preference to processing under the Budget-Based Rents approach to certain unique projects, such as those designated for occupancy by elderly families and those located in rural areas.

(3) Calculation of Budget-Based Rents. Under the Budget-Based Rents approach, rents will be set at a level sufficient to support the aggregate amount of the applicable project's reasonable operating expenses, provided that such rents do not exceed the rents under the expiring HAP contract.

For purposes of the Budget-Based Rents approach, a project's reasonable operating expenses shall include:

(a) Reasonable and necessary operating expenses, including adequate annual contributions to the reserve for replacements account;

(b) A reasonable return to the owner, based on the Owner's Distribution; and
(c) Debt service payments that remain on the existing FHA-insured mortgage loan after principal reduction, if any.

The amount of the reasonable operating expenses (and contributions to the reserve for replacements account) will be determined based upon an appraisal of the project prepared in accordance with the USPAP and a physical needs assessment.

The rents set under the Budget-Based Rents Approach will be reevaluated each year prior to any further renewal of the HAP contract. Each annual HAP contract renewal is subject to Congressional appropriations.

(4) Funding of Rehabilitation Costs.

Under the Budget-Based Rents approach, the HUD approved rehabilitation costs will be financed with funds available in the project's residual receipts account and excess funds in the project's reserve for replacements account, as of the date the Budget-Based Rents are implemented. If the rehabilitation costs exceed the amount of such funds, the rehabilitation costs may be funded by a contribution of cash equity from the owner's partners/investors. For projects with a negative NOI at market rents, HUD may supplement the funds available for rehabilitation with a grant of up to \$5,000 per unit, which amount may be

increased in extraordinary circumstances.

2. Project Underwriting

a. Purpose. The purpose of demonstration project loan underwriting is to reduce annual section 8 contract renewal costs that result from subsidizing rents at above market levels. Projects in the Demonstration Program will be analyzed and restructured to bring their rents and expenses in line with the rents and expenses that are comparable to unassisted units in the local market area. The majority of projects will continue to receive project-based section 8 assistance *at those market levels* through one-year contract renewals, subject to annual appropriations. At the same time, FHA-insured first mortgages will be reduced to reflect changed project income.

b. Method. HUD will first estimate a project's net operating income (NOI) by deducting operating costs, including reserves for replacement, from market rents. The NOI will be used to determine the Supportable Debt; that debt may be adjusted downward to accommodate the cost of scheduled repairs and to provide the minimum Owner's Distribution. HUD will determine the amount of first mortgage principal reduction by subtracting the supportable mortgage and other sources of funds from the unpaid principal balance of the original mortgage.

For project loans restructured by HUD, project underwriting necessary for restructuring will be the responsibility of the Demonstration Manager, operating most often from selected HUD field offices and assisted by a Due Diligence Contractor. The Due Diligence Contractor will contract for appraisals, Physical Needs Assessments and any other reports as may be required by HUD.

Appraisals must meet the standards and procedures of the Uniform Standards of Professional Appraisal Practice (USPAP), published by the Appraisal Standards Board of The Appraisal Foundation, as modified by HUD. The appraisal will be the basis for determining market income and expenses.

(1) *Determination of Adjusted Net Operating Income.* The adjusted Net Operating Income (NOI) will be used to help determine which Demonstration Approach should be employed with respect to a particular project and to determine the size of the Supportable Debt. Computation of the adjusted Net Operating Income will require an analysis of the estimated income and expenses of each project after adjustment to market levels.

(a) *Estimation of Income.* To estimate the total income of a project, HUD will analyze: (a) The expected rental revenues to be generated from operation of the project at market rents; (b) the anticipated vacancy rate for the project; and (c) any other income (e.g., income from laundry and parking facilities) that is expected to be generated by the project. The determination of market rent will assume the project has been rehabilitated to meet the requirements of the Physical Needs Assessment as described in Section IV.E.2.b.(1)(c). Market rents, for the purpose of underwriting, are the rents achievable in the immediate vicinity for comparable unassisted units in good condition.

(b) *Estimation of Expenses.* For the purposes of project underwriting, total expenses will include: (1) Reasonable operating expenses; and (2) contributions to the reserve for replacement account.

(i) *Operating Expenses.* It is the intent of this Demonstration Program that project operations be reevaluated in order to reduce operating costs where possible. HUD will analyze ordinary and necessary operating expenses for the project. The analysis will consider, among other factors, historical operating statements, owner input, and standard expenses by type and market. Project expenses will be compared to FHA-insured mortgage portfolio averages, other market data and industry standards published regularly by entities, including, but not limited to, the Institute for Real Estate Management (IREM).

(ii) *Reserves for Replacement.* An allowance for scheduled contributions to the reserve for replacement account to fund ongoing capital needs will be included under gross expenses. The amount will be based on an inspection of the building and a schedule of improvements included in the Physical Needs Assessment.

(c) *Determining the Level of Required Physical Improvements.* In determining the level of physical improvements a property requires, HUD will direct a Due Diligence Contractor to inspect the project and complete a Physical Needs Assessment.

Participation in the Demonstration Program will not affect the responsibility of owners who undertake a rehabilitation program to comply with the accessibility requirements described at 24 CFR 8.23, Alterations of existing housing facilities, and 8.24, Existing housing programs, as applicable.

The Physical Needs Assessment will be done in accordance with the Fannie Mae (FNMA) Physical Needs Assessment Guidance to the Property

Evaluator for the Delegated Underwriting and Servicing (DUS) Program, as may be modified by HUD. This guide instructs the property evaluator to examine the condition of the building, including all its systems and components, and provide (1) a description of significant repair and replacement needs, both immediate and long-term, and (2) a description of any significant issues affecting tenants' health and safety.

In addition, the Demonstration Manager will direct the Due Diligence Contractor to estimate the cost of any improvements necessary to enable the project to compete with similar but unsubsidized projects in its local market. The intent of physical improvement is not to reposition the property in the market place, but to create a product that is consistent with its original position in the market. In determining the amount of rehabilitation to be done, the Demonstration Manager will balance the need to enable the project to compete with similar but unassisted projects in its local market with the need to keep the rents as affordable as possible. The result should be a marketable project that competes on rents rather than on amenities.

(d) *Determination of Net Operating Income.* Net Operating Income (NOI) is the amount of project income that remains after all operating expenses, including the contribution to the replacement reserve, have been estimated. It is calculated by deducting total expenses from total income.

(2) *Owner's Distribution from Net Cash Flow.* In exchange for the payment it makes to reduce principal on the original mortgage, HUD will require owners to share Net Cash Flow dollar-for-dollar with HUD. As an incentive to maintain the property, however, the owner may receive an annual distribution of 100% of Net Cash Flow up to a ceiling equal to \$25 per unit per month ("Owner's Distribution"); and also, where appropriate, a New Equity Distribution.

The Owner's Distribution, in all cases, will be subordinate to the first mortgage and will be paid only to the extent that the cash flow to pay it is available. Any unpaid distributions will not accrue. Further, the Owner's Distribution will be held in an escrow account and paid to the owner only after HUD or its representative inspects the project and finds that all units are in substantial compliance with maintenance standards set forth by HUD as part of the restructuring agreement. Any owner who fails to deposit all Net Cash Flow

to the retention account will waive its rights to future distributions.

In sizing the amount of supportable debt, HUD will make an adjustment so that Net Cash Flow on a pro forma basis is not less than \$25 per unit per month. The adjustment will be made as follows:

If Net Cash Flow is equal to or greater than or equal to \$25 dollars per unit per month, the distribution will not be deducted from debt service for the purpose of sizing the mortgage.

If Net Cash Flow is less than the distribution of \$25 per unit per month, the difference between the distribution and Net Cash Flow will be deducted from the amount of projected debt service, thus reducing the size of the supportable loan and insuring the availability of the Owner's Distribution.

The Owner's Distribution must be earned and maintained through efficient management. It is not a guarantee. Adjustments to debt service and cash flow will be made only at initial underwriting; future adjustments to Owner's Distribution to offset rising operating costs will not be allowed by HUD. HUD, however, may make future adjustments to the \$25 per unit per month ceiling to respond to inflation.

V. Additional Demonstration Program Matters

A. Required Consents

The implementation of one or more of the Mandatory Demonstration Approaches shall be subject to receipt of all necessary third party consents. The owner and/or HUD as appropriate, shall be responsible for obtaining the consents from necessary parties. Guidance on projects with Ginnie Mae Mortgage Backed Securities will be provided in the future.

B. Additional Restructuring Tools

In addition to the mandatory demonstration approaches described above, HUD has authority to take any of the following actions with respect to each project in the Demonstration Program:

1. Full or Partial Prepayment

With the prior consent of the insured mortgagee, HUD may choose to make a full or partial prepayment to the holder of the FHA-insured loan prior to the date of any defaults.

2. Sale or Transfer of HUD's Economic Interest

HUD may enter into contracts either to purchase reinsurance or to transfer to third parties HUD's economic interest in contracts of insurance or insurance premiums paid. HUD may not elect to do this for more than 5,000 units in the

Demonstration Program during FY 1997. Any contract HUD executes under this paragraph shall require that associated units be maintained as low-income units for the life of the mortgage(s), unless HUD has waived this provision for good cause.

3. Credit Enhancement

HUD may provide new FHA multifamily mortgage insurance, contract for reinsurance or provide other credit enhancement alternatives. HUD may also retain the existing FHA insurance on a restructured supportable first mortgage loan, or permit the use of the multifamily risk-sharing mortgage programs, as provided under section 542 (b) and (c) of the Housing and Community Development Act of 1992 (Pub. L. No. 102-550; 106 Stat. 3794; 12 U.S.C. 1707 note), to the extent that appropriations or housing units are available. Unless otherwise agreed to by the project owner, not more than 25% of the units with expiring Section 8 contracts, in the aggregate, may be restructured during FY 1997 without FHA insurance.

4. Tenant-Based Section 8

With the consent of the owner of the project, and after consulting with tenants, HUD may substitute tenant-based Section 8 assistance for some or all of the units covered by a project's Section 8 rental assistance contract. This Section 8 tenant-based assistance, however, can be provided only where HUD has determined and certified that there is adequate, available, and affordable housing within the local area and that tenants will be able to use the Section 8 tenant-based assistance successfully.

HUD may make this substitution for not more than 10% of the aggregate number of units in projects restructured during any one fiscal year.

5. Removal of Restrictions

HUD, with the owner's consent and other parties' consent, as necessary, and after consulting with the tenants, may remove, modify or agree to the removal of any mortgage, regulatory agreement, project-based assistance contract, use agreement, or restriction that had previously been imposed or required by HUD which would interfere with the ability of the project to operate without above-market rents. HUD may also remove any limitations previously imposed by HUD with respect to the distribution of a project's Net Cash Flow. It is HUD's intention after restructuring to eliminate the limited dividend distribution requirements, should they be currently required, and

associated collection of residual receipts.

6. Use of Accumulated Residual Receipts

HUD may require the owner to apply any accumulated residual receipts towards effecting the purposes of the Demonstration Program.

7. Payments by HUD

HUD may enter into such agreements, provide such concessions, incur such costs, make such grants (including grants to finance approved rehabilitation costs) and other payments, and provide other valuable consideration, as HUD determines are reasonably necessary in order to enable owners, lenders, servicers, third parties and other entities to participate in the Demonstration Program.

C. Structures to Address Tax Liability

Owners of projects undergoing restructuring may be exposed to tax consequences associated with cancellation of debt, and taxation of capital gains or ordinary income. It is the expressed desire of Congress that the Demonstration Program minimize, if possible, tax consequences to owners. Absent specific legislative relief, HUD will accept proposals from owners which include any tax motivated structure deemed by the owner to be acceptable to the Department of the Treasury that will limit or defer tax liability and which will not adversely affect a project's financial integrity or management.

D. Sources and Uses of Funds Under the Demonstration Program

1. Sources of Funds

The funds which HUD anticipates using in connection with an owner's participation in the Demonstration Program may include the following:

- a. Funds in the project's residual receipts account;
- b. Excess funds in the project's reserve for replacements fund;
- c. New project financing, either FHA-insured or non-FHA-insured obtained by the owner;
- d. New equity to be contributed by new or existing owners and partners/investors (including additional capital contributions);
- e. New equity raised from a proposed sale or other disposition of the project (100% of the purchase price relating to any sale or other disposition must be supported by a third party USPAP appraisal);
- f. New equity raised from the sale of low-income housing tax credits;

g. To the extent other sources of funds are not available, full or partial mortgage prepayments from HUD;

h. To the extent required, as determined by HUD, direct loans or grants from HUD; and

i. With respect to projects with Section 8 contracts expiring after FY 1997, the capitalized value of Section 8 project-based assistance in excess of market rents.

2. Uses of Funds

Subject to the approval of HUD and, where required, to mortgagee approval, the permitted uses of such funds will include the following:

a. Reduction or cancellation of existing FHA-insured debt and, where appropriate, other debt on the property approved by HUD, including a payment to an escrow account to be used for such purposes;

b. Payment of delinquent taxes, insurance premiums and/or other amounts owing with respect to the project, including amounts necessary to remove liens or judgments;

c. Payment of reasonable rehabilitation, renovation, maintenance or construction expenses necessary to meet the requirements of the Physical Needs Assessment;

d. Payment of reasonable legal and other transactional costs (including title, survey, appraisals, etc.);

e. Payment of reasonable fees and costs associated with obtaining new financing (including prepayment penalties, discounts, etc.);

f. Payments of reasonable oversight fees for nonprofits to cover reasonable pre-development costs; and

g. Relocation costs.

E. Affordability Requirements

1. Projects with Renewed or New HAP Contracts

Unless otherwise waived by HUD for good cause, each project owner participating in the Demonstration Program that is provided with a new or renewed HAP contract (other than any temporary renewal provided during the Demonstration Program processing period) will be required for a period of up to 20 years from the date of closing of the Demonstration Restructuring, to accept each offer by HUD to renew the project's HAP contract. The terms and conditions of the HAP contract renewals shall be set forth in: (a) The Restructuring Commitment (as described in Section VI.G.) between HUD and the owner, and/or (b) an amendment to the renewed HAP contract. All such renewals shall be subject to annual Congressional appropriations.

2. Projects without Renewed or New HAP Contracts

Unless otherwise waived by HUD for good cause, with respect to any project participating in the Demonstration Program that is not provided with a new or renewed HAP contract, the owner and HUD shall execute a Use Agreement in the same form as that described in Section V.E.1.; *provided, however*, that such Use Agreement shall also require the owner to accept Section 8 tenant-based certificates or vouchers from the project's existing tenants, to the extent such tenants choose to remain in the project, for a period, in the aggregate, of up to 20 years after the Demonstration Restructuring closing for the project occurs.

3. Long-Term Project Affordability

When the Mortgage Restructuring or Debt Forgiveness approaches are used, the project will be required to comply with affordability requirements established by HUD. Unless otherwise agreed to by HUD, the affordability requirements shall remain in effect for a minimum of 20 years from the date the Mortgage Restructuring or Debt Forgiveness is made effective. Affordability requirements shall be incorporated into a recorded Use Agreement.

If statutorily permitted by the section of the National Housing Act under which the mortgage is insured, the affordability requirements will be the same as those of the Low-Income Housing Tax Credit program, namely, the project shall be required to maintain: (a) At least 20% of the units in the project with families whose adjusted income does not exceed 50% of the area median income, or (b) at least 40% of the units in the project with families whose adjusted income does not exceed 60% of the area median income. Affordability requirements may be waived by HUD for good cause.

4. Affordability Waiver Authority for Designees

None of the affordability requirements in this Section V.E. may be waived by a Designee, except with express prior written approval of HUD.

F. Tenant Protections

If the owner has provided the required notice, any eligible family residing in a project-based Section 8 assisted unit that is covered by an expiring contract that is not renewed will be offered tenant-based assistance as provided in Housing Notice H 96-89 prior to the date on which the project-based HAP contract expires. If the owner chooses not to request a renewal

and if proper notice was not given, the owner must permit the tenants assisted by the expiring Demonstration Agreement to remain in their units for the full notice period without increasing the tenant portion of the rent under the Demonstration Agreement. Public housing authorities will be allocated additional HAP contract authority on an annual basis in order to assure that families so affected will be provided tenant-based Section 8 contracts. Public housing authorities will be responsible for administering the issuance of these tenant-based Section 8 contracts.

G. Funding and Unit Limitations

The funding limitation for the Demonstration Program is set at \$40,000,000. This amount is comprised of \$30,000,000 made available under section 210 of the Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act, 1996, appropriated to remain available through September 30, 1997 and \$10,000,000 appropriated under section 212 of the FHA Multifamily Demonstration Authority HUD 1997 Appropriations Act, appropriated to remain available until September 30, 1998. Total funds available are net of commitments made in the implementation of the FY 1996 Portfolio Reengineering Demonstration Program.

The \$40,000,000 shall include any credit subsidy costs associated with providing direct loans or mortgage insurance as well as costs of modifying and restructuring loans held or guaranteed by the Federal Housing Administration.

H. Transfer of Projects

When the owner of a project in the Demonstration Program voluntarily transfers the property, HUD shall facilitate the transfer to tenant organizations, tenant-endorsed nonprofit organizations or public agency purchasers which are qualified to own and manage multifamily properties. HUD will give final approval to the selected purchaser upon the completion of the following selection process by the owner, and certification by the owner that this process has been followed. To facilitate a transfer to a qualified purchaser, HUD may transfer existing Section 8 project-based assistance to the purchaser or transferee. In the transfer of physical assets, demonstration project owners must follow the process below:

1. The owner shall notify potential qualified tenant organizations and experienced tenant-endorsed nonprofit organizations or public agency

purchasers of the availability of the project for sale by:

- a. Mailing notices to eligible organizations;
 - b. Placing notices in the major local newspaper(s) in the jurisdiction in which the project is located;
 - c. Mailing notices to clearinghouse networks; or
 - d. Using any other means of notification which HUD determines would be effective to notify potential qualified purchasers of the sale of the property.
2. For the 90-day period beginning on the date of receipt by HUD of a notice of intent to transfer physical assets, the owner may accept a bona fide offer only from:
- a. A resident council intending to purchase the project and retain it as rental housing, certifying that it has the support of a majority of tenants;
 - b. A tax-exempt nonprofit organization that has a record of service over at least five years of providing quality low-income housing and which has the support of a majority of tenants; or
 - c. A qualified public agency.

3. During this 90-day period, although offers may be made by other prospective purchasers, these offers may not be accepted by the owner until the expiration of the 90-day period. If no bona fide offer to purchase the project is made by any of these groups and accepted by the owner at the end of the 90-day period, which period may be extended by HUD for good cause, the owner may accept an offer to purchase the project from any qualified purchaser.

VI. Demonstration Process

This section explains the Demonstration Program process that will be followed by HUD and project owners for eligible project loans. The Demonstration Program provides for both Designee Processing and Alternate Processing as well as direct HUD processing of Demonstration project loans.

In the case of Designee processing, initial intake and referral to the appropriate Designee is the responsibility of HUD and thereafter the Designee is responsible for project management. (See Section VII. for further information on Designee Processing.)

Owners seeking new first mortgage financing may bypass the majority of the HUD restructuring process and have the qualified lender perform the necessary underwriting and due diligence activities. In cases where the FHA loan is being retained, HUD may request the

mortgagor or loan servicer to perform certain due diligence and underwriting of activities under certain conditions. (See Section VIII.)

The following describes the restructuring process to be implemented directly by HUD.

A. Owner's Request to Participate

To participate in the Demonstration Program, owners with Section 8 contracts due to expire in FY 1997 must complete, execute and return to HUD, no later than 45 days prior to the expiration of their Section 8 contract, a Request to Participate in the Demonstration Program (the Request to Participate). The Request to Participate should be in the form of a letter of interest which includes the name and address of the project and the date the Section 8 contract expires.

Owners with contracts expiring within 45 days of the date of publication of these Guidelines who, therefore, cannot provide the full 45 days of notice, must provide notice to HUD as soon as possible but not later than 45 days from the publication of these Guidelines. If the project has more than one Section 8 contract, the 45 days will be measured from the expiration date of the contract with the earliest expiration.

Owners who do not submit the above Request to Participate on or before the required deadlines will not be eligible to participate in the Demonstration Program, unless compliance with the deadlines is waived by HUD for good cause. This Request to Participate should be addressed to the Director of Multifamily Housing in the HUD field office with jurisdiction over the project.

B. Demonstration Agreement

Within ten business days of HUD's receipt of the owner's Request to Participate in the Demonstration Program, the field office Director of Multifamily Housing will prepare and send to the owner the following:

1. A Demonstration Agreement which:
 - (a) Sets forth the Owner's obligation to proceed in good faith to negotiate a Restructuring Commitment with HUD within 180 calendar days after execution of the Demonstration Agreement;
 - (b) sets forth the Owner's obligation to provide all documents and information reasonably requested by HUD in order to enable the project to participate in the Demonstration Program; and
 - (c) requires the owner to certify that it has provided the notice to the tenants, the Affected Unit of Local Government and the lender(s), as required in Section VI.D.;
2. An Addendum to the

Demonstration Agreement in the form of

a Housing Assistance Payments Demonstration Renewal Contract, the form of which is included as Attachment 3(c) of the Housing Notice H 96-89 dated October 15, 1996 (the HAP Renewal Contract).

3. An attachment containing the name and address of the project, the Section 8 and FHA project numbers, the section of the National Housing Act under which the mortgage is insured, an owner or owner agent contact name, address and telephone and fax numbers, and unit type and rental information, consisting of contract rents, utility allowances, if any, and FMR's.

C. Execution of Demonstration Agreement

In order to participate in the Demonstration Program, the owner will be required to execute and deliver the Demonstration Agreement to the Director of Multifamily Housing in the HUD field office with jurisdiction, no later than 10 business days prior to the Section 8 contract expiration date. This deadline may be extended by the Demonstration Program Coordinator for good cause. HUD will execute the HAP Renewal Contract and Demonstration Agreement only after receipt of owner's evidence that proper notification to project tenants, the Affected Unit of Local Government and project lender(s) has been provided in accordance with Section VI.D.

HUD will assign a Demonstration Program Tracking Number to the project after execution of the Demonstration Agreement.

D. Delivery of Notice to Project Tenants, Affected Unit of Local Government and Lender(s)

Simultaneously with the delivery of the Request to Participate to HUD, the owner shall deliver notice of the owner's intention to participate in the Demonstration Program to: (a) The tenants residing in the project, (b) the chief official of the Affected Unit of Local Government having jurisdiction over the project, and (c) the mortgagee of the project's FHA-insured loan. The "Affected Unit of Local Government" is the smallest unit of general local government with jurisdiction in which the project is located.

Notification to project tenants must be accomplished by delivery of notices to each project tenant and by posting the notice in at least two conspicuous public places in each building for a minimum of three (3) consecutive calendar days. If a tenant organization of project tenants exists which officially represents all tenants, notice may be provided to the tenants' organization

rather than to each tenant individually, but notice must still be posted in all project buildings as described in this paragraph.

The notice to project tenants required under the Demonstration Program shall be in addition to the required one-year notice of Section 8 contract expiration required under the section 8(c)(9) of the United States Housing Act of 1937 and HUD Notice H 96-89.

The notice must also include:

1. A copy of the "Request to Participate" provided by the owner to HUD, including the date of the Section 8 contract expiration;
2. An explanation of tenant protections afforded.
3. A statement that project tenants, the Affected Unit of Local Government and lender(s) have the opportunity to provide written comment. They are particularly encouraged to provide written comments on the project's physical needs and property management.
4. A statement that comments should be sent to the Director of Multifamily Housing in the HUD field office with jurisdiction over the project and that written comments will be accepted for up to 45 days after the date of execution of the Demonstration Agreement.
5. A statement that prior to the start of preparation of the Physical Needs Assessment for the project by a Due Diligence Contractor, a preinspection meeting will be held on site and that up to 3 representatives each, of both project tenants and the Affected Unit of Local Government, and their technical consultants, if any, will be invited to this meeting. It should further indicate that the owner will provide a separate written 10 day notice of this meeting to the project lender(s), project tenants and to the chief official of the Affected Unit of Local Government. Any written comments received by the time of this meeting will be provided to the Due Diligence Contractor responsible for preparing the Physical Needs Assessment. The notice should advise that upon completion of the Physical Needs Assessment, one copy of the Assessment will be provided to the insured lender, project tenants and one copy to the chief official of the Affected Unit of Local Government.
6. A statement that the owner will provide the project lender(s), project tenants and the chief official of the Affected Unit of Local Government with a brief summary of HUD's Restructuring Commitment.
7. A statement that if the owner chooses to appeal the terms of a Restructuring Commitment, the owner will notify the project lender(s), project

tenants and the chief official of the Affected Unit of Local Government in writing concurrently with its submission of the appeal to HUD. It will further advise these parties that they will have 20 days from the date of the appeal submission to provide written comments to HUD.

8. In instances where lender consent is needed, a request that the lender state its willingness to participate in the Demonstration Program.

9. A statement that the Affected Unit of Local Government is encouraged to apprise representatives of the local community and neighborhood of this notice.

Evidence that proper notice was provided must be sent to the Demonstration Manager.

E. Assignment of Restructuring Responsibility

Within 10 business days following HUD's receipt of the executed Demonstration Agreement from the owner, HUD will assign responsibility for the project either to a qualified Designee, whenever possible or, if there is no available Designee for the project location, to a HUD Demonstration Manager. (See Section VII. for Designee Processing.)

In the case of HUD processing, the Demonstration Manager will operate most often out of selected field offices and will be assisted by a Due Diligence Contractor who will contract for appraisals, Physical Needs Assessments and any other reports as may be required by HUD. The Demonstration Manager will be responsible for:

1. Working with the owner, a Due Diligence Contractor, project tenants, project Lender(s), the Affected Unit of Local Government, and others as necessary to accomplish the restructuring;
2. Determining which of the demonstration approaches are appropriate for restructuring the project loan;
3. Negotiating the terms and conditions of a Restructuring Commitment and related documents with the owner; and
4. Coordinating the preparation, processing and closing of the Restructuring Commitment and the related documents.

F. Due Diligence Period

Once the Demonstration Manager or the Designee is selected, the Due Diligence period will commence.

1. Pre-Restructuring Conference with Owner

Promptly following the execution of the Demonstration Agreement by HUD and the owner, the Demonstration Manager will meet with the owner to discuss the owner's views with respect to the appropriate level of debt, market rents, operating costs, capital needs, preference for debt forgiveness, any of the additional restructuring tools listed in Section V.B., and any other related matters. At this conference, the owner's restructuring proposal, if any, may be presented and given initial review.

2. Pre-Inspection Meeting at Project

Prior to the inspection of the property by a Due Diligence Contractor responsible for preparation of the Physical Needs Assessment, a pre-inspection meeting must be held on site. Participants will include, at a minimum, the HUD Demonstration Manager and Due Diligence Contractor, the owner or owner's representative, up to three representatives of the project tenants or their technical consultants, if any, and up to three representatives of the Affected Unit of Local Government. Local HUD field office representatives will also be invited to attend. The owner must provide a minimum of 10 days written notice of the meeting to project tenants, project lender(s), and the Affected Unit of Local Government.

3. Due Diligence/Underwriting

Promptly following the execution of the Demonstration Agreement by HUD, the Demonstration Manager and Due Diligence Contractor will work closely with the owner to obtain the required information and perform the underwriting necessary to negotiate a restructuring commitment. The Demonstration Manager and Due Diligence Contractor will analyze the project's market rents and expenses, determine Net Operating Income, estimate the project's market value, and obtain any other information regarding the financial, physical, environmental, or other condition of the property he/she needs to negotiate a restructuring commitment with the owner.

The owner must cooperate fully with the Demonstration Manager and Due Diligence Contractor during this process and must provide timely access to the property and to project documents as requested. In addition, within 14 calendar days of executing the Demonstration Agreement, the owner may submit to the Demonstration Manager a detailed estimate of project operating costs after restructuring is completed. Failure to cooperate is

grounds for terminating the Demonstration Agreement.

HUD intends to develop additional administrative guidance for determining market rents, operating expenses, the level of rehabilitation required, the use of replacement reserve account balances, and other such matters.

G. Preparation of HUD'S Restructuring Commitment

The Demonstration Manager, using the information produced during the Due Diligence phase of the Demonstration Process, will develop a Restructuring Commitment that utilizes one or more of the mortgage restructuring, forgiveness of debt, or budget-based rents approaches.

The Restructuring Commitment will be presented in writing to the owner and the owner will be provided 30 calendar days to accept the Commitment or to submit a counter proposal to the Demonstration Manager.

Any project rehabilitation or capital improvements financially supported or required by HUD must be processed in accordance with HUD's environmental review requirements in 24 CFR part 50, prior to HUD's presentation of the Restructuring Commitment. All projects must be in conformance with flood insurance purchase requirements, as applicable, in accordance with 24 CFR 50.4(b)(1).

H. Notification of Project Tenants, Affected Unit of Local Government and Project Lender(s)

Upon receipt of the Restructuring Commitment, the owner shall deliver by mail a brief summary of the document to project tenants, the chief official of the Affected Unit of Local Government, and the lender(s), and submit evidence to the Demonstration Manager that proper notification was provided. If an organization of project tenants exists, which officially represents all tenants, notice may be provided to the tenants' organization rather than to each tenant individually. The Affected Unit of Local Government shall be requested to provide this notification to any representatives of local communities and neighborhoods that it chooses to inform.

I. Owner Response to HUD'S Restructuring Commitment

Within 30 calendar days following the owner's receipt of HUD's Restructuring Commitment, the owner must either (i) execute the Restructuring Commitment (without modification) and return it to the Demonstration Manager; or (ii) notify the Demonstration Manager in writing of any modifications to the

Restructuring Commitment that it requests prior to its execution. Should the owner accept the Restructuring Commitment, the execution of the commitment must be accompanied by any required third party consents. For example, these include the consent of the insured mortgagee and the consent of limited partners, if required under the terms of a limited partnership agreement.

J. Modification of Restructuring Commitment

The Demonstration Manager shall, promptly following its receipt from the owner of any modifications to the Restructuring Commitment, work closely with the owner to review and evaluate all such modifications, resolve any issues, and prepare and deliver to the owner a revised Restructuring Commitment which reflects those modifications acceptable to HUD. Final negotiation of a Restructuring Commitment shall occur during a period not to exceed 40 calendar days after the Demonstration Manager's receipt of the owner's modifications, unless extended by HUD for good cause.

K. Issuance of Restructuring Commitment After Modification

Upon receipt of the modified Restructuring Commitment, the owner, only if the changes are substantive and substantial, shall deliver a brief summary of the document to project tenants, the chief official of the Affected Unit of Local Government, and the lender(s) by mail and shall submit evidence to the Demonstration Manager that proper notification was provided. If a tenant organization of project tenants exists, which officially represents all tenants, notice may be provided to the tenants' organization rather than to each tenant individually. The Affected Unit of Local Government shall be requested to provide this notification to any representatives of local communities and neighborhoods that it chooses to inform.

The owner will have 30 days from the date the Restructuring Commitment is delivered by HUD in which to execute that document and return it to HUD. This 30 day period may be extended by the Department.

L. Owner Appeal of Restructuring Commitment (if applicable)

If, for any reason, an owner desires to appeal the modified Restructuring Commitment issued by HUD, an appeal must be submitted in writing to the Director of Multifamily Housing or Director of Housing, in the local field office, within 10 calendar days of the

issuance date of the modified Restructuring Commitment.

The written notice of appeal shall specifically state, in reasonable detail, the issues and bases upon which the owner seeks review. The Department will issue a written determination within thirty (30) calendar days of the date of the appeal.

The owner must notify the project lender(s), project tenants and the chief official of the Affected Unit of Local Government in writing concurrently with its submission of the appeal to HUD. It will further advise that these parties will have 20 days from the date of the appeal submission to provide written comment to HUD. If an organization of project tenants exists, which officially represents all tenants, notice may be provided to the tenants' organization rather than to each tenant individually.

If the appeal process results in a mutually satisfactory conclusion, HUD and the owner will execute a final version of the revised Restructuring Commitment. If HUD denies the owner's appeal, HUD will so notify the owner in writing. Upon such notification, the owner may execute the Restructuring Commitment as last revised by HUD, or may choose not to participate in the Demonstration Program.

In cases where no restructuring agreement is reached and the Demonstration Agreement expires, the owner may request a one-year Contract renewal in accordance with section 211(b) of the HUD FY 1997 Appropriations Act, as implemented by Housing Notice H 96-89. In most cases, the rents under the one-year renewal Contract will be set at 120% of the applicable FMR. Section 211(b) (2) and (3) contain exemptions to the 120% limitation; if the project qualifies for one of these exemptions, rents would be maintained at current levels.

If the owner chooses not to request a renewal, and if the appropriate notice has been provided, HUD will provide tenant-based assistance to all eligible families in accordance with Housing Notice H 96-89.

If the owner chooses not to request a renewal and if proper notice was not given, the owner must permit the tenants assisted by the expiring Demonstration Agreement to remain in their units for the full notice period without increasing the tenant portion of the rent under the Demonstration Agreement.

M. Closing the Restructuring Transaction

Loan closing must occur within 60 days of execution of the Restructuring

Commitment. If necessary for closing, HUD will extend the HAP Renewal Contract by up to 60 calendar days. An additional extension period may be granted by HUD, if closing is delayed due to circumstances beyond the control of the owner. In no case may the HAP Contract be extended for more than 6 months if the Restructuring Commitment has not been executed.

The Demonstration Manager will be responsible for coordinating the closing. Where the restructuring involves new FHA-insured financing, the closing must be completed in accordance with FHA processing requirements.

VII. Designee Selection and Processing

HUD will provide qualified Designees the opportunity to enter into arrangements with HUD for restructuring Demonstration Program projects in their jurisdiction or service area. HUD will select qualified state housing finance agencies, housing agencies or nonprofit entities (Designees) to take responsibility for processing project restructuring under the Demonstration Program.

A. Selection Criteria to Determine Qualified Designees

HUD's selection of qualified Designees will be made based on the criteria listed in the following paragraph. Interested state and local housing participants must submit letters of interest to HUD on or before February 15, 1997, and should include the potential Designee's geographic area of jurisdiction and its qualifications. Applicants who are already approved as FHA risk sharing lenders are not required to submit qualifications. Letters of interest must be accompanied by a letter of support from the Chief Elected Official of the area(s) of jurisdiction. Credentials will be screened and applicants will be selected on or before April 1, 1997. HUD may resolicit public entity applicants on or about April 15, and make selections on or about May 31. HUD will accept late submissions only for areas that have not been assigned a Designee. However, for projects with Section 8 contracts that expire prior to February 15, 1997, on a case by case basis, HUD will assign these projects to Designees who have submitted Letters of Interest prior to February 15, 1997, for specific projects.

Nonprofit Designees will be selected through a formal Request for Qualification (RFQ) process. The RFQ will be published in early 1997.

The selection criteria on which the applicants will be rated are as follows:

1. Demonstrated experience with multifamily loan restructurings;

2. Demonstrated experience in multifamily financing, and asset/property management experience relating to affordable multifamily housing;

3. Demonstrated staff experience and capacity for managing a restructuring process for multifamily projects; and

4. A history of stable, financially sound, and responsible administrative performance.

These selection qualifications may be demonstrated either by the Designee applicant alone or in partnership with other entities with proven experience and capacity in this area. If a team approach is chosen, the Designee applicant must provide evidence of its ability to manage this type of team. Designee applicants are encouraged to develop partnerships with each other as well as with other private and public entities, including: (i) Financial institutions, (ii) mortgage servicers, (iii) the Federal National Mortgage Association, (iv) the Federal Home Loan Mortgage Corporation, (v) Federal Home Loan Banks, (vi) other state or local mortgage insurance companies or bank lending consortia, (vii) nonprofit and for-profit housing organizations.

In its selection, HUD will give preference to qualified Designees that have had positive previous association with specific projects that may seek restructuring.

Once a Designee is selected, it will then be responsible for processing all projects in the Demonstration Program in its area of jurisdiction, although in some circumstances, HUD and the Designee may agree to a more limited initial engagement. The Designee may choose to reject certain projects that represent extraordinary risk, which by mutual agreement can be retained by HUD. In the event the Designee rejects a project, responsibility for that project will be given to the Demonstration Manager. Until and unless a Designee is selected for an area, HUD will act as Designee.

The management plan setting forth the manner in which the Designee will carry out the restructuring must be approved by HUD and will be attached as a provision of the contract to be entered into by the Designee and HUD.

In the event that potential Designees with overlapping jurisdictions express interest and are determined to be qualified, they must first attempt to enter into an agreement as to how projects to be restructured will be allocated. This agreement must be executed by the Chief Elected Official of each jurisdiction. Until such time as agreement is reached, HUD will be responsible for processing

demonstration projects in the affected service area.

In the event qualified nonprofit entities desire to operate in areas where state or local agencies are acting as Designees, the nonprofit will be required to enter into a cooperation agreement with the relevant Designee with jurisdiction prior to participating in restructuring in that jurisdiction. Where more than one nonprofit desires to operate in a single geographic area, HUD will allocate projects based on their qualifications and familiarity with the local market area.

Until such time as qualified Designees are selected for specific areas, HUD will be responsible for Demonstration Program implementation.

B. Alternative Approaches for Designee Participation in the Demonstration Program

Designees may contract with HUD under one of two approaches:

1. Fee for Service With Performance Incentive

a. Compensation Structure. Under this approach, the Designee will be paid on a uniform fee structure, to be established by HUD, which will include both a Base Fee and an incentive fee, called a Bonus Fee, as defined in the contract to be negotiated between HUD and the Designee.

(1) Base Fee. The Base Fee will be earned and paid based on achievement of certain stages of performance as indicated below.

Stages of Performance Criteria on which Base Fee will be earned:

Stage I: Submission of Detailed Business Plan

Submission to HUD of a detailed Business Plan to include:

(i) An outline of the ownership entity, loan documents (and bond documents, if applicable);

(ii) Required third party approvals;

(iii) A completed appraisal meeting the requirements of the Uniform Standards of Professional Appraisal Practice (USPAP), published by the Appraisal Standards Board of the Appraisal Foundation, as modified by HUD, incorporating data on operating expenses available from FHA and entities such as IREM;

(iv) Underwriting analysis including assessment of market rents and operating expenses based on the appraisal, historical operating expenses, and determination of Net Operating Income, supportable financing, proposed principal reduction, rehabilitation financing, and owner input;

- (v) Assessment of rehabilitation needs;
- (vi) Description and rationale for the mandatory demonstration approach being selected;
- (vii) Evidence of proper notification to tenants, Affected Unit of Local Government and lender(s);
- (viii) Summary of comments received in the process and how they were addressed;
- (ix) Environmental issues;
- (x) Litigation issues;
- (xi) Tax issues;
- (xii) Public policy issues;
- (xiii) Written record of inquiries from public officials regarding the restructuring; and
- (xiv) Other issues as provided more specifically in further guidance to be provided by HUD. All information in the Business Plan is to be supported by the findings of the due diligence activities.

Stage II: Executed Restructuring Commitment

Reach agreement on a post-appeal Restructuring Commitment or aggregate Commitments in the case of multiple project restructurings, executed by the Designee and owner within 180 days of the date of the contract between HUD and the Designee that:

- (i) Meets or exceeds net savings to government anticipated by the HUD cost saving model as adjusted and agreed to by HUD to accommodate project financing and public policy needs; and
- (ii) Achieves HUD's public policy objectives to be defined jointly by the Designee and HUD.

Stage III: Closing of the Transaction

Close transaction based on a Restructuring Commitment within 60 days of the execution of the Restructuring Commitment.

(2) Bonus Fee. In addition to the Base Fee for Service, a Bonus Fee would be earned based on the following Bonus Objectives being achieved:

- (a) Amount of Savings to the Federal Government, based on the HUD model for credit scoring;
- (b) Timeliness. Closing the transaction in a period shorter than the projected 60 days after execution of the Restructuring Commitment; and
- (c) Achieving HUD and local Public Policy Objectives. Providing an exceptional solution to meeting HUD's public policy objectives, in HUD's sole estimation.

b. Processing. Once a project in the Demonstration Program has been assigned by HUD to the Designee, the Designee will be responsible for accomplishing the restructuring of the

project in a period of 180 days from the date of the Demonstration Agreement and closing in a period not to exceed 60 days from the execution of the Restructuring Commitment. The Designee's process for restructuring must be consistent with the authorizing legislation for the Demonstration Program and must meet mandatory Demonstration Program objectives including statutory notification requirements.

The Designee will be required to seek HUD approval and the approval of the insured mortgage and other necessary third parties at the three Stages described above in Section VII.B.1.a.(1). The Business Plan and the Final Restructuring Commitment will require HUD approval.

As in direct HUD processing, the owner will have 10 calendar days from the issuance of the Restructuring Commitment to appeal, in writing, to the Director of Multifamily Housing in the HUD field office with jurisdiction, the terms Restructuring Commitment. The written notice of appeal shall specifically state, in reasonable detail, the issues and bases upon which the owner seeks review. Following the appeal, a modified Commitment may be issued by HUD. If needed, after signing a modified Commitment, the owner will qualify for an extension of the Demonstration HAP Contract. Failure to sign a Restructuring Commitment will result in the termination of the Demonstration Agreement and a reduction of project rents to 120% of FMR.

Any project rehabilitation or capital improvements supported or required by HUD must be processed in accordance with HUD's environmental review requirements in 24 CFR part 50, prior to HUD's approval of a Designee's Detailed Business Plan. All projects must be in conformance with flood insurance purchase requirements, as applicable, in accordance with 24 CFR 50.4(b)(1). HUD will also execute the closing documents. Where full or partial mortgage prepayment from the FHA Insurance Fund or new FHA-insured financing is included in the restructuring, new regulatory agreements must be entered into.

The Demonstration Program limits the number of units for which HUD may permit assignment of its insured position, enter into contracts to purchase reinsurance or otherwise transfer economic interest in the contracts of insurance to 5,000 units. HUD will approve requests from Designees to receive such assignment in the order in which they are received and subject to HUD's assessment of the

benefit to the Federal Government and the timeliness of implementation. In the absence of designees for any geographic area, HUD may assume the role of designee and sub-contract the assignment of economic interest.

The Demonstration Program also limits the number of units for which HUD may substitute tenant-based Section 8 assistance for project-based assistance to 10% of the aggregate number of units in projects restructured in any one fiscal year. HUD will approve requests for tenant-based assistance for projects that demonstrate new and innovative approaches to restructuring, subject to availability, given the 10% limitation.

In the Designee's restructuring process, HUD will be the initial point of contact with owners and will be responsible for allocating projects to the selected Designee.

2. Joint Venture Approach

a. Compensation Structure. HUD seeks joint venture arrangements in which nonprofit or public entity Designees assume some or all of HUD's risk of restructuring in exchange for a share of the savings to the Federal Government resulting from restructuring. In most cases, savings to the Government will be measured by comparing the cost to the Government that would occur if the project were not restructured and the first mortgage defaulted with the cost to the Government of the restructuring by the joint venture.

The objective of the joint venture approach is to explore ways to significantly reduce HUD's administrative role while simultaneously advancing the interest of the Federal Government (taxpayers) in the restructurings. The risk of restructuring assumed by designees could include originating a new uninsured or partially insured loan, making a cash payment for the assignment of HUD's economic interest in insurance in force, or other form as designed and proposed by the Designee.

In joint venture arrangements, the Designee investment can take the form of money, time, or credit exposure. The investment may be made directly by the Designee or by a partner of the Designee, such as those public and private entities listed in Section VII.A. The freedom of the Designee to control the transaction will be commensurate with the level of investment. HUD seeks to transfer sufficient risk and reward to the Designee to insure that HUD's objectives will be met with substantially reduced HUD monitoring and involvement. Ideally, HUD would not review interim

stages of the restructuring process and would accept the Designees' warranties, certifications and representations. It is possible that HUD would delegate all its powers to the designees including the ability to authorize full or partial mortgage prepayment and would rely solely on a post-restructuring audit to verify that the interests of the Federal Government were fairly represented in the transaction.

Payments to Designees for fees, return on investment and, if applicable, administration of Section 8 will be funded from transaction proceeds, Section 8 appropriations and other funds as HUD may determine.

b. Process. The Joint Venture Designees will be responsible for all decision making. HUD approvals will be based on representations and certifications made by the Designee. The Designee's process for restructuring must be consistent with the authorizing legislation for the Demonstration Program and must meet mandatory Demonstration Program objectives including statutory notification requirements and affordability requirements.

Joint Venture Designees will indicate in their letter of interest or RFQ that they desire to handle, on a joint venture basis, some or all of the projects in their service areas whose owners opt to participate in the Demonstration Program. Once the joint venture is in place, HUD will assign the Designee demonstration projects. In its selection, HUD will give preference to qualified Designees that have had positive previous association with specific projects that may seek restructuring.

After being selected by HUD, the Designees will meet with the Demonstration Program Coordinator and HUD financial advisors to develop a joint venture approach that is mutually satisfactory to HUD and the Designees. The approach with each Designee will be formally described in a joint venture agreement that will set forth Designee risk and authority, HUD oversight, a cost to government calculation model and a method of sharing savings to government with HUD and the Designee. The joint venture agreement shall provide that HUD shall complete its environmental review requirements under 24 CFR part 50, as applicable, prior to the entry of any restructuring commitment by HUD or binding HUD. The agreement shall also provide that all projects must be in conformance with flood insurance purchase requirements, as applicable, in accordance with 24 CFR 50.4(b)(1).

The Demonstration Program limits the number of units for which HUD may

permit assignment of its insured position, enter into contracts to purchase reinsurance or otherwise transfer economic interest in the contracts of insurance to 5,000 units. HUD will approve requests from Designees to receive such assignment in the order in which they are received and subject to HUD's assessment of the benefit to the Federal Government and the timeliness of implementation. In the absence of Designees for any geographic area, HUD may assume the role of Designee and sub-contract the assignment of economic interest.

The Demonstration Program also limits the number of units for which HUD may substitute tenant-based Section 8 assistance for project-based assistance to 10% of the aggregate number of units in projects restructured in any one fiscal year. HUD will approve requests for tenant-based assistance for projects that demonstrate new and innovative approaches to restructuring, subject to availability, given the 10% limitation.

VIII. Alternative Processing

The following alternative processing may also be used for projects that are not within the jurisdiction of a Designee.

Within 10 days of execution of the Demonstration Agreement in the case of FY 1997 contract expirations, or upon submission of a restructuring proposal in the case of post-1997 contract expirations, and where the FHA loan is refinanced by a new loan with or without FHA insurance, owners may elect to engage an FHA approved lender or servicer to undertake some or all of the due diligence and underwriting described in these guidelines, subject to review and approval by the Demonstration Manager or the field office Multifamily Director. The lender/servicer shall submit to HUD a detailed Business Plan signed by the owner to include:

A. An outline of the ownership entity and loan documents required for the restructuring proposal (and bond documents, if necessary);

B. Third party approvals required;

C. Completed appraisal meeting the requirements of the Uniform Standards of Professional Appraisal Practice (USPAP), published by the Appraisal Standards Board of the Appraisal Foundation, as modified by HUD, incorporating data on operating expenses available from FHA and entities such as IREM;

D. Underwriting analysis including assessment of market rents and operating expenses based on the appraisal, proposed operating expenses,

determination of NOI, supportable financing, proposed principal reduction, rehabilitation financing, owner input;

E. Assessment of rehabilitation needs;

F. Description and rationale for the mandatory demonstration approach to restructuring being selected;

G. Evidence and certification of proper notification of tenants, Affected Unit of Local Government and lender(s) of the owner's intent to participate in the Demonstration Program, and a summary of comments received in the process and how they were addressed. The same process that HUD requires owners to follow for notification, outlined in Section VI.D., must be followed;

H. Description of environmental issues, if any;

I. Description of litigation issues and tax issues;

J. Description of public policy issues;

K. Written record of inquiries from public officials regarding the restructuring; and

L. Other issues as provided more specifically in further guidance to be provided by HUD.

All information in the Business Plan is to be supported by the findings of the due diligence activities.

The restructuring Business Plan will be submitted to the Demonstration Manager and or Field Office Multifamily Director for approval. Any project rehabilitation or capital improvements supported or required by HUD must be processed in accordance with HUD environmental review requirements in 24 CFR part 50, prior to HUD's approval of the restructuring Business Plan. All projects must be in conformance with Flood Insurance purchase requirements, as applicable, in accordance with 24 CFR 50.4(b)(1). HUD will respond to the Business Plan in 30 days, after negotiating with the owner and lender, with a Restructuring Commitment. As in direct HUD processing, the owner will have 10 calendar days from the issuance of the Restructuring Commitment to appeal, in writing, to the Director of Multifamily Housing in the HUD field office with jurisdiction, the terms Restructuring Commitment. The written notice of appeal shall specifically state, in reasonable detail, the issues and bases upon which the owner seeks review. Following the appeal, a modified Commitment may be issued by HUD. If needed, after signing a modified Commitment, the owner will qualify for an extension of the Demonstration HAP Contract. Failure to sign a Restructuring Commitment will result in the termination of the Demonstration Agreement and a reduction of project rents to 120% of FMR.

In cases where the FHA loan is being retained, HUD may request the mortgagee or loan servicer to perform due diligence activities and underwriting, in coordination with the Demonstration Manager, as currently permitted for certain mortgagees and servicers under FHA policies.

IX. Other Provisions of Demonstration Program Legislation

A. Participation of Projects With Post-FY 1997 Expirations

In the allocation of Demonstration Program funding resources, priority will be given to projects with Section 8 contracts expiring in FY 1997. Demonstration projects with contracts expiring after FY 1997 will not be processed until (i) all projects with contracts expiring in FY 1997 have either closed on a Restructuring Commitment or the Demonstration Agreement has expired; or (ii) HUD determines that the proposed restructuring imposes no cost to the Federal Government as calculated using the rules established for implementation of the Budget Enforcement Act of 1990. In general, the determination of cost to government will compare the loss to the Government (cost to FHA) that would occur if the demonstration candidate were to have rents set in accordance with section 211(b) of the HUD FY 1997 Appropriations Act, to the cost to FHA of the proposed restructuring. If the restructuring of a project costs less, on a discounted basis, than the total costs if the project goes all the way through the default process (assuming project rents are reduced to 120% of FMR), then that project will be included in the Demonstration Program.

Post-FY 1997 project owners may enter the Demonstration Program by submitting a letter of interest to the Demonstration Program Coordinator. The letter of interest must include the following:

- a. Project Name and Address;
- b. FHA Project Number;
- c. FHA Insurance Program;
- d. Unit Rental Information: Gross rent (contract rent plus utility allowance, if

applicable) by unit type, number of total units and assisted units by unit type, owner estimate of market rents by unit type, gross rent as a percentage of FMR;

e. HAP Expiration Date and a copy of the HAP contract and Section 8 Identification Number;

f. Loan Information: Unpaid Principal Balance of the FHA-insured mortgage(s), original principal amount, loan maturity date;

g. Owner contact name, address, telephone number and fax number; and

h. Management agent name, address, telephone number and fax number.

Within 30 calendar days after HUD's receipt of letters of interest, HUD will respond to the owner with a calculation of probable cost or savings to government, based on the comparison described above. If the proposed restructuring appears to generate savings, it will be referred to a Designee or to a HUD Demonstration Manager for processing. At the same time, project tenants, Lender(s) and the Affected Unit of Local Government will be notified in the same manner as required for projects with Section 8 contracts expiring in FY 1997. This notice must be coordinated with the Field Office having program jurisdiction. HUD's restructuring processing for projects with post-FY 1997 expirations follows the same process the projects with FY 1997 expirations. Designee processing is discussed in Section VII of these Guidelines and Alternate processing is discussed in Section VIII.

B. Sunshine Provision

In order that others may learn from the experience of the Demonstration Program, all proposals accepted by HUD to participate in the 1997 Demonstration Program may be posted on the Department's Web Page (www.hud.gov/fha/mfh/mfhsec8.html). The posted information will include, but not be limited to, the final restructuring commitment, detailed financial information regarding the asset and tenant issues. Owners will be requested to waive the provisions of the Privacy Act (5 U.S.C. 552a) and the Trade Secrets Act (18 U.S.C. 1905).

X. HUD Findings and Certifications

A. Environmental Impact

A Finding of No Significant Impact with respect to the environment has been made in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969. The Finding of No Significant Impact is available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk at the above address.

B. Executive Order 12612, Federalism

The General Counsel, as the Designated Official for HUD under section 6(a) of Executive Order 12612, Federalism, has determined that the provisions in this notice are closely based on statutory requirements and impose no significant additional burdens on States or other public bodies. This notice does not affect the relationship between the Federal Government and the States and other public bodies or the distribution of power and responsibilities among various levels of government. Therefore, the policy is not subject to review under Executive Order 12612.

C. Executive Order 12606, The Family

The General Counsel, as the Designated Official under Executive Order 12606, The Family, has determined that this notice does not have potential for significant impact on family formation, maintenance, and general well-being, and, thus, is not subject to review under the order. The notice implements a statutorily authorized demonstration program and is intended to find ways of reducing the impact on families that might otherwise be caused by the nonrenewal of Section 8 project-based rental assistance.

Dated: January 14, 1997.

Stephanie A. Smith,
General Deputy Assistant Secretary for
Housing—Federal Housing Commissioner.

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