U.S. Department of Housing and Urban Development
Office of Recapitalization

Preservation Options for Section 236 Properties

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CONTENTS

INTRODUCTION

Owners of Section 236 properties play a critical role in providing affordable housing for low-income families and individuals across the nation. As these mortgages mature, thousands of low-income elderly, special needs residents, and other households are at risk of losing affordable housing. The U.S. Department of Housing and Urban Development (HUD) Office of Recapitalization (Recap) is committed to working with owners to retain Section 236 units as affordable by providing incentives for their recapitalization and preservation, as well as guidance to help owners make sound decisions that benefit both owners and residents. These preservation and recapitalization options will allow owners to secure new funding for capital improvements and place their properties on solid financial footing while still serving their low-income residents. Assessing the options and taking action may seem overwhelming at first. This guide, along with other available learning tools, can help by providing a roadmap for owners in making a decision and taking action to preserve their affordable property.

There is no one-size-fits-all approach to any recapitalization effort, so the reader should consider this guide and its related set of options for preservation as a whole. A recapitalization strategy involves an overlay of interacting components, including: refinancing; possible restructuring of the Section 236 subsidy (for example, Interest Reduction Payment (IRP) decoupling); renewal of rental assistance contracts; and possible participation in the Rental Assistance Demonstration 2 (RAD 2) program and/or Low-Income Housing Tax Credit (LIHTC) program. Coordinating and considering all of the funding timelines, recapitalization requirements, and needs of the property are the key elements to success.

This guide provides information about the preservation of multifamily affordable rental properties financed with the following types of Section 236 mortgages:

- FHA-insured
- HUD-held loans
- State Housing Finance Agency (HFA)-insured

ACT NOW

Contact HUD for Help

Section 236 preservation transactions are managed in HUD's Office of Recapitalization (Recap). Recap staff are available to help owners get started on their preservation strategies and to guide them through process. Owners may contact Recap staff at 236Preservation@hud.gov for guidance on their preservation options, to ask questions about preparing an application, and to discuss how to pay for predevelopment costs.

Organization of the Guide

A successful preservation action can be structured into a five-step approach:

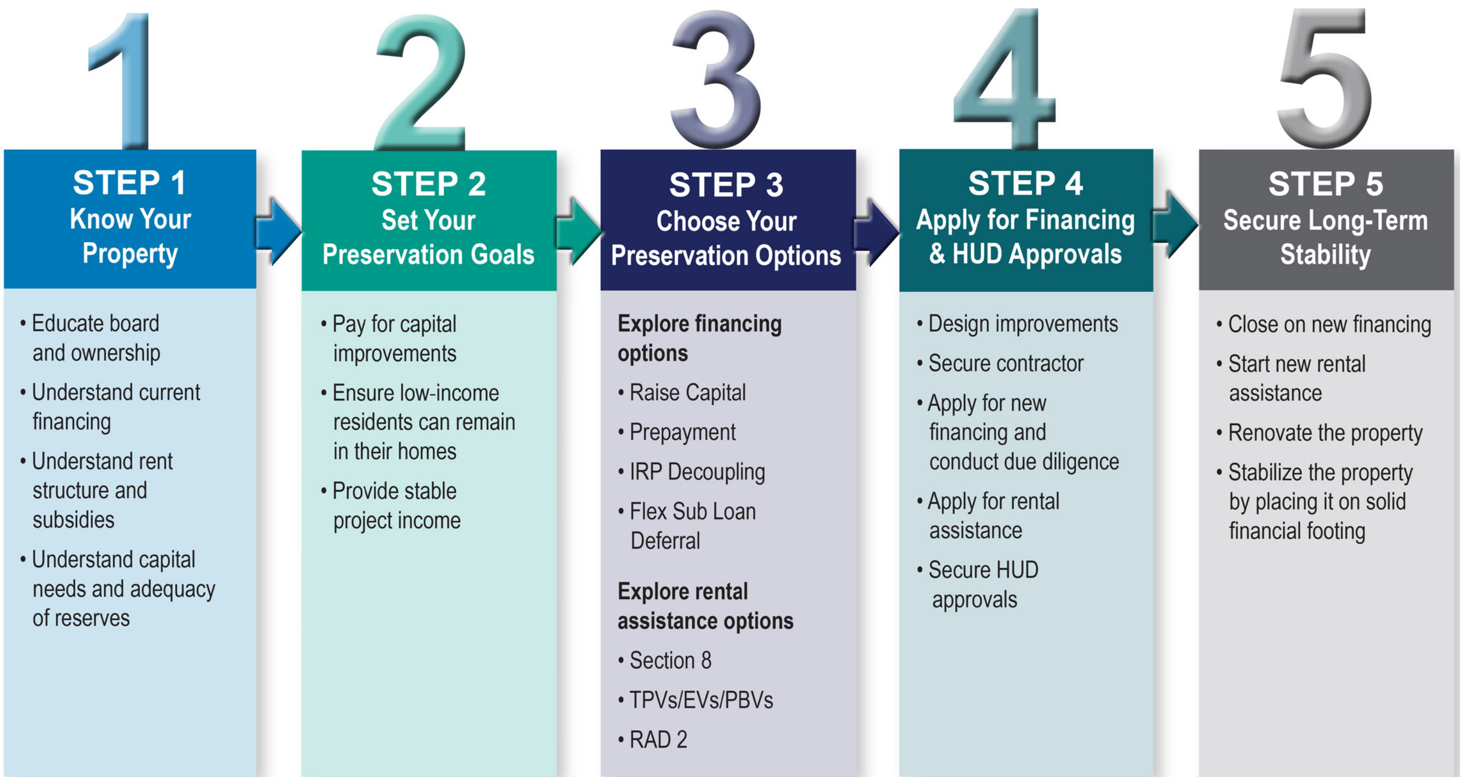


Figure 1: *Five-Step Preservation Process*

To learn about **Step 1: Know Your Property** and **Step 2: Set Your Preservation Goals,** readers may review the webinar and accompanying slides on *How to Preserve and Recapitalize a Section 236 Property,* which are posted on the Section 236 page of the HUD Exchange. This guide complements the webinar with additional detail and context. HUD has also posted a resource document called *Get Started on Your Preservation Strategy,* which describes the steps that an owner should take at the onset of the preservation decision-making process.

The purpose of this guide is to provide detailed guidance for Section 236 property owners on **Step 3: Choose Your Preservation Options.** The guide explains the requirements and processes that govern the various policies that HUD has implemented to incentivize the preservation and recapitalization of these properties. It contains guidance on the owner's available Section 236 financing options: raising capital, Section 236 loan prepayment, IRP decoupling, and Flexible Subsidy Loan deferral. It also discusses the following rental assistance options: Section 8 contracts, Tenant Protection Vouchers, Enhanced Vouchers, Project-Based Vouchers, and RAD 2.

The guide also provides basic instructions on **Step 4: Apply for HUD Approvals.** It includes information about the application process for prepayment and other HUD approvals, guidance on selling a Section 236 property, and project management timing considerations. **Step 5: Secure Long-Term Stability** begins when the preservation preparations are completed. Owners will be able to move forward on closing on their new financing, starting any new rental assistance, and renovating their properties. This work will put their properties on solid financial footing for years to come. Be aware that, from time to time, HUD releases new information or programmatic changes that could impact some of the approaches outlined herein. This guide is intended to be broad enough to account for small tweaks to the program, but the reader should still always check the HUD websites for any updates and the latest news. A list of relevant webpages and notices can be found in Appendix A.

Appendix B provides a checklist of documents and information that a Section 236 owner should gather in **Step 1: Know Your Property.** Appendix C contains a flow chart of the HUD approval process steps for a typical Section 236 preservation transaction that are referenced in **Step 4: Apply for Financing and HUD Approvals.** Appendix D describes considerations for selling a property because in some cases, the best preservation alternative is a sale of the property to an entity that is committed to long-term, sustainable affordability.

Additionally, the Glossary of Multifamily Housing Preservation Terms provides definitions of technical and preservation terminology.

How Does Section 236 Financing Work?

Created by Congress in 1968, HUD's Section 236 Loan program was an effort to enlist the private market to assist with the creation of needed affordable rental housing for families and seniors. Owners could be for-profit, nonprofit, and cooperative entities.

- Market-rate loans were made by eligible lenders at the prevailing market interest rates. Loans were either HUD/Federal Housing Administration-insured or state Housing Finance Agency-financed.
- HUD provided an Interest **Reduction Payment (IRP)** that subsidized the borrower's mortgage payment, making it equivalent to that of a loan with an interest rate of 1%. The IRP was fully funded to flow monthly to the mortgage lender for the entire 40-year mortgage term.
- With **Lower Mortgage Payments**, the owners were required to restrict occupancy to residents with incomes at or below 80% of Area Median Income (AMI).
- Consequently, HUD required **reduced rents** that were capped at a HUD-approved, cost-based Section 236 Basic Rent.
- Certain higher income residents may have rents capped at a higher, cost-based Section **236 Market Rent level**, which reflects the full cost of the debt service without the IRP. (Section 236 Market Rent is not to be confused with actual comparable unassisted rents in the marketplace.)
- **Project-based rental assistance** was included for many properties in the form of a Rent Supplement (Rent Supp), Rental Assistance Payment (RAP), and/or a Section 8 Project-Based Rental Assistance (PBRA) contract.

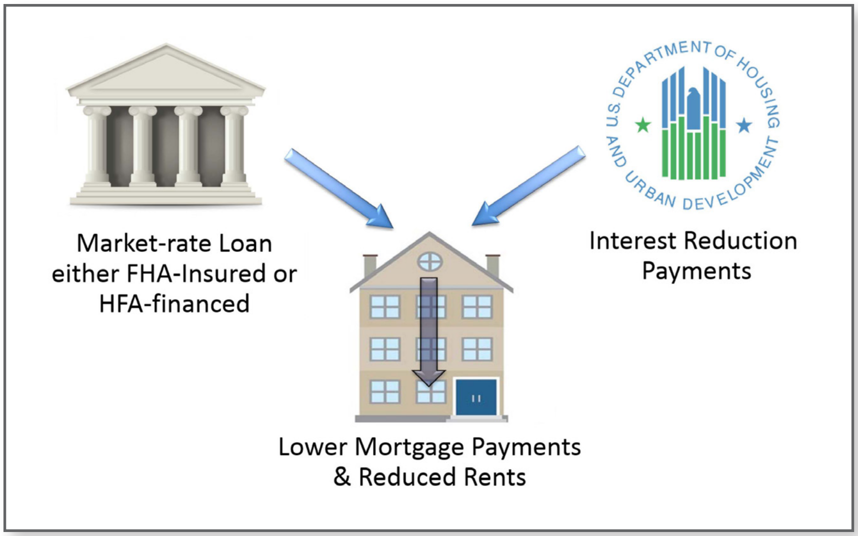


Figure 2: *How the Section 236 Program Works*

CHOOSE YOUR SECTION 236 PRESERVATION OPTIONS

This section describes the options and incentives that an owner will evaluate to design an effective preservation strategy, resulting in long-term affordability and stability of a Section 236 property. Choose Your Preservation Options is the third of the Five-Step Preservation Process described in the Introduction:

For the first two steps of property analysis and goal setting, guidance is provided in the resource document Get Started on Your Preservation Strategy. Also, see Appendix B for a checklist of items to gather for Section 236 properties. These documents will help the owner to:

- Understand the property's current financing
- Understand the property's current rent structure and subsidies
- Understand the property's capital needs and the adequacy of its reserves to address those needs

Once an owner has a thorough understanding of the property and has set preservation goals **(Steps 1 and 2)**, an owner is ready to evaluate options and incentives to plan the recapitalization of a Section 236 property **(Step 3)**. Both financial and rental assistance options are available to help owners meet their goals:

- On the financing side, an owner's options include: refinancing to raise capital, prepaying the original Section 236 loan; decoupling and continuing to use the Interest Reduction Payment (IRP) mortgage subsidy stream, and finding relief from balloon payments due on certain Flexible Subsidy (Flex Sub) Loans.
- On the rental assistance side, options include: renewal and the potential rent increase of expiring Section 8 contracts, Tenant Protection Vouchers (TPVs) that can be available as a resource, and the Rental Assistance Demonstration 2 (RAD 2) program.

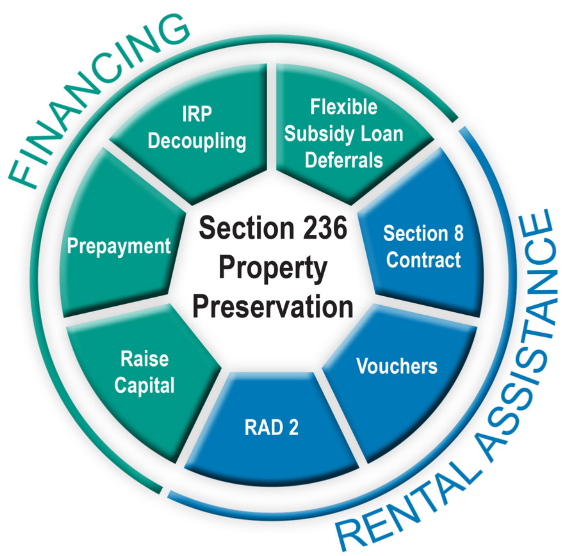


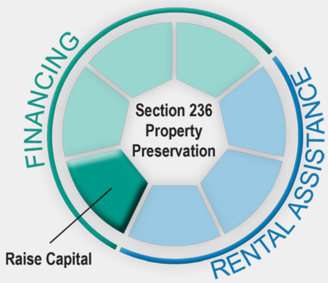
Figure 3: *Preservation Options and Incentives*

ACT NOW

MORTGAGE MATURING SOON?

If the property's mortgage is maturing in the next 12 months or has already matured, contact HUD immediately for guidance.

1. RAISE CAPITAL



Q: **Why raise new capital funds for your property?**

A: To address capital needs

To get access to accumulated equity

Typical preservation transactions require new funds to pay for large-scale capital improvements that reduce utility usage, reduce operating costs, and improve living conditions for residents. Your team's ability to successfully address these needs will rely on its ability to secure the necessary financing. Some owners may also want to recover a portion of the equity appreciation accumulated over the years, or may want to use this cash to support other affordable properties in their portfolio. Typical financing tools used in recapitalization of Section 236 projects are:

- Hard Debt:
  - Conventional loans
  - Federal Housing Administration-insured, Fannie Mae, Freddie Mac, or state Housing Finance Agency (HFA) loans
- Equity:
  - Low-Income Housing Tax Credits
  - Cash-on-cash
- Soft Debt:
  - HOME funds, Community Development Block Grant program funds, State housing trust funds, or National Housing Trust Funds (starting in 2016)
- Foundation and Corporate Grants

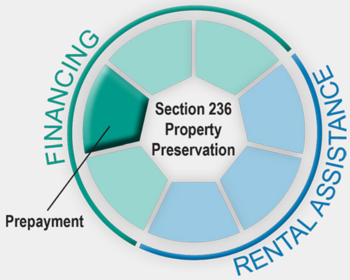
As a Section 236 owner progresses along the path of a refinancing, there are many factors to consider that are unique to Section 236 and other HUD-funded properties. Prepayment, decoupling the IRP subsidy, and Flex Sub Loan deferrals are the key options that are triggered in the recapitalization of a Section 236 property.

RECAP TIP

Income Certification Requirements

Many properties with stable occupancy also have residents paying the maximum Section 236 Market Rent. These residents do not currently have to recertify their incomes. After a refinancing and recapitalization, however, these residents may be subject to new rules related to the new financing, such as Low-Income Housing Tax Credit (LIHTC) income certification requirements. It is wise to be very aware of the various income certification requirements of the refinancing sources so that initial and ongoing compliance will not be surprising and will be less complicated.

2. SECTION 236 LOAN PREPAYMENTS



Q: Why prepay your Section 236 loan?

A: To enable refinancing of a property

To trigger issuance of Tenant Protection Vouchers

As noted above, a refinancing indicates that an owner will be prepaying an existing loan to leverage new debt to address capital improvements. Another reason for Section 236 owners to prepay is that this may trigger the creation of Enhanced Vouchers (EVs) to protect unassisted residents from rent increases.

Owners with Rent Supplement (Rent Supp) or Rental Assistance Payment (RAP) contracts may prepay to trigger termination of these non-renewable rental subsidy contracts in order to initiate the issuance of Tenant Protection Vouchers (TPVs). This process (or the natural expiration of Rent Supp or RAP contracts) permits the owner to participate in the Rental Assistance Demonstration 2 (RAD 2) program that allows for the voucher assistance to be converted into a project-based subsidy.

Owners with Flex Sub Loans that have been deferred for the term of the loan and must be paid at maturity or prepayment may wish to prepay the Section 236 loan in order to proactively address the looming balloon note, as well as to generate EVs.

Some owners who do not need HUD permission to prepay their Section 236 loan will be prepaying without entering into a preservation transaction (see section below). This may create EVs for tenant protection and may deregulate the property, which would eliminate the property's use restrictions.

Note that, in general, prepayment of the loan will trigger the termination of the Section 236 Regulatory Agreement. In some cases, a substitute use agreement will be required, as discussed below.

Is Prepayment Permission or Prepayment Approval Required for the Property?

Not every Section 236 loan can be prepaid "as-of-right;"[1] permission to prepay may be required from HUD. The first consideration in determining whether HUD consent is needed for a prepayment is to examine the language of the Section 236 first mortgage note. Typically, it will state something similar to the following:

"The debt ... may not be prepaid ... prior to final maturity without the prior written approval of the Federal Housing Commissioner, except that a ... limited dividend corporation may prepay without such approval after 20 years."

Owners of Section 236 properties that were originally developed by nonprofits may not prepay without HUD consent, and some properties with both Rent Supp contracts and Section 221(d)(3) mortgages also require HUD prepayment consent.

Limited dividend owners generally may prepay after 20 years, unless an owner has waived the prepayment right as part of a subsequent transaction, such as receipt of a Flex Sub Loan. In every case, the right to prepay must be verified by HUD's Office of General Counsel, and the owner must follow HUD's prepayment procedures. Therefore, the prudent course of action for owners contemplating the prepayment of a Section 236 mortgage is to engage in preliminary discussions with HUD and, in complicated cases, consult with legal counsel.

[1] This guide uses the term "as-of-right" to refer to prepayments that are not explicitly prohibited by the terms of the note or related financing documents.

When prepayment permission is required ("Discretionary Prepayment", governed by Section 250(a) of the National Housing Act): Per Notice H 2006-11 "Prepayments Subject to Section 250(a) of the National Housing Act," HUD requires that an owner provide a 150-day advance notice[2] to residents, to the head of the unit of local government, and to the HUD project manager/account executive. A continuing Use Agreement will remain in place through the term of the original Regulatory Agreement. HUD can also require relocation assistance, if applicable. Additionally, HUD requires the execution of a replacement Section 250(a) Use Agreement to take the place of the original Section 236 Regulatory Agreement and remain in effect through the end of the original mortgage term.

When prepayment permission is NOT required ("As-of-Right Prepayment," governed by Section 219 of the FY 1999 HUD Appropriations Act): A different tenant notice procedure is required for "as-of-right" prepayments. The prepayment notice (typically referred to as a "Wellstone Notice") must be delivered to each resident, to HUD, and to the state *or* local government. It must also be delivered between 150 and 270 days prior to the prepayment. Upon prepayment, the Section 236 Regulatory Agreement is dissolved.[3] Finally, no rent increases may be implemented for 60 days after the prepayment.

Follow the Required Tenant Notice Procedures

Discretionary Prepayments: Notice H 2006-11 prescribes the tenant notice requirements for discretionary prepayments. It includes a notice template, instructions for delivering and posting the notice, a requirement for a 30-day tenant comment period, and a requirement for the owner to consider the tenant comments and to make any corresponding adjustments in the plan for the property.

As-of-Right Prepayments: Although the statute does not require a tenant comment period, it is always a useful practice to solicit such opinions. The specific delivery and posting requirements in Notice H 2006-11 provide a good guide to a best practice approach to the Wellstone Notice.

General Guidelines: When the prepayment is an essential part of a preservation transaction, it is best not only to recite the fact of the intent to prepay, but also to communicate the context and the preservation plan to residents.

HUD's general guidelines for resident participation are found in Notice H 2014-12, "Implementation of Tenant Participation Requirements in accordance with 24 CFR Part 245." All owners of Section 236 and other HUD-assisted properties should be familiar with these principles and requirements. This Notice states, among other things, that "Tenants also have the right to be notified of and to formulate responses to: … loan prepayments," although no specific procedures are required.

RECAP TIP

Tenant Engagement

Beyond the tenant notice requirements, it is important to engage residents early in the preservation process to seek their input regarding the needs of the community. Residents may be under the impression that affordability is terminating and may think they need to find other housing. It is especially important to communicate early and often.

Note that in some jurisdictions there may be other state or local notice laws. These are not preempted or superseded by HUD's notice requirements and they must also be followed.

[2] *If the project matures within 150 days and prepayment permission is required, HUD can waive the 150-day requirement on a case-by-case basis. Discuss the timeline as soon as possible with HUD in these cases.*

[3] *In certain instances where it is not practical to file a Wellstone Notice, HUD can waive this requirement but only in order to facilitate a preservation transaction and only if the owner executes a new Use Agreement.*

Does Prepayment Trigger Rehabilitation Requirements for the Property?

Discretionary Prepayments: For a discretionary prepayment that is subject to HUD approval, HUD requires in a policy clarification memo that one or more of the following rehabilitation requirements be met in order to receive prepayment permission:

- Total hard costs (rehabilitation costs) are at least $15,000 per unit.
- The rehabilitation includes the replacement or modernization of at least one major system or major building component.
- The total hard costs are greater than or equal to 25% of the Total Development Cost, which include all costs of the transaction including acquisition, rehabilitation, reserves, and fees.

In practice, HUD considers these criteria in the context of the specific preservation transaction.

As-of-Right Prepayments: For as-of-right prepayments, there are no rehabilitation requirements. A new funding source for the prepayment, however, may have underwriting requirements that include resolving any physical issues at the property.

RECAP TIP

HUD Approvals

Apply for HUD prepayment approvals at the Multifamily Preservation Resource Desk. Learn how to get started in the "Apply for Financing and HUD Approvals" section of this document.

What are the Prepayment Requirements for Section 236 Properties Financed by State Housing Finance Agencies?

While many Section 236 properties were created using HUD-insured loans via the FHA, a large number of these properties have permanent debt that was originated by state HFAs without federal mortgage insurance. Because FHA is not involved, these are sometimes referred to as non-insured, HFA-issued Section 236 loans. As with their HUD-insured counterparts, HFA Section 236 loans are assisted with IRPs and the underlying regulatory structure is identical in all material respects.

Responsibilities: The business terms of prepayment rights are governed by the HFA's loan documents and by HFA policy. The HFA, as the lender, manages the Section 236 prepayment approval process, but the federal Wellstone Notice provisions still apply. Because HFA Section 236 loans are not backed by HUD, the HFA bears more risk than a HUD-insured lender. As a result, the HFA, instead of HUD, carries out most asset management responsibilities for these properties. These responsibilities include: processing rent increases; oversight of maintenance; financial management and other regulatory compliance; and, commonly, administration of rental assistance contracts, all pursuant to HUD oversight.

HFA Role in a Preservation Transaction: Aside from the federally-required procedures, each HFA will manage the prepayment process according to its own business procedures. IRP decoupling, if included in the transaction, must be approved by HUD's Office of Recapitalization (Recap). If the HFA will also be the source of new debt, it will have underwriting procedures for that process.

ACT NOW

Check in with HUD and Your HFA

An early discussion with the HFA asset management staff and the HUD Office of Recapitalization is essential to understanding all requirements and process details.

What if the Property has an ELIHPA or LIHPRHA Use Agreement?

Some Section 236 projects have Use Agreements under the Emergency Low-Income Housing Preservation Act (ELIHPA) of 1987 or the Low-Income Housing Preservation and Resident Homeownership Act (LIHPRHA) of 1990. Both Acts authorized HUD to offer incentives to owners to renew the affordability of their properties and restrict as-of-right prepayments. Typical ELIHPA Use Agreements expire at the originally scheduled maturity date of the underlying mortgage loan.

Accordingly, most ELIHPA Use Agreements have already expired. LIHPRHA Use Agreements, on the other hand, remain in effect for the remaining useful life of the property. Many ELIHPA and LIHPRHA properties have very low-income non-Section 8 residents who are currently rent burdened, or who may face rent increases when ELIHPA Use Agreements expire. Prepayment of the Section 236 loan can make Enhanced Vouchers available to assist those residents and to support new financing for rehabilitation.

<table>
<tr><th colspan="2">REVIEW: Prepayment</th></tr>
<tr><td>Prepayment when HUD Consent is Required
Governed by Section 250(a) of the National Housing Act</td><td>Prepayment when HUD Consent is NOT Required
Governed by Section 219 of the FY 1999 HUD Appropriations Act (Wellstone Amendment)</td></tr>
<tr><td rowspan="3">Who:
• Nonprofits, properties with Flex Sub Loans, certain FHA loans with Rent Supp or RAP
Tenant Notification Requirements:
• Notify tenants, HUD, and local government at least 150 days before prepayment
HUD Rehab Requirements:
• Minimum rehab requirements—see policy clarification memo for prepayments subject to Section 250(a) of the National Housing Act
Affordability Requirements:
• Property must be maintained with equal benefits for low-income residents through the original mortgage note term
• Owner must execute a new Use Agreement (HUD Form 93142)</td><td>Who:
• Usually for-profit entities
Tenant Notification Requirements:
• Notify tenants, HUD, and state or local government 150 -270 days before prepayment may occur
HUD Rehab Requirements:
• None
No rent increases for 60 days after prepayment</td></tr>
<tr><td>Prepayment of State HFA Loans</td></tr>
<tr><td>• The HFA manages the Section 236 prepayment approval process, but the federal Wellstone Notice provisions still apply
• All Section 236 preservation rules and incentives apply to these properties
• Apply for approvals through HUD as with all Section 236 projects PLUS contact the HFA about their required prepayment approvals</td></tr>
</table>

3. IRP DECOUPLING

Q: Why decouple the IRP from your Section 236 loan?

A: Owners may "decouple" the remaining IRP subsidy at prepayment and apply it to a new loan. These funds could help leverage new dept capital.

Understand How Decoupling Works

The original Section 236 loans have an interest rate subsidy, called the Interest Reduction Payment, which lowers the effective loan interest rate to 1% for the borrower and is paid directly to the lender. In return for this subsidy, the owner must agree to restrict the rents and the resident incomes for the term of the mortgage. This restriction is codified through a recorded Regulatory or Use Agreement. Unless an owner could transfer or capture this IRP subsidy, it would be lost upon refinancing, reducing the incentive to refinance a Section 236 property prior to its maturity date.

To aid in preservation of these properties, Congress created direct authority for HUD to "decouple" the balance of the IRP subsidy and apply it to a new loan as part of a prepayment and refinancing transaction. Reference Notice H 2013-25, "Updated Guidelines for Continuation of Interest Reduction Payments after Refinancing: 'Decoupling,' as allowed by the National Housing Act, under Section 236(e)(2)," for the current decoupling guidance.

The decoupled IRP will flow directly to the new mortgagee until its original maturity date and at the same pay-out schedule as originally designed. Note that in some cases, upon request, the IRP may be paid over a longer period if the monthly IRP payments are reduced accordingly and the total of the revised payments is no greater than the remaining amount of IRP funds at the time of the decoupling.

Uses of the Decoupled IRP

The IRP stream that is decoupled from the original loan is generally used in one of two ways.[3]

[4] There is a third, little-used procedure that is authorized by Section 236(b), in which a public agency (a) purchases the original Section 236 loan from HUD and (b) issues additional debt secured by the original mortgage. The IRP continues to flow to the original note. See Notice H 2000-08 for details.

[5] "Loan sizing" refers to the lender's calculation of a borrower's ability to repay, and in this case, the repayment is enabled by the IRP.

New "B" Loan

IRP subsidy is used to size[4] a "B" loan (secondary to the new primary "A" loan) that can be fully amortized with the balance of remaining scheduled IRP payments.

- To properly size the new B loan, the amortization schedule for the original Section 236 loan should be referenced to learn exactly how the IRP will be paid out over the remaining years. This sizing should be tied to the estimated date of the prepayment so that the most accurate amount of IRP subsidy can be used for this B loan calculation.
- Note that a lender familiar with the decoupled IRP stream will be able to size the B loan for the transaction, taking into account the fact that, for HUD-insured loans, the IRP included a small, declining mortgage insurance premium payment and is therefore not strictly level. Owners should also have a sense of the amount of the B loan, so that they can prepare their internal financial model as they consider project feasibility.

Subsidize the New "A" Loan

The decoupled IRP stream continues to flow to the lender to offset the new debt service payments on the new financing. In this way, it continues to subsidize the new loan.

- Since the IRP stream will not continue for the full life of the new mortgage, the lender will not consider the IRP stream in the debt service coverage calculations for sizing the new debt.
- If the decoupled IRP continues to flow to service the new first mortgage without leveraging a B loan, it will mean that the same Section 236 Basic Rent can sustain additional approved, above-the-line uses, such as programming additional cash into the Reserve for Replacements Account during that limited timeframe for smaller capital improvement projects.
- In effect, the remaining IRP subsidy can support rehabilitation work spread out over the remaining term of the original Section 236 loan. This strategy may be most useful when the remaining IRP term is too short to justify the transaction costs of a B loan.

EXAMPLE

Decoupled IRP Used to Support B Loan

An owner has a Section 236 property with a loan that matures on March 30, 2019. The owner is refinancing the property and the new loan is anticipated to close on March 30, 2015. This would result in the IRP income stream from April 1, 2015 through March 30, 2019 (48 months) being available to support a new B loan. The total IRP subsidy would be approximately $1.28 million for the four remaining years.

Using an assumed interest rate of 5.25% with a 48-month term for the B loan and the monthly equivalent of the remaining IRP balance, one can calculate a new B loan in the amount of about $1,150,000. (For simplicity, assume that the new loan does not have HUD insurance, and therefore, none of the post-decoupling IRP is needed for a mortgage insurance premium.)

This loan would be paid off in 48 months with this IRP stream. The net result to the transaction is $1,150,000 of additional proceeds for preservation activities, including capital improvements and associated soft costs.

In practice, since the IRP stream is already fully funded and is not dependent on the property's operations, the B loan's lender may permit a debt service coverage as low as 1.00 or 1.05.

RECAP TIP

Decoupling Requests

Apply for IRP decoupling approval at the [Multifamily Preservation Resource Desk](). Learn how to get started in the section "Apply for Financing and HUD Approvals" of this document.

Submitting a decoupling request as early as possible will allow HUD staff time to review and approve the transaction, and will help keep the overall recapitalization timeline on track.

Five-Year Use Agreement Extension Required in an IRP Decoupling

In return for being allowed to decouple the IRP stream, the owner must agree to a Use Agreement that extends five years past the term of the Section 236 Regulatory Agreement (or an additional five (5) years from the termination of the IRP subsidy if the remaining IRP payments are reduced and paid out over a longer term). Since the IRP stream is timed to finish at the end of the original Section 236 regulatory period, this would mean that even though the property is not receiving any additional IRP, it will still be required to comply with tenant income and rent restrictions for an additional five years beyond the original term. For those five years, the unsubsidized rents will still be set by the Section 236 rules for cost-based Basic Rent and Market Rent, including dividend restrictions. If the new debt is HUD-insured, HUD will provide oversight and enforcement of the new Use Agreement. Otherwise, a public agency must agree to provide regulatory oversight. This oversight and responsibility could be fulfilled by a public agency, such as an HFA, acting as the new permanent lender.

What are Factors to be Considered for IRP Decoupling?

Decoupling the IRP for new uses comes with many requirements, and potentially adds time and complexity to a transaction. The following are some things to consider when thinking through the possibility of decoupling.

- **Section 236 Regulatory Extension:** As noted, an additional five years of Section 236 restrictions will be added beyond the end of the IRP payments, via a Decoupling 236(e)(2) Use Agreement, including: use restrictions; income limits; continuation of the Basic Rent and Market Rent affordability limitations; and rent determination.
- **Timing and IRP Balance Available:** What is the most realistic closing date on the Section 236 loan prepayment and decoupling, and how much IRP will be remaining at that time? Generally, the per-unit dollar value of decoupling decreases as the loan maturity approaches, and the owner should carefully assess the trade offs between additional debt and increased processing time and cost. Understand the IRP balance expected at closing, and consider the balance of the potential additional proceeds against the additional timeline requirements. As noted above, the remaining IRP term may influence whether or not it is used to support a B loan, but in any event, its value to the transaction can be retained.

- **Ability to Program Surplus Cash for Capital Improvements:** As detailed above, even if the IRP decoupling is not used to support a "B loan," it could reduce net debt service until the IRP is depleted and the increased cash flow can support capital improvement projects.
- **Section 236 Budget-Based Basic Rents:** In an IRP decoupling, since the rent-setting mechanisms continue for another five years beyond the end of the IRP payments, it is important to remember how rents are calculated. The Basic Rents are allowed to cover operating costs, including the new debt service and debt service coverage, minus the IRP subsidy. HUD may waive this IRP discount used to calculate rents if necessary for financial feasibility, provided that no equity is taken out, rents are budget-based, and (if the transaction includes an ownership transfer) the sales price is not above market for the sale of comparable properties. Reference Notice H 2013-25 "Updated Guidelines for Continuation of Interest Reduction Payments after Refinancing: 'Decoupling,' as allowed by the National Housing Act, under Section 236(e)(2)" regarding the issues of IRP decoupling, rent setting, and change in ownership.

RECAP TIP

Use of Reserve for Replacement and Residual Receipts

In a prepayment, an IRP decoupling, and/or a refinancing scenario, the owner may be able to include the existing Replacement Reserve deposits as a source of funds. A portion of the Residual Receipts account may also be released upon HUD approval for specific property needs, following Handbook 4350.1 REV-1 (Asset Management Handbook), Chapter 25-9. However, the full Residual Receipts account will only be released to the owner at the final termination of the original Section 236 Regulatory Agreement or, if later, the expiration of any successor Use Agreement resulting from decoupling, a Section 250(a) prepayment, or any ELIHPA or LIHPRHA Use Agreement. Owners can aggregate these funds and leverage them with new capital.

Distributions in an IRP Decoupling Transaction

All Section 236 properties are subject to limited distributions. This remains true after a decoupling until expiration of the new decoupling use agreement. HUD permits several adjustments to the amount of the distribution, however, as follows:

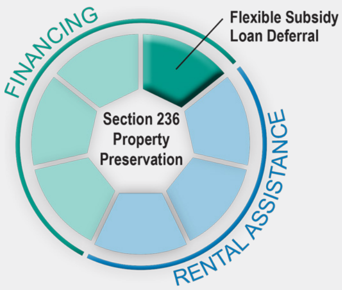
- If new equity: 6% of new equity less any developer fee at the time of the transaction, including LIHTC equity, long-term deferred developer fee, and owner cash, but not grants and soft loans
- If no new equity: If there is new FHA-insured or conventional debt, or a sale from a nonprofit to a for-profit, 10% return on 10% of the new mortgage amount
- Taken only from surplus cash (not included in budget-based rent calculation)
- For HFA-issued Section 236: state or local law controls distributions

REVIEW:

IRP Decoupling

- **IRP payments to a lender may be continued after a prepayment.**
- **Owner agrees to retain Section 236 rules for five years beyond original mortgage maturity.**
- **Requests are centrally processed in HUD headquarters at the Office of Recapitalization.**
- **Rent increases are budget-based, per Handbook 4350.1, Chapter 7.**
- **Permitted distributions may be increased.**

4. FLEXIBLE SUBSIDY LOAN DEFERRAL



Q: Why should I defer my Flex Sub Loan?

A: You may be able to defer repayment of the loan so you do not have to make a balloon payment at prepayment, maturity, or sale.

When May the Flexible Subsidy Loan be Deferred in the Preservation Transaction?

Some Section 236 properties have Flexible Subsidy (Flex Sub) Loans, many of which were non-amortizing balloon notes that are due at maturity or prepayment of the underlying Section 236 loan. There are two categories of these loans: Capital Improvement Loan Program (CILP) loans and Operating Assistance Program (OAP) loans.

Typically, CILP Flex Sub Loans were structured to be fully amortizing loans with terms that matched the term of the Section 236 loan. Therefore the CILP Flex Sub Loans should have low outstanding balances and there should not be an unmanageable balance due at prepayment of the 236 loan. The OAP Flex Sub Loans were fully deferred loans, however, with balloon notes due at maturity or prepayment. To resolve this issue, HUD has created the ability for owners with OAP Flex Sub Loans to defer the balloon notes beyond the prepayment or maturity date, upon HUD approval.

Reference Notice H 2011-05, "Policies and Procedures for the Deferred Repayment of Operating Assistance Flexible Subsidy Loans," to understand the deferral process and note that the request for an OAP Flex Sub Loan deferral is part of the overall Section 236 loan prepayment and, if applicable, IRP decoupling request. In general, the extended repayment term is subject to HUD underwriting regarding the need for deferral. HUD may permit an owner to defer the loan for a period not to exceed the term of any new financing or, if there is no new debt, for 20 years.

An application for a Flex Sub Loan deferral must include (among other things):

- Narrative to demonstrate how deferring the loan will benefit the project
- Evidence that there are no other sources of funds for repayment of the Flex Sub Loan
- A copy of the current year's budget and the most recent interim financial statement
- Last three annual audits
- Cash flow projections showing repayment of the Flex Sub Loan during the prescribed period
- Written agreement to comply with program requirements

In the application for deferral the owner must evidence:

- A passing score on a Real Estate Assessment Center (REAC) physical inspection (60 or above)
- Compliance with fair housing and civil rights laws
- Satisfactory Management and Occupancy Review for the prior three years
- Compliance with audited financial statement filings for the prior three years
- Mortgage kept current over prior three years
- Compliance with excess income reporting requirements for a seven year period
- No other outstanding defaults or violations

Owners that receive a Flex Sub Loan deferral will be expected to enter into a new Extended Use Agreement that restricts the property to the same affordability requirements as were required under the original financing for the new term of the Flex Sub Loan (see above for factors determining the new Flex Sub loan term).

RECAP TIP

Deferral Requests

Apply for Flex Sub Loan deferral approval at the Multifamily Preservation Resource Desk. Learn how to get started in the section "Apply for Financing and HUD Approvals" of this document.

REVIEW

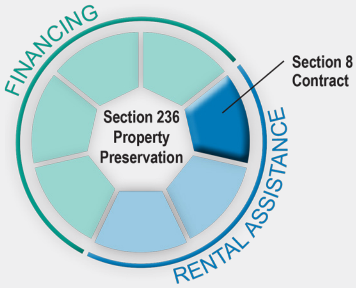
Flexible Subsidy Loan Deferral

Flex Sub Loans are required to be paid in full at the maturity or prepayment of the Section 236 Loan or at sale of the property.

- ***Capital Improvement* Loans were amortized and typically have low balances.**
- ***Operating Assistance* Loans were structured as balloon payments.**

The repayment requirement can cause difficulty when an owner is putting together an application to prepay and refinance a loan. As an incentive to owners to preserve the affordability of their properties, HUD allows the owner to request to defer repayment of the Flex Sub *Operating* Loan, which will allow it to be re-amortized for the term of the new loan.

5. SECTION 8 CONTRACT



Q: Why renew your Section 8 for 20 years?

A: Lenders and LIHTC investors expect a new 20-year contract for refinancing.

It's possible to increase rents to market level.

Many Section 236 properties have Section 8 Project-Based Rental Assistance (PBRA) in the form of Housing Assistance Payment (HAP) contracts issued by HUD that provide rental subsidy to qualified low-income residents. (Note: These HAP contracts are different from Project-Based Voucher (PBV) HAP contracts that are issued by local Public Housing Authorities (PHAs), as described in Section 6 below.) Note that after renewal, rent-setting and annual increases for PBRA units follow the rules laid out in the Section 8 Renewal Guide.[5]

It is important to understand the implications that the various preservation strategies might have on a Section 236 property's PBRA contract. The Section 8 Renewal Guide provides the available options for renewal of the Section 8 contract, including rent setting procedures. Owners will also need to reconcile Section 8 rent underwriting requirements with the rent setting requirements of any new financing.

What Happens to my Section 8 Contract in a Section 236 Preservation Transaction?

In the case of an Interest Reduction Payment decoupling transaction for a property that has PBRA units, the existing HAP contract must be terminated and renewed for 20 years at or just before the refinancing closing. The owner must also execute a Preservation Exhibit as part of the new PBRA HAP contract that provides for automatic renewal after the 20-year term for the unused term of the contract that is being terminated and renewed. For example, if there were 3 years remaining on the existing HAP, then the property would be subject to the HAP for a total of 23 years. In addition, for certain discretionary prepayments, whether or not they decouple, the owner may be required to accept any HUD offer of a HAP renewal.

Increasing Section 8 Rents to Market

When refinancing a property, the owner may have the opportunity to request an increase in the Section 8 rents if the rents are below market.

- Many nonprofit owners have used the Mark-up-to-Budget (MU2B) process to increase the Section 8 rents when the rents are below market. As provided in the Section 8 Renewal Guide, effective November 5, 2015, this procedure is also available to certain for-profit owners without the previously-required waiver. To use the MU2B process, the budget presented to HUD must include what is called the "current" debt service amount. This has been clarified to mean the anticipated new debt service that will be the result of the refinancing. HUD allows this budget to include a line item for debt service coverage required by the new lender. In this way, a refinancing can support an increase in income to the property when the new income is used to support the new debt. See Chapter 15 of the Section 8 Renewal Guide for more details.
- The Mark-up-to-Market (MU2M) process allows some owners with certain HAP contracts to receive rent increases up to the HUD confirmed market-rate rents without the submission of a budget-based request. See Option 1 in the Section 8 Renewal Guide for more details.

REVIEW:

SECTION 8 CONTRACTS IN A PRESERVATION TRANSACTION

- **In a Section 236 refinancing, owners will want to renew their Section 8 PBRA HAP contracts for 20 years.**
- **Section 8 rents are set per the Section 8 Renewal Guide.**
- **Rent underwriting requirements for Section 8, Section 236, and funding sources such as LIHTC and FHA loans must be coordinated.**

[6] *The August 2015 version noted on this web page is effective for renewal requests submitted on or after November 5, 2015.*

6. TENANT PROTECTION VOUCHERS, ENHANCED VOUCHERS, PROJECT-BASED VOUCHERS

Q: How do Tenant Protection Vouchers assist your residents?

A: TPVs provide Section 8 assistance after loss of rental assistance or a Section 236 mortgage prepayment.

TPVs protect residents from being displaced due to rent increases.

Tenant Protection Vouchers

TPVs may be provided by HUD, subject to available appropriations, when there is a risk of involuntary resident displacement as a result of a change in a property's subsidy status. Once issued, TPVs are subject to the normal Housing Choice Voucher (HCV) regulations and guidance (with certain exceptions for Enhanced Vouchers, as described in this section). As with all HCVs, TPVs are administered by a PHA. Rents (except for EV rents as described below) are capped at the PHA's Payment Standard, which must normally be between 90 and 110% of the current Section 8 Fair Market Rent (FMR). As a result, owners of properties with both TPVs and HUD-issued Section 8 PBRA will have two different contract administrators: the PHA and the HUD Performance-Based Contract Administrator, respectively.

Families who are issued TPVs must qualify under new voucher occupancy standards. For example, if the family size has changed since original occupancy and no correctly-sized unit was previously available in the property, they would be considered to be over-housed or under-housed for TPV purposes. In this case the PHA would not approve their use of the TPV at the property but would approve its use for another correctly-sized unit at another property.

Enhanced Vouchers

Enhanced Vouchers (EVs) are a special class of TPVs, triggered in certain circumstances. EVs provide additional protections to residents, and requirements for rent setting are more flexible compared to TPVs.

Triggering events for the issuance of EVs are:

- **Section 236 loan is prepaid and subject to Section 219 (payment permission is as-of-right):** In an as-of-right prepayment of a Section 236 loan, the owner can request EVs for the units that are not already assisted with a Section 8 PBRA subsidy. This includes HFA-issued loans since HUD consent is not required for prepayment.
- **Flex Sub Loans:** If the property has received a Flex Sub Loan, then EVs are available when the project is preserved as affordable (as determined by HUD).
- **Section 8 PBRA:** EVs can be issued to affected residents when a Section 8 PBRA contract is not renewed at expiration.

Unique characteristics of EVs are:

- The contract rent may be equal to comparable market rent.
- The tenant has the right to remain in the unit (unless it is being substantially rehabilitated or converted from rental housing use).
- In the case of EVs issued as a result of prepayment (as opposed to nonrenewal of a Section 8 HAP contract), tenants with incomes up to 95% of Area Median Income (AMI) may be eligible if they are elderly, disabled, or residing in a low-vacancy area.
- In the case of prepayment-generated EVs, a floor rent equal to the rent at the time of prepayment is required, with certain exceptions for declining resident income. For all TPVs, including EVs, a tenant must requalify for the unit, as to income eligibility and the appropriateness of the unit size.

Notice H 2012-03 "Guidance on Eligibility for Tenant Protection Vouchers Following Certain Housing Conversion Actions," summarizes the distinctions among different circumstances that trigger TPVs and EVs. The rules are complex, depending on a variety of circumstances, and the detailed guidance in this Notice should be followed.

RECAP TIP

Timing and Tenant Protection

When the Section 236 loan can be prepaid as-of-right, or when the property has received a Flex Sub Loan or is HFA-issued, don't miss the opportunity to obtain Enhanced Vouchers for eligible residents. Be sure to prepay *prior to maturity*, allowing enough time for required notices and to process the new vouchers.

Project-Based Vouchers

The Section 8 Project-Based Voucher (PBV) program permits a PHA to agree to link HCVs to a specific property, providing rental assistance at the project level. When TPVs are issued, they may also be converted into a PBV contract, such as through RAD 2 or the special allotments described below. This long-term PBV contract can be used to support new financing against this stable income stream.

PBV requirements are different from the Section 8 PBRA requirements in many ways. The owner contracts with the PHA rather than with HUD for PBV assistance, and the PHA manages the waiting list of tenants. After one year of living in a PBV unit, a tenant is eligible to receive a portable voucher that can be used to move to another rental unit, and the PHA fills the vacancy at the property with another HCV holder. The owner may screen voucher holders referred by the PHA. The PBV contract term may be up to 15 years, subject to appropriations, and is renewable. The rent limit is generally 110% of FMR or any excepted payment standard approved by HUD.

RECAP TIP

Benefits of Project-Basing Rental Subsidies

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

The PBV regulations at 24 CFR 983.304(c) establish contract rent setting rules that are different in a Section 236 property (including one that has decoupled the IRP), as compared to a non-Section 236 property. This table summarizes how PBV rent setting takes place in a Section 236 property.

RENT SETTING FOR PROJECT-BASED VOUCHER CONTRACTS IN SECTION 236 PROPERTIES

Without Decoupling the IRP	With Decoupling the IRP
The PBV rents are set at the **lesser** of: • The public housing authority's (PHA) payment standard (not to exceed 110% of Section 8 Fair Market Rent (FMR) or the HUD-approved exception payment standard, if higher) • The reasonable (i.e., market-comparable) rent • The owner's request	While Section 236 restrictions remain in place for 5 additional years, the PBV rents are capped by the Section 236 Basic Rent. • If the Section 236 Basic Rents are much lower than the other three potential PBV rent caps without decoupling, compare the benefit of using the decoupled IRP to that of a potentially higher PBV rent when the IRP is not decoupled. • However, note that, in a preservation transaction involving decoupling, the new Basic Rent will factor in the new debt service, so this limitation may not have a practical effect.

Special Allotments for Projects That Do Not Normally Qualify for Tenant Protection Vouchers

Notice HUD 2015-07 "Funding Availability for Tenant-Protection Vouchers for Certain At-Risk Households in Low-Vacancy Areas – Fiscal Year 2015" implemented a $5 million allotment of EVs or PBVs permitted by Congress for, among others, certain Section 236 properties in low-vacancy areas where residents are at risk of displacement due to mortgage maturity or expiration of related HUD use restrictions. This includes both properties that require HUD permission to prepay and other properties with mortgages that have already matured. Congress has provided a series of annual special set-asides of TPVs, and owners should look out for new special allotments that may benefit their unassisted residents. These allotments will typically be announced on the HUD Housing Notices page on HUDCLIPS.

REVIEW

Vouchers

Tenant Protection Vouchers (TPVs)

- **TPVs are issued through the local Public Housing Authority (PHA).**
- **TPVs may be Enhanced Vouchers (EV) or regular Housing Choice Vouchers (HCV).**
- **TPVs can be triggered by Section 236 mortgage prepayment, creating a resource to benefit residents and the property.**
- **Availability is subject to annual appropriations.**
- **Residents and units must be qualified.**
- **Vouchers are portable; they follow the resident and are not attached to the property.**

How are EVs different than TPVs?

- **EVs are a category of TPVs.**
- **EVs are triggered in certain circumstances.**
- **EVs provide additional protections to residents compared to TPVs.**
- **EV requirements for rent setting are more flexible than TPVs.**

Project-Based Vouchers

- **TPVs may be converted to Project-Based Vouchers in certain circumstances (for example, RAD 2).**
- **Special PBV contract rent setting requirements apply in a preservation transaction that includes IRP decoupling.**

7. RENTAL ASSISTANCE DEMONSTRATION 2

Q: Why RAD 2?

A: RAD 2 allows conversion of expiring non-renewable Rent Supp and RAP contracts into long-term project-based Section 8.

How is RAD 2 an Important Tool for Section 236 Preservation Transactions?

Rental Assistance Demonstration 2 (RAD 2) was created to maintain continuity of *project-based* assistance after the expiration of Rent Supp and RAP contracts.[7] Rent Supplement and RAP contracts are not renewable forms of subsidy. Further, a Rent Supp or RAP contract is terminated upon prepayment of the first mortgage, as well as at contract expiration, and then cannot be renewed. It is currently HUD's policy that extensions will only be granted in the context of a RAD conversion.[8] Upon termination for any of these reasons, Tenant Protection Vouchers (which, in some cases, may be Enhanced Vouchers) will be awarded to eligible residents to preserve rent affordability.

RAD 2 allows project-basing of those TPVs as Project-Based Vouchers (PBVs) or as a conventional Project-Based Rental Assistance (PBRA) Section 8 contract. In the case of conversion to PBVs, RAD provides waivers of certain PBV rules to create flexibility. Further, if the underlying Section 236 mortgage is prepaid "as of right" when the Rent Supp or RAP termination occurs, then tenants without rental assistance, pending eligibility, will also have the opportunity to receive TPVs (in the form of EVs) and those vouchers may also be converted to project-based assistance under RAD 2.

When working on a RAD 2 transaction, always verify with HUD the project's Rent Supp or RAP contract expiration dates.

The option to convert TPVs to PBRA assistance was provided by Congress, along with other RAD program changes, in the FY 2015 appropriations act.

The PBV or PBRA contract provides a stable source of income to the project for a 15-year or a 20-year term, respectively, with renewal options. Consequently, RAD 2 can help an owner leverage additional financing for capital improvements. The RAD 2 program is described in Notice PIH 2012-32 REV-2, "Rental Assistance Demonstration – Final Implementation, Revision 2." The original RAD Notice has been modified several times to allow for statutory changes. The most recent revisions implement program changes in the FY 2015 HUD appropriation that expanded HUD's RAD authority to allow project-basing of the rental subsidies as either Section 8 PBVs through a PHA or as a Section 8 PBRA contract with HUD. See Notice PIH 2012-32 REV-2 for other important program revisions.

[7] *RAD 2 also addresses Section 8 Moderate Rehabilitation contracts.*

[8] *Congress has recently provided year-to-year authority and funds for short-term extensions of expiring Rent Supp or RAP contracts to maintain these subsidies until another form of rental assistance can be put in place.*

In the case of PBVs as the project-basing platform, RAD 2 provides the following flexibilities:

- RAD 2 units do not count against a PHA's normal limitation of project-basing for more than 20% of the PHA's total vouchers.
- The 25% limitation on the number of units that may receive PBV assistance in a project is increased to 50% under RAD 2. An owner may still project-base 100% of the units provided at least 50% of the units at the project qualify for the exceptions for elderly, disabled, or families eligible to receive supportive services, or are within single-family properties.
- HUD's normal PBV contract competitive selection requirement is not applicable to RAD.
- Note also that, for both PBRA and PBV conversions, TPVs in non-Rent Supp and non-RAP units that are generated by the prepayment may also be project-based under RAD 2. Pre-existing Housing Choice Vouchers may also be project-based, but only if the triggering event creates Enhanced Vouchers for those units and the tenant provides consent to convert.

RAD 2 applications can be submitted to the HUD Multifamily field office on a rolling basis according to the rules outlined in [Notice PIH 2012-32 REV-2.]

REVIEW:

RAD 2

TPVs are tenant-based, but RAD 2 allows conversion to project-based rental assistance. The benefits include:

- **RAD 2 now permits an owner choice of converting TPVs either to PBRA or PBV.**
- **RAD 2's long-term project-based Section 8 contracts can be used to leverage new financing in a preservation transaction.**

APPLY FOR FINANCING AND HUD APPROVALS

The previous chapter focused on **Step 3: Choose Your Options**. Owners were provided information about tools, resources, and options to consider that would support their preservation goals. In **Step 4: Apply for Financing and HUD Approvals**, the owner will:

- **Design improvements and hire a contractor.** Owners work with an architect to design and estimate the price of renovations and capital improvements, and then hire an experienced contractor who will manage the project.
- **Apply for new financing.** In order to pay for the improvements, owners apply for a conventional, FHA, or HFA loan; grants or soft debt like HOME or Community Development Block Grant funds; and/or raise equity through Low-Income Housing Tax Credits (LIHTC).
- **Issue required tenant notices.** Owners who are prepaying their Section 236 loans must provide the required tenant notifications. They also must consider local or state laws, such as right-of-first refusal.
- **Secure HUD approvals.** Owners will need to apply to HUD to secure approvals for the various tools described in **Step 3: Choose Your Options.** These include prepayment, Interest Reduction Payment (IRP) decoupling, Flexible Subsidy (Flex Sub) Loan deferral, Section 8 Renewal, Tenant Protection Vouchers (TPVs) , including Enhanced Vouchers (EVs), and Rental Assistance Demonstration 2 (RAD 2).

This section of the guide focuses on the mechanics and processes for applying for and obtaining HUD approvals in a preservation transaction. These approvals are also prerequisites to moving ahead with financing and they may affect the rehabilitation requirements for the property.

Step 4 is an interactive process of interdependent factors and options that must be carefully coordinated and timed. This section ends by outlining factors an owner will want to consider in sequencing the approval and financing processes.

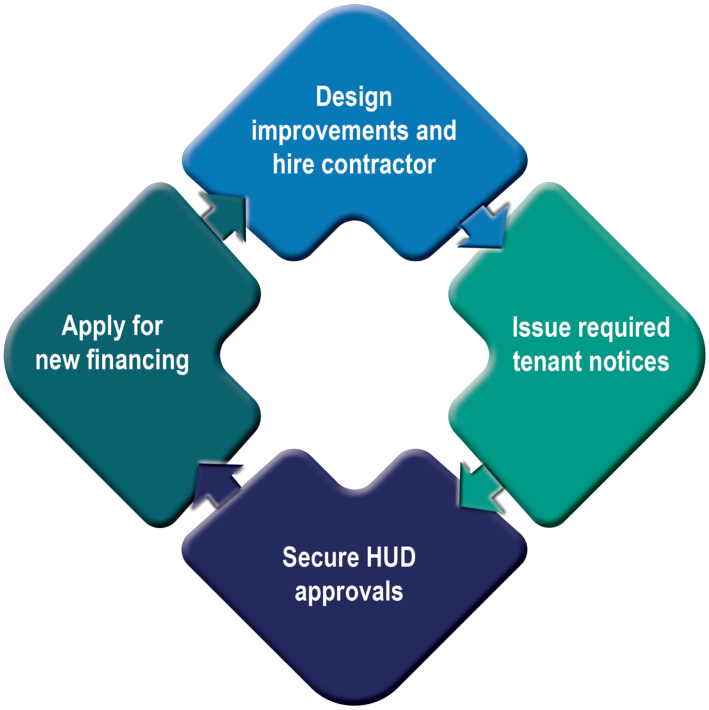


Figure 4: *Apply for Financing and HUD Approvals*

RECAP TIP

Your Preservation Team

Assemble a team of experts who are familiar with and specialize in affordable housing preservation. Teams typically include a preservation consultant, lender, attorney, architect, property manager, and contractor. The team and HUD will help the owner evaluate the property's preservation options for refinancing, rental assistance, and long-term financial stability.

Steps to Secure HUD Approvals

To proceed with a transaction involving an active Section 236 loan, owners can find current information, guidance, and the Section 236 application tool at www.hudmfpreservation.net. This website includes the latest relevant HUD Notices, the Section 236 Excel spreadsheet application tool, and a very informative webinar that explains how to use the tool for requests related to the Section 236 loan.

RECAP TIP

Ask a Question

This webpage also includes a link to "Ask a Question" for further guidance. It is recommended that owners use this method to submit broad questions regarding their Section 236 loans and to seek guidance from HUD.

Preservation Application Process: Preparation and Submission

- **HUD Section 236 Consolidated Application Package:** Applicants are strongly encouraged to use this tool to describe proposed preservation transactions, request HUD approvals, and upload supporting documents. While HUD does not require owners to use the Consolidated Application tool, this tool meets HUD's electronic submission requirement, while also providing users with one central portal through which to submit all required documentation (e.g., Interest Reduction Payment (IRP) Decoupling, Flex Sub Loan deferral) that are currently collected under the established Paperwork Reduction Act (PRA) approval numbers.
- Prior to submitting a completed 236 prepayment application, owner applicants must first complete one of the following steps:
- **HUD-Held 236 Mortgages:** The owner must e-mail a written request to 236preservation@hud.gov for approval to prepay the active HUD-held Section 236 mortgage.
- **FHA-Insured 236 Mortgages:** The property owner's mortgage servicer must submit a completed Form 9807 to HUD, care of 236Preservation@hud.gov.
- **Consolidated Application Training Webinar:** This training (recorded on July 24, 2013) walks the user through the step-by-step process of completing an online Section 236 preservation application using the Consolidated Application tool and submitting it electronically to HUD.
- **HUD Policy Guidance:** The Resource Desk Policy Guide provides a summary of current HUD guidance on preservation transactions, including HUD Notices and Handbooks. This page also provides links to HUD Standard Forms that applicants are required to complete and submit as a part of the preservation application.

Use the application tool to request:

- ✓ Prepayment approval
- ✓ IRP decoupling
- ✓ Flex Sub Loan deferral requests
- ✓ Increase in post-transaction rents
- ✓ Issuance of TPVs
- ✓ Nonprofit fees and sales proceeds
- ✓ LIHPRHA-ELIHPA amendments
- ✓ Unit conversions (combining efficiencies into 1-BR units)
- ✓ Assumption of Housing Assistance Payment contracts if ownership is transferred
- ✓ Other HUD-required approvals

RECAP TIP

For HFA-issued Section 236 loans, apply for approvals through HUD like all other Section 236 projects *AND* contact the HFA about their required prepayment approvals. All Section 236 preservation rules and incentives apply to these properties.

Prepayment Application Requirements

Prior to submitting any prepayment request to HUD for a HUD-insured Section 236 loan (whether as-of-right or not), the owner must first notify the HUD-insured lender/mortgagee (or HUD, if the loan is HUD-held and has been assigned to HUD as a result of a mortgage insurance claim). The mortgagee then submits a completed HUD Form 9807, "Insurance Termination Request for Multifamily Mortgage," demonstrating their consent to the prepayment. Form 9807 provides a checklist that is relevant to determining eligibility for prepayment without HUD consent.

If the loan has been assigned to HUD, then the owner must notify the HUD Office of Recapitalization by email to obtain approval. Details regarding this process are found in Chapter 22 of the Asset Management Handbook, "Prepayments and Voluntary Terminations" (4350.1, REV-1). The completed request must be submitted to the HUD Office of Recapitalization (Recap) via the following email address: 236preservation@hud.gov.

When a prepayment will generate any form of TPVs, including EVs where applicable, there is also a timing consideration: the prepayment process must be coordinated with the selection of a public housing authority to administer the vouchers, and it typically takes five months or more from application to the time that tenants actually receive the rental assistance. Guidance on that coordination is provided in Notice PIH 2001-41, "Section 8 Tenant-Based Assistance (Enhanced and Regular Housing Choice Vouchers) For Housing Conversion Actions – Policy and Processing Guidance" and Notice PIH 12-03, "Guidance on Eligibility for Tenant Protection Vouchers Following Certain Housing Conversion Actions."

Sequencing the Preservation Steps

In a refinancing of a Section 236 property, the owner is responsible for submission of the prepayment, decoupling, Flex Sub Loan deferral, and TPV requests, as well as any rental assistance contract renewals. One of the most important considerations in a preservation transaction is how to sequence the submission of these requests.

The planning for the HUD approval process starts well before the 150-day notice to residents. Critical timing considerations include:

- **Lenders and investors** have long lead times from initial application to closing on their debt and equity funding.
- If **Section 8 or other rental assistance contracts** need to be renewed or have the rents adjusted, those procedures and timelines must be synchronized with other transaction elements. See the Section 8 Renewal Guide for detailed guidance and procedures.
- If new **TPVs** (including EVs) will be obtained, time is needed for coordination with the administering PHA, including the time needed for individually qualifying each resident and unit.
- If TPVs (including EVs) will be **project-based,** additional time is needed for processing the decision with residents.
- **New subsidies** are applied for, typically from state and local government, in periodic competitive cycles ("funding rounds") at specified times.
- To place new debt on the property, the owner will need to negotiate with holders of any **existing soft public** debt to seek waiver of due-on-sale or refinancing provisions, or re-subordination to the new first mortgage debt. There is no guarantee that state or city public lenders will agree.
- The owner will need to conduct **due diligence,** typically before applying for new debt and equity, using third party architects, engineers, and counsel.
- Beginning with the funding of a prepayment, a typical transaction may include a sequence of financing actions, each dependent on the other. Therefore, the owner must be aware of **state and local deadlines for funding rounds,** including, in some cases, additional public notice requirements required by state and local law.
- It is advisable not only to ensure that required prepayment **tenant notices** not get "stale," but also to keep residents informed as to the actual date of prepayment and other changes resulting from the transaction. For example, delays in assembling financing may result in the prepayment occurring more than 270 days after a Wellstone Notice was filed.
- For projects that will require renovations with residents in place, allow time to **seek input from residents** on timing and how best to minimize the impact on their lives during the rehab process.
- Consult policy guidance to determine if **relocation** must comply with the requirements of the Uniform Relocation Act.

RECAP TIP:

Timing Considerations

To manage this complex web of activities, it is best to take a critical path approach. Many processes are interdependent, further complicating the schedule. With respect to tenant and other public notice requirements, it is vitally important both to ensure that notices are neither too late nor too early, and to anticipate the communication with residents and public officials that these notices will stimulate.

Secure Long-Term Stability

Step 5: Secure Long-Term Stability is the implementation of a preservation plan that stabilizes the Section 236 property and places it on solid financial footing. In Step 5, the owner:

- **Closes** on new financing
- **Starts or renews** the new rental assistance programs
- **Renovates** the property

ACT NOW:

Get Started on Your Preservation Strategy!

HUD can guide owners through the Section 236 preservation process. Contact the staff at the Office of Recapitalization at 236Preservation@hud.gov with any questions.

APPENDIX A: SECTION 236 PRESERVATION RESOURCES AND TOOLS

This resources and tools list provides information about where to find detailed guidance on how to preserve and recapitalize a Section 236 project. The information applies to each of the following types of Section 236 mortgages:

- FHA-insured
- HUD-held loans
- State Housing Finance Agency (HFA)-issued

PRESERVATION BASICS	
Get Started: Basic Information about HUD Multifamily Affordable Housing Preservation	• On the HUD Exchange Multifamily Housing Preservation page: – Webinar: Welcome to Preservation: Strategies to Preserve and Refinance Affordable Housing Properties – Get Started on Your Preservation Strategy – Glossary of Multifamily Affordable Housing Preservation Terms – Roadmap to Preservation • Subscribe to the Multifamily Housing Preservation Mailing List to receive emails with news, events, training, and information about how to maintain housing affordability
HUD.gov Websites	• HUD's Office of Recapitalization administers Section 236 preservation transactions • HUD.gov Section 236 Preservation Overview • HUD.gov Preserving Multifamily Properties

SECTION 236 PRESERVATION GUIDANCE	
Section 236 Preservation: General Guidance	
Get Started: Preservation of a Section 236 Project	• HUD Exchange Section 236 Page • Webinar: How to Preserve and Recapitalize a Section 236 Property • Preservation Options for Section 236 Properties (this document)
Apply for Section 236 Preservation Approvals	• HUD memorandum issued on June 28, 2013: Instructions for requesting HUD approvals related to Section 236 loans (revisions pending) • Section 236 preservation information and resources are available via the Multifamily Preservation Resource Desk: Application for prepayment and other preservation transaction approvals

Section 236 Preservation: Refinancing Guidance	
Prepayment Permission	• Notice H 2006-11: Prepayments Subject to Section 250(a) of the National Housing Act • Policy Clarification for Prepayments Subject to Section 250(a) of the National Housing Act
Section 236 IRP Decoupling	• Notice H 2013-25: Updated Guidelines for Continuation of Interest Reduction Payments after Refinancing: "Decoupling," as allowed by the National Housing Act, under Section 236(e)(2) • Notice H 2000-08: (Superseded except for Section 236(b) transactions) Guidelines for Continuation of Interest Reduction Payments after Refinancing: Decoupling under Section 236(e)(2) and refinancing of insured Section 236 projects into non-insured Section 236(b) projects • HUD guidance on the treatment of Section 8 in decoupling transactions is codified in the Section 8 Renewal Guide, issued August 7, 2015 and effective November 5, 2015
Deferral of Flexible Subsidy Operating Assistance Loans	• Notice H 2011-05: Policies and Procedures for the Deferred Repayment of Operating Assistance Flexible Subsidy Loans (Extended by Notice H 2012-04) • Notice H 2013-02: Collection Procedures for Delinquent Section 201 Flexible Subsidy Loans
Mortgage Insurance Termination	• Form 9807: Insurance Termination Request for Multifamily Mortgage
Section 236 Preservation: Rental Assistance Options	
Renewal of Project-Based Section 8 Contracts	• Section 8 Renewal Policy Guide Book, Issued August 7, 2015 and effective November 5, 2015: Description of owners' options for renewing expiring Section 8 Project-Based Rental Assistance
Tenant Protection Vouchers and Enhanced Vouchers	• Notice PIH 2001-41: Section 8 Tenant-Based Assistance (Enhanced and Regular Housing Choice Vouchers) For Housing Conversion Actions — Policy and Processing Guidance • Notice H 2012-03: Guidance on Eligibility for Tenant Protection Vouchers Following Certain Housing Conversion Actions • Notice HUD 2015-07: Funding for Tenant-Protection Vouchers for Certain At-Risk Households (July 20,2015 update)
RAD 2	• Notice PIH 2012-32, REV 2 (June 15, 2015): Rental Assistance Demonstration — Final Implementation, Revision 2
Project-Based Voucher Regulations	• 24 CFR 983 Project-Based Voucher (PBV) program regulations • Applicability of Davis-Bacon Labor Requirements to Projects Selected as Existing Housing Under the Section 8 Project-Based Voucher Program — Guidance
General Rules Integrating Section 236 Operations with Rental Assistance	• For Rent Supplement, Section 236 Rental Assistance Payment (RAP) and Section 8 Loan Management Set-aside (LMSA): Asset Management Handbook (4350.1) (revisions pending)

Section 236 Preservation: Other Considerations	
Allowance of Nonprofit Sales Proceeds and Distributions	• Notice H 2011-31: Policy for Treatment of Proceeds Resulting from the Sale of FHA-insured or HUD-held formerly insured Multifamily Projects by Nonprofit Owners
Amendment of Use Agreements pursuant to ELIHPA and LIHPRHA	For Emergency Low-Income Housing Preservation Act (ELIHPA) and Low-Income Housing Preservation and Resident Homeownership Act (LIHPRHA): • Regulations at 24 CFR Part 248 • Individual property Plans of Action and Use Agreements • Notice H 2012-25: Policy for Amended and Restated Use Agreement for Multifamily Projects Subject to the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (LIHPRHA) • HUD guidance is pending on additional flexibilities to owners of LIHPRHA properties with regard to rents and access to reserves and distributions provided all capital needs have been met (per Fixing America's Transportation Act, enacted on December 4, 2015, Title LXXVII)
Conversion of Efficiency Units to One-Bedroom Units	• Notice H 2011-03: Policies and Procedures for the Conversion of Efficiency Units to One-Bedroom Units
Tenant Participation Requirements	• Notice H 2014-12: Implementation of Tenant Participation Requirements in accordance with 24 CFR Part 245

APPENDIX B: SECTION 236 PRESERVATION CHECKLIST

STEP 1

Know Your Property

This checklist provides guidance on the documents and information that Section 236 owners should gather at the start of the preservation planning process. The information applies to FHA-insured, HUD-held loans and State Housing Finance Agency (HFA)-issued Section 236 mortgages.

Before your property's ownership team develops a preservation strategy, you and your team will need to understand the property's current financing, rental assistance, and capital needs. Taking this step to "know your property" will result in a clear understanding of the issues that will impact the property's preservation goals.

A: Financing

GATHER DOCUMENTS	KNOW YOUR PROPERTY
☐ **Section 236** Mortgage Note and Regulatory Agreement ☐ **Interest Reduction Payment** (IRP) Use Agreement, IRP Payments Agreement, and IRP Amortization Schedule ☐ **Flexible Subsidy** (Flex Sub) Loan Grant Agreement, Financial Assistance Contract or Residual Receipts Note, and the Flex Sub Loan Use Agreement ☐ **Other Financing** Use Agreements, Covenants, Mortgages, Deed Restrictions, and/or Regulatory Agreements ☐ **ELIHPA or LIHPRHA** Plan of Action and Use Agreement ☐ Most recent 3 years of **financial statements** (audited if available), including notes and supporting schedules	☐ When does the Section 236 loan mature? Confirm your maturity date with your lender. ☐ Can the loan be prepaid? Figure out if you need HUD permission to prepay your Section 236 loan: • Was the original owner a nonprofit? • Did the property ever have a Rent Supp contract? If so, was it converted to Section 8? • Did the property receive a Flex Sub Loan? ☐ How many months of IRP subsidy will remain at the anticipated closing date? ☐ Is there a Flex Sub loan that is due at the maturity/prepayment of the Section 236 loan? ☐ What concerns or issues are you aware of that might prevent the property from being financially and operationally viable over the long term?

B: Rental Assistance

GATHER DOCUMENTS	KNOW YOUR PROPERTY
☐ **Rental Subsidy Agreements** (Section 8 Housing Assistance Payments, Project-Based Vouchers, RAP, and/or Rent Supp) ☐ Most recent three months of **rent rolls** ☐ **Resident income certifications**	☐ What is the breakdown of assisted and unassisted units by bedroom/unit type? ☐ For each rental assistance contract: • When does it expire? (To be confirmed by HUD.) • Is the contract renewable? How is it renewed? • How are rents increased? • Are the current rents under, at, or above market rate? ☐ For unassisted units: • Which of the families have incomes at 80% or less of the Area Median Income and are paying less than the market rent now? • How is rent increased on these units?

C: Capital Needs and Reserves

GATHER DOCUMENTS	KNOW YOUR PROPERTY
☐ Latest **REAC** report (know the REAC score) ☐ Account balances of **reserves for replacement** and **residual receipts** ☐ **Capital Needs Assessment,** if any, that evaluates the property's upcoming capital replacement needs	☐ When was the property built? ☐ What capital improvements have been completed since it was built? ☐ What concerns or issues are you aware of that might prevent the property from being physically viable over the long term? Are capital improvements needed? What are the renovation priorities of the building's residents? What improvements would improve the marketability of the building? ☐ What funds are available to address future improvements needed?

Once you have gathered these documents and information, you will have a clear understanding of your property and can begin **Step 2: Set Your Preservation Goals.**

APPENDIX C: SECTION 236 HUD APPROVALS FOR A PRESERVATION TRANSACTION FLOW CHART

STEP 4

Apply for Financing & HUD Approvals

To move forward on a preservation transaction, owners apply to HUD to secure approvals for the various tools, options, and incentives described in Step 3: Choose Your Options. These include prepayment, Interest Reduction Payment (IRP) decoupling, Flexible Subsidy (Flex Sub) Loan deferral, Section 8 contracts, Tenant Protection Vouchers (TPVs) and Enhanced Vouchers (EVs), and RAD 2. This flow chart will help owners understand the sequencing of the decisions that need to be made. This is an iterative process of interdependent factors and options that must be carefully coordinated and timed.

1. PREPAYMENT

Have you already decided whether to prepay your Section 236 loan, as opposed to allowing it to mature?

a. I WILL PREPAY: Proceed to #2.

b. I WILL NOT PREPAY, or NOT SURE:

- Is your property eligible for and do you need TPVs for unassisted residents at the property?
- **YES:** You can only receive the needed TPVs if you prepay your Section 236 loan. Proceed to #2.
- **NO:** Do you need to address capital repairs from a new source of funds before your loan matures?
  - **YES:** You will likely want to prepay. Proceed to #2.
  - **NO:** You may not need to prepay. Discuss with your consultants and assuming no prepayment, proceed to #4.
- **NOT SURE:** Discuss with HUD the possibility of adding TPVs, and whether or not you are eligible for the TPVs. Proceed back to 1(b) once you know the answer.

2. PERMISSION TO PREPAY

Does your Section 236 loan need HUD permission to prepay?

a. YES: Issue the 150-day notice to tenants, local government, and HUD. Proceed to #3.

b. NO: Issue the Wellstone notice to tenants, local government, and HUD. Proceed to #3.

c. NOT SURE: Consult with HUD, and then depending on your answer, proceed to 2(a) or 2(b).

3. IRP DECOUPLING

Do you want to decouple the IRP from the Section 236 loan?

a. YES: Include the decoupling request with your prepayment request. Proceed to #4.

b. NO: You will not need to include decoupling in your requests to HUD. Proceed to #4.

c. NOT SURE:

- Do you have more than 18 months of IRP balance remaining, and could that balance be useful in leveraging additional capital in a refinancing plan?
- **YES:** Will you accept a 5-year extension of your 236 Use Agreement?
  - **YES:** Decoupling is likely a very good idea. Proceed to 3(a).
  - **NO:** You may not decouple if you don't accept the 5-year extension. Proceed to 3(b).
- **NO:** Decoupling may not be useful for this transaction. Proceed to 3(b).

4. FLEXIBLE SUBSIDY LOAN DEFERRAL

Do you have a Flex Sub Operating Assistance Loan that has a balloon note due at maturity or prepayment of your Section 236 loan?

a. YES: Will you have sufficient funds to pay the balloon note in full at maturity and/or refinancing?

- **YES:** It doesn't appear that you need to defer your Flex Sub Loan. Remember to budget for full pay-off at refinancing and/or maturity. Proceed to #5.
- **NO:** You will need to request a Flex Sub Loan deferral from HUD. Proceed to #5.

b. NO: Proceed to #5.

c. NOT SURE: Review your audited financial statements carefully. Any outstanding debt such as this should be reflected there. Proceed back to 4(a) or 4(b) depending on what you learn.

5. NEXT STEPS

CONGRATULATIONS! You are ready to prepare your preservation transaction requests to HUD.

Based on the answers above, the request will include any of the following that are applicable: prepayment permission, IRP decoupling request, request for TPVs, and/or Flex Sub Loan deferral.

Remember that for projects prepaying that issued the 150-day tenant notice or the Wellstone notice, the prepayment may not be made until 150 days after the notice (but not more than 270 days after, if it is a Wellstone notice). If you do not have 150 days before loan maturity, discuss your transaction with HUD as the 150-day period may be waived.

Owners should allow six to twelve weeks for HUD to process these requests. Proceed to #6.

6. RAD 2

Do you have a RAP or Rent Supplement contract?

a. YES: Plan to convert it to long-term assistance through RAD 2. Be sure to allow enough time for the conversion in your overall refinancing plan. Proceed to #7.

b. NO: Proceed to #7.

7. SECTION 8 PBRA

Do you have a Section 8 Project-Based Rental Assistance contract with less than a 20-year term?

a. YES: Plan to terminate and replace with a new 20-year contract at the closing on new financing. See the Section 8 Renewal Guide for more information.

b. NO: No action needed.

APPENDIX D: CONSIDERATIONS WHEN SELLING A SECTION 236 PROPERTY

In some cases, the best preservation alternative is a sale of the property to an entity that is committed to long-term, sustainable affordability. The new entity could also be a joint venture with the current owner. This could be the case if the current owner does not have the technical capacity or financial strength required for a major recapitalization transaction. In particular, the use of Low Income Housing Tax Credits (to recapitalize the property) requires both prior program experience and the ability to make significant financial guarantees.

It should be noted that the LIHTC program requires a sale of the real estate to a new, single-purpose, ownership entity. If an owner wishes to retain control and use LIHTCs as a preservation funding source, special rules must be followed about the structure of the new owner to avoid so-called related party issues.

If the selling owner is a nonprofit, HUD guidance in Notice H 2011-31, "Policy for Treatment of Proceeds Resulting from the Sale of FHA-insured or Secretary-held formerly insured Multifamily Projects by Nonprofit Owners," provides flexibility in the use of any equity released by the transaction. Nonprofit sellers may retain net sales proceeds for uses consistent with their charitable purpose, provided that:

- The property will be subject to a new Use Agreement, extending affordability for at least 20 years beyond the original mortgage maturity date.
- Any Project-Based Section 8 contract is renewed for 20 years, and includes a Preservation Exhibit providing for automatic renewal after the 20-year term for the unused term of the contract being renewed.
- There is no involuntary displacement of existing residents as a result of the transaction.
- Existing over-market Section 8 rents may not continue to exceed comparable market rents and Option 4 renewal is not permitted. Non-Section 8 rent increases must be phased in to avoid a rent burden and may not exceed 10% without a waiver from HUD.
- The purchaser must conduct a Capital Needs Assessment. Any significant repair needs (accessibility repairs, major building systems, or life safety items) must be addressed beginning at the closing of the transaction, and completed in a time frame acceptable to HUD.
- The transaction must include a feasible financing plan.
- The purchaser must have adequate experience and capacity as an owner of affordable rental housing.