Preserving USDA’s MFH Portfolio – KEY TOPICS

• The MFH Program Overview
• Basic Revitalization Realities
• RD’s Revitalization strategy and results
• Revitalization funding and case studies
• Key transfer issue – dividing the pie
• Thoughts on RD’s strategy and working with RD
• The current state of RD’s approach
Typical Section 515 Multifamily Property
Critical to Rural Infrastructure

Multi Family Housing Property Locations
Timeline of Federal Housing Programs

Public Housing
- Housing Act of 1937

Elderly Housing
- Housing Act of 1959

Housing and Community Dev’t
- Act of 1974

Low-Income Housing

Multifamily Assisted Housing
- Reform and Affordability Act of 1997

LIHTC
- Tax Reform Act of 1986

Housing and Urban Dev’t
- Act of 1968

LIHTC
- Tax Reform Act of 1986
4 Basic Realities: 515/514 Portfolio (data 5-1-11)

- **Reality #1 Wonderful National Asset that is worth preserving!**
  - 15,559 Properties with 443,153 Units (28 units avg. size)
  - $11.3 B in outstanding principal (2.9% delinquent)
  - The tenants served need our help:
    - $11.4K Annual Average Income ($9.4K for RA)
    - 65% receive RA (15% receive HUD project or tenant based subsidy)
    - 20% receive no deep tenant subsidy
  - Tenant Households headed by:
    - 59% Elderly
    - 71% Female
    - 31% Minority
    - 24% Handicapped or disabled
    - 30% Tenant turnover

- **Reality #2 – Markets are always an issue and program losing units**
  - 30% Properties in counties with declining income
  - 65 K Families “overburdened”
  - 2 K units lost each year (average over last five years)
Reality #3 – Historical funding curve means preservation funding must be from 3rd party sources – No memo issued!

Section 515 Rural Rental Housing Program, FY 1963 - FY 2008

Source: HAC Tabulations of USDA-Rural Development Data

Rural Housing Preservation Associates, LLC - contact Larry Anderson at landerson@rhpallc.com
Reality #4 – It’s all about the Rental Assistance (95% of RD’s MFH BA) – mostly for annual RA contract renewal

FY 2012 Budget Authority in $Millions

- MPR (2)
- Voucher (11)
- FLH (14)
- 538(0)
- 515(22)
- RA(904)

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Biggest Reality: RD RA Strategy – By 2014, bend the outlay (spending) curve back to FY 2008 level (17% drop) * Data in millions and from USDA FY 2014 Budget:

- RA Obligations
- RA Outlays
- Fiscal year

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Key Revitalization Study findings

- **Comprehensive Property Assessment (CPA) found:**
  - Irreplaceable rural rental housing option
  - Portfolio in good shape, but aging and reserves under funded
  - Addressing now is more cost effective

- **Study also said:**
  - Portfolio breaks into 3 segments
    - 10% in great markets – expensive to preserve
    - 10% in bad markets – not feasible to preserve
    - 80% in the middle – feasible to preserve
  - Just using rent increases and “more” RA is too expensive
  - We need new cost effective revitalization tools
  - Reinvent program delivery for smarter & faster decisions
Why is preserve rather than build new?
When you’re rapidly losing units it’s:

- Cheaper
- Faster
- Greener
- Reverse NIMBY
- Necessary (worst case rental need has exploded - 3 year growth of 2.5 M now at 8.5 M)
Key RD Revitalization challenges:

- **Nature of the portfolio**
  - Aging – earliest projects from the 60’s
  - Small properties
  - Rural Markets
  - Not enough RA
  - Aging of physical structure-project specific

- **Nature of ownership entities**
  - SELLER EXPECTATIONS!
  - Aging owners and entities
  - Conflicting interests within ownership
  - Tax consequences for selling or not selling

- **Cloud of Prepayment statute litigation now lifting**
  - Franconia Case and Tucker Act Settlement – damages for restrictions
  - Goldammer – APA violation to not follow regulation

- **Limited pool of purchasers and funding resources**

- **Tightening Federal budget for traditional subsidies and administration**
  - Impact of cumulative cuts
  - Smaller program or smarter program?

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Access to Preservation Resources

- **MPR (MFH Preservation and Revitalization Demo)**
  - Access RD rehab funds – key tool: deferrals (pre-92 only)
  - Apply thru NOFA
  - Simple (stay in owners)/Complex (transfers) Portfolio (transfers and stay in owners)

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

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

- **Substitution of GP’s or "no funds" transfers**
  - Access to project control - no new resources available (existing RA helps)
  - **Notify RD Office**
  - “pottery barn” affect - “white knights” beware

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RD’s Revitalization Strategy

- **Components of all deals**
  - Project is needed in market
  - Post transaction Owner is eligible

- **Basic Feasibility Thresholds**
  - CNA to determine capital needs, timing and funding
  - Underwriting to determine feasibility and tools
    - SUSTAINABLE RENTS = SUSTAINABLE PROPERTIES!
    - CNA needs - O&M - operating cushion – vacancy - accounts current
  - Seller payments and increased RTO is market based
    - Market value for equity when hard loan part of deal
    - CRCU limit for equity payment and increased RTO
    - CRCU test before any MPR tools
  - Consider impact on tenants

- **Long Term Commitment** – RD’s RA funding/Owner’s RUP

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Properties Preserved (06 – 11)(no RD data for 12 or 13)

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tr>
<td>Prepayment</td>
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<td>47</td>
<td>57</td>
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<td>MPR</td>
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<td>83</td>
<td>135</td>
<td>107</td>
<td>142</td>
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<tr>
<td>Transfers</td>
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<td>194</td>
<td>235</td>
<td>165</td>
<td>185</td>
<td>229</td>
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</table>
Transfers closed FY 2006 to 2010

- Transfers – 922 Closed - $2.36 B total activity
  - $877 M - Tax credits (571)
  - $833 M - RD loans assumed (922)
  - $619 M - Third party loans (652)
  - $48 M - New RD funds 515 or 538 (54)

- Summary – Transfer funding
  - $1.5 B - Third party equity or loans
  - 97% - New funding from third party
  - 70% - Minimum number with third party funding
  - 184 – Average transfers closed each year
# MPR “Tools” - Demo results (In Millions)

<table>
<thead>
<tr>
<th>Tools (in Millions)</th>
<th>2006</th>
<th>2007</th>
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<th>2011</th>
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<tr>
<td>Partial or full 515 Deferral</td>
<td>$48</td>
<td>$56</td>
<td>$100</td>
<td>$50</td>
<td>$117</td>
<td>$31.7</td>
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<tr>
<td>“Bullet” aka “Soft-second” loans</td>
<td>$4.5</td>
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<td>Grants</td>
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<td>$0.4</td>
<td>$0.2</td>
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<td>515 Loan @ zero percent interest</td>
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<td>$4.6</td>
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<td>Payment to owner of some costs</td>
<td>(CNA from reserve)</td>
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<tr>
<td>Forgiveness of 515 Debt</td>
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<td>Re-amortization of 515 Debt</td>
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<td>Subordination of 515 Debt</td>
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<tr>
<td>Consolidation of 515 projects</td>
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<td>YES</td>
<td>YES</td>
<td>YES</td>
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<tr>
<td>Other RD funds (Section 538/515)</td>
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<td>$25</td>
<td>$58</td>
<td>$27</td>
<td>$44.8</td>
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<tr>
<td>Third party funds</td>
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<td>$45</td>
<td>$65</td>
<td>$25</td>
<td>$112.7</td>
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<table>
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<th></th>
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<td>$112.7</td>
<td>unk</td>
</tr>
</tbody>
</table>

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MPR “Simple” 16 unit family (7 RA) - Tower City, ND
Stay in non-profit owner – built in two phases 74 and 79

- Sources: $53.4 K MPR bullet
  $172 K MPR zero pct
  $11.6 K MPR H&S grant
  $5 K local grant

- Uses: $237 K Rehab (to reserve)
  $0 K Equity, and
  $5 K Soft

- $27.7 K - 20 year CNA per unit

- $9.2 K deferred RD debt service
  $8.9 K new debt service (zero pct)

- Reserve deposit inc: $3.2K to $9.2K

- Rents:
  
<table>
<thead>
<tr>
<th>Pre-MPR</th>
<th>Post-MPR</th>
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</thead>
<tbody>
<tr>
<td>$301</td>
<td>$332</td>
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</tbody>
</table>
MPR “Complex” – 74 unit family (64 RA) – Rogers, CT
Transfer (w/acq, rehab and consolidation) - $7.8 M TDC

- $2.8 M Existing RD debt
- Sources: $2.9 M tax credit equity,
- $2.1 M 3% HFA loan
- Uses: $2.1 M Rehab
- $ .9 M Equity, and $2.0 M Soft
- $20.5 K - 20 year CNA
- $72 K Annual RD debt service deferred
- Reserve deposit inc: $30K to $51K
- Rents: CRCU $625, $775, $900
- Pre-Transfer $480, $580, $705
- Post-Transfer $500, $700, $825
- w/MPR deferral, $465, $620, $765
MPR Portfolio - SC MFH Portfolio Transfer

- 23 Projects in the transfer, 3 consolidations
- 15 project in MPR Portfolio transaction, 3 consolidations
- Long term A&B Bonds and 4% non-competitive Low Income Housing Tax Credits with Subordination of RD lien position
- Converted to Short Term A Bonds $15,812,000 & $1,948,070 B Bonds, 4%LIHTC $16,968,347 and Section 515 Subsequent Loans$15,812,000
- RD 515 funds to provide permanent financing at more favorable terms.
- Cost saving achieved by reducing debt service from long term Bonds at 5.75% over 30 yrs to RD financing at 1%@50 yrs. Reduced debt service by$567,247 annually. Cost saving to RA of $248,100 annually.
- Rents reduced at an average of $45/unit/month or $448,200 annually. Rents remained consistently under CRCU.
- MPR will further provide cost savings to the properties to save RA and protect tenants from excessive rent increase.
Some advice on a preservation strategy:

- Look for deals that work
  - Where are current rents in the market?
  - How many RA units?
  - What about RUPs?
  - Rehab vs. transfer?

- Line up third party money
  - Lot’s of competition for 9% LIHTC
  - 4% LIHTC with tax exempt bonds are less utilized
  - Combine with MPR – usually only deferral is needed

- Line up green money
  - Long term operational savings
  - Look at energy generation

- Work with all to simplify process – really!

Rural Housing Preservation Associates, LLC - contact Larry Anderson at landerson@rhpallc.com
Successful strategies to coordinate and cooperate

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

- **Expect and schedule a series of meetings with all parties**
  - Issues will rise throughout the process
  - Establish a positive effective working relationship

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

- **Is the MPR Team Leader available for fast tracked help advice and solutions?**

- **Big Deals need big time team work**
  - Coordinate developer, financial and RD resources (loan/servicing and technical)
  - Focus on critical times – application, underwriting, obligation, closing, and construction

Rural Housing Preservation Associates, LLC - contact Larry Anderson at landerson@rhpallc.com
Key issue with transfers – How does the resource pie get divided?

- Balanced deal
  - $60 K per unit
- Rehab cost ($20K)
- Seller payment ($20K)
- Soft costs ($20K)
- CRCU ($600)
Good market –
How does the pie get divided?

- High sales price
  - $80 K per unit
- Rehab cost ($20K)
- Seller payment ($40K)
- Soft costs ($20K)
- CRCU ($800)
Poor market – How does the pie get divided?

- Low sales price
  - $40 K per unit
- Rehab cost ($20K)
- Seller payment ($0?)
- Soft costs ($20K)
- CRCU ($400)
Revitalization Battleground – Sizing the split: rehab, seller and soft costs

- Sustainable rents –
  - What does CRCU support?

- Rehab
  - upfront/spread out

- Seller payment
  - loan or cash?

- Soft costs
  - loan/cash
  - upfront/deferred
Key concepts with the “pie split” and the MPR

- **Stay in owners** – No split - It’s all about rehab
  - Underwritten once
  - Full use of MPR tools to fund rehab
  - Some soft costs may be included.

- **Transfer** – It’s a three way split
  - Underwritten twice
  - First to fit the CRCU test
    - seller payment and soft costs must make economic sense
    - RD funds can be included if “in hand”
    - If not in hand - use 538 at AFR to size the transaction
  - Second to fit MPR underwriting
    - Deferral used to keep rents affordable
    - MPR tools not used for seller payment
Why is the MPR a good idea for the Program?

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

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

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

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

- **Magnet for third party funding**
  - Last year $100 Million leveraged by $30 Million in MPR BA
  - Provides additional funds to get the transaction to work
Preservation Strategies – Lost Resources

• MPR (MFH Preservation and Revitalization Demo)
  • No USDA MPR request - FY 2012 Budget
  • No USDA Sec. 515 request – FY 2013 Budget
  • No MPR NOFA FY 2012

• Transfer
  • FY 2012 and 2013 stopped re-using RA from paid off projects (no RD data, but about 2,000 units each year). FY 2013 no unused RA transfers from State Office.
  • Tightened appraisal requirements – No current underwriting guidance

• Prepayment process
  • No USDA NP advance request FY 2011, 2012, 2013, or 2014 Budgets
  • No USDA Incentive RA request FY 2011, 2012, 2013 or 2014 Budgets
  • No USDA Sec. 515 request for incentive or NP sale loans - FY 2013 Budget
  • Current freeze on new incentive offers

• Sales of Inventory Projects
  • No USDA 515 for credit sales requested in FY 2013 or 2014 Budgets

• Ended all New Construction in FY 2012 – no replacement for 2,000 units lost each year

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Current Preservation Status

- Senate Approps Committee and others say RD’s vision “out of focus” and asks:
  - Why zero out MPR in 2012 and zero out 515 in 2013?
  - Where is preservation legislation and how much RA do you really need?
  - What is being done to address retirements and uneven national staffing?

- Other “out of focus” RD MFH management actions
  - No longer requesting incentive RA or NP advances required by ELIPHA
  - Ending 515 without full consideration of impact (no incentives or REO sales)
  - New RA retirement policy (taking 2,000 units out of circulation each year)
  - Bizarre reaction to Supreme Court “Salazar” decision (fund all on incentive list, no 515 new const. NOFA and a moratorium on new incentive offers

**No memo – But cutting RA is now more important than preservation**
- Actions include eliminating new construction and preservation tools, freezing management fees, reducing preservation transactions and ending incentive offers

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Current Preservation Status – There are better answers!

- As a direct lender find ways to use some of the $500 M in RHIF liquidating account funds annually turned back to Treasury to protect the portfolio and attract 3rd party funds!
  - Here’s what’s authorized now – More RA, deferrals, forgiveness, protective advances to cover operations, can be in the form of recoverable/non-recoverable, amortized/unamortized cost items.

- More & faster consolidation and alignment w/HFA’s & HUD!
  - Consolidate critical program field staff into national program. Review and accept 3rd party underwriting, CNA’s and appraisals.

- Ask for RA and funds that you need to protect the portfolio!
  - If RA must be cut - do it by reducing requirements and regulations – not the number of people served, freezing operating expenses or increasing tenant contribution!

- Much more transparency – share facts and policy in writing and seek input – stakeholders have a stake!

Rural Housing Preservation Associates, LLC - contact Larry Anderson at landerson@rhpallc.com
RD’s response to Sequestration

RD Under Secretary says in writing:

• Fully fund RA until we run out - maybe 10K to 15K units short!
• Mitigate with 3560.454 [(a)change rents (b)occupancy waivers (c) more RA (d) SNR (e)fire mgt], and
• 3560.455 [(a)defer, restructure or legal action (b)re-am (c)write off]

RD says on a May 22, 2013 stakeholder call:

• Maybe only contracts running out of money in September will not be funded until FY2014. We will let you know in June (3rd week).
• Nothing will be in writing, but we will internally train our staff to work with you to close one month’s gap.
• Our attorney’s say new RA can not make up for the September gap.

Here are some more ideas for RD to think about this fiscal year:

• Use 3560.453 WOP authority - include use and replace reserves
• Use RHIF authorities including 1% deferrals and advances
• Share reports and give more advance warning
• Share reports and assure fairness in the renewal queue
• Put something in writing to protect tenants and assure stakeholders
RD’s response to Sequestration

Next year is going to be tougher – Here’s some ideas:

Start early and spread the affect over all contracts!
- Share RA data – How long does “12 month” funding last now?
- Will individually funded contracts provide more precision?

Suspend or reduce requirements with high cost and limited value!
- Are $5,000 CPA Audits really needed for 16 units?
- Can consolidation rules be loosened to allow for greater efficiency in project operations and reporting?

Start working on long term solutions!
- Find ways to lower energy and utility costs (hint – go after the energy hogs first)
- Seek legislation to simplify income verification processes (hint – heavy lift, but game changing savings)
• 1: NEW FUNDS OR SUBSEQUENT LOANS (By Rural Development or others)
  • New construction
  • Rehab/repair construction

• REQUEST: “Prospective Market Value, Subject To Restricted Rents within 7 CFR Part 3560.752(b)(1)(i)”. (The appraiser must consider all restrictions and report the value of intangible assets individually and separately from the real estate.) “Prospective Market Value within 7 CFR Part 3560.752(b)(1)(ii), Premised Upon A Hypothetical Condition As- If Conventional Housing”. (Optional value used to analyze the affects of restrictions).
QUICK REFERENCE OF VALUES TO REQUEST

2: EXISTING LOAN

- Transfer
- Loan assumption
- Loan write-down
- Subordination

REQUEST: “Market Value, Subject To Restricted Rents within 7 CFR Part 3560.752(b)(1)(i)”. (The appraiser must consider all restrictions and report the value of intangible assets individually and separately from the real estate).
QUICK REFERENCE OF VALUES TO REQUEST

- **3: VALUE OF PROPERTY** (Does NOT qualify for Prepayment Incentives Offers within 7 CFR Part 3560.656 Incentives Offers).
  - Validation of sale/marketing price
  - Equity determination
  - Acquisition of property into program

- **REQUEST:** “Market Value, within 7 CFR Part 3560.752(b)(1)(ii)”. (All restrictions and prohibitions currently existing must be considered, including Restrictive Use Provisions).

Rural Housing Preservation Associates, LLC - contact Larry Anderson at landerson@rhpallc.com
QUICK REFERENCE OF VALUES TO REQUEST

- **4: VALUE OF PROPERTY** (Qualifies for Prepayment Incentives Offers within 7 CFR Part 3560.656 Incentives Offers).
  - Validation of sale/marketing price
  - Equity determination

- **REQUEST**: “Market value within 7 CFR Part 3560.752(b)(1)(ii), Premised Upon A Hypothetical Condition As-If Unsubsidized Conventional Housing in compliance with 7 CFR Part 3560.656(c)(1)(i)”  
  (In order to use this value the property must qualify for a prepayment incentives offer within the Code of Federal Regulations).

Rural Housing Preservation Associates, LLC - contact Larry Anderson at landerson@rhpallc.com
QUICK REFERENCE OF VALUES TO REQUEST

- **5: VALUE FOR SALE - ELIGIBLE AS PROGRAM PROPERTY**
  - Maintain in program, REO’s, foreclosure, etc.

- **REQUEST:** “Market Value within 7 CFR Part 3560.752(b)(1)(ii), Premised Upon A Hypothetical Condition As-If Conventional Housing”. “Market Value, Subject To Restricted Rents within 7 CFR Part 3560.752(b)(1)(i)”. (The appraiser must consider all restrictions and report the value of intangible assets individually and separately from the real estate).

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QUICK REFERENCE OF VALUES TO REQUEST

- **6: VALUE FOR SALE - NON PROGRAM PROPERTY**
  - Properties leaving program, REO’s, etc.

- **REQUEST:** “Market Value within 7 CFR Part 3560.752(b)(1)(ii), Premised Upon A Hypothetical Condition As-If a Conventional Market Property”. “Liquidation Value Premised Upon a Marketing Period of (enter days) Days”. (Optional value, market period prescribed by USDA.)
For follow up questions please contact:
Larry Anderson at 571-296-4746 or landerson@rhpallc.com