Evaluation of the Mark-to-Market Program

U.S. Department of Housing and Urban Development
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Foreword

The Mark-to-Market (M2M) program, authorized by the Multifamily Assisted Housing Reform and Affordability Act (MAHRA), was enacted on October 27, 1997 to reduce the subsidy costs in FHA-insured properties with project-based Section 8 that had above market rents, to preserve the affordable housing stock, and to introduce administrative efficiencies in the multifamily FHA insured Section 8 portfolio. The Office of Multifamily Housing Assistance Restructuring (OMHAR) was created within HUD, to manage the M2M program. OMHAR will sunset on September 30, 2004, but HUD's authority to enter into M2M agreements will continue through September 30, 2006.

This study aimed to assess the effectiveness of the M2M program in achieving the objectives stipulated in the authorizing legislation. The study made estimates of the savings to HUD to be derived from all M2M restructurings completed as of July 31, 2003. The savings amount is based on calculating the 20-year impact of M2M-based rent reductions along with the costs associated with reducing the FHA-insured mortgages, administrative costs, and possible costs of default for Watch List properties. The base case comparison assumes that, without the program, rents would remain at their (above-market) pre-restructuring levels for the 20-year period.

Since operations began in early 1999, the efficiency of the processing time for the M2M program has improved greatly. The decline in processing time appears to be associated with a number of policy changes implemented by OMHAR, including an Owner Incentive Package, changes in the M2M underwriting standards, and the personnel and organizational changes at OMHAR. Much of this gain in efficiency may also reflect the fact that M2M is a complicated program and it therefore takes time for all the relevant parties to learn and accumulate experiences.

The clear intent of the legislation was that OMHAR should operate as a single function entity, with responsibility solely for implementing the MAHRA requirements. This administrative design appears to have been an effective means of achieving M2M programmatic goals.

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Executive Summary

Introduction

This evaluation of the Mark-to-Market (M2M) Program was conducted under a contract issued by the U.S. Department of Housing and Urban Development's (HUD) Office of Policy Development and Research (PD&R) to Econometrica, Inc. and its subcontractor Abt Associates in September 2002. The M2M program was authorized by Congress to address concern about the rising costs of rent subsidies in HUD's Section 8 multifamily housing program. The goal of the study is to evaluate the overall implementation of the program. This includes both the cost-effectiveness of the program and its success in addressing the needs of key stakeholders, the owners and residents of Section 8 properties.

The Section 8 program pays rental subsidies to owners of multifamily properties that provide rental units to low-income households. The level of rent subsidy for each property was based on initial rents that were established when the properties entered the program in the late 1970s through the mid 1980s. Often rents were set above local market levels to compensate for the costs of Section 8 administration, the higher construction costs occasioned by using Davis-Bacon wage rates, and special features for the elderly. It should also be kept in mind that new construction is expensive by definition and in this period costs were driven up by high inflation. For example, in 1981 the FHA single-family interest rate peaked at 17.5%. Rent allowances supported the goal of developing new affordable rental housing in better areas than in the past. However, by the late 1990s many of these Section 8 properties received rental subsidies that were substantially above market levels. HUD analysis in the early 1990s indicated that the continued growth in the level of subsidies would eventually be unsupportable within HUD's budget limitations.

To contain the rising costs of rental subsidies, while preserving the viability of the properties, the M2M program authorizes HUD to reduce rents to market levels on Section 8 properties financed with HUD (FHA) insured mortgages. The primary mechanisms for maintaining the financial viability of the properties is to write-down and/or reduce the FHA mortgage to a level that can be supported by the lower rents. These rental adjustments and mortgage restructurings would be negotiated as existing Section 8 contracts expired in the late 1990s and early 2000s. A primary programmatic goal was the preservation of affordable housing. Preservation encompassed the continuing physical and financial viability of a property while being able to charge affordable rents.

The Executive Summary begins with an overview of the M2M program and the structure and objectives of the evaluation. The Executive Summary next reports the more quantitative evaluation findings in four sections that discuss:

- The level of M2M activity and the characteristics of the properties that participated or chose not to participate.

- Estimates of the quantifiable costs and benefits of the program.
- Improvements over the life of the program in the efficiency with which it moves projects through the restructuring process.
- Preliminary data on the post-M2M financial performance and physical condition of projects that have been restructured.

The Executive Summary then presents our assessment of OMHAR as an organizational strategy and the effects of the M2M process on owners and tenants. The Executive Summary closes with a discussion of lessons for future M2M-type efforts to manage HUD's portfolio of assisted multifamily properties.

Overview of the M2M Program

The M2M program was authorized by the Multifamily Assisted Housing Reform and Affordability Act (MAHRA) enacted on October 27, 1997. A key provision of MAHRA required an independent office, created within HUD, to manage the M2M program. This was the Office of Multifamily Housing Assistance Restructuring (OMHAR). It was expected that projects would enter the program when their original Section 8 contracts expired in the late 1990s and early 2000s. Therefore, the legislation, as amended, stipulated that OMHAR would sunset on September 30, 2004. HUD's authority to enter into M2M agreements would continue through September 30, 2006, to allow for completion of processing on the last projects.

The **first** goal of the M2M program is to reduce project-based Section 8 subsidized rents that are greater than market level in projects with FHA-insured mortgages. The program authorizes HUD to reduce Section 8 rents to market rent levels in these projects. In some cases the project will remain viable with the reduced rents, without further action by OMHAR. These are called "Lite" transactions or "rent restructurings." The processing required for these transactions is limited and no long-term use agreement is obtained from the owner.

In many cases, however, a simple rent reduction would result in a default because a project would no longer be able to pay its expenses and debt with the reduced income. Therefore, M2M authorizes partial or full payments of mortgages from the FHA Insurance Fund to reduce the size of the first mortgage debt. By reducing the monthly mortgage payment to the point where market rents can adequately cover it (and appropriate project expenses), the Section 8 subsidy is reduced and the project remains viable. These transactions are called "Fulls" or "mortgage restructurings." The processing required for these transactions is quite substantial, and a 30-year Use Agreement, requiring that the property continue to provide affordable housing, is obtained from the owner.

In a Full transaction, the existing FHA-insured first mortgage is paid off in its entirety and a new, generally much smaller mortgage, is put in its place. In most, but not all, cases the new mortgage is also FHA-insured. In many cases, the amount of the claim (mortgage) payment is not forgiven; rather the project carries this amount as additional debt in second and third mortgages that are payable only to the extent funds are available over time or at the time the project is sold or refinanced.

The **second** goal of the M2M program is the preservation of affordable rental housing where it is needed. Aspects of the program targeted to this goal include:

- Provision for current project repairs where needed, through a rehabilitation escrow that provides for repairs to be completed after closing. Those repairs may include items necessary to bring the property up to a reasonable non-luxury standard, such as the installation of air conditioning in areas where all the comparable properties are air-conditioned.

- Requiring ongoing deposits to reserves for replacement that are designed to assure that the property remains sound during the entire term of the new mortgage. These are nearly always much greater than the reserves that were required under existing HUD mortgages.

- Authority to grant above-market rents in jurisdictions where there is a need for affordable housing and the property cannot be made financially viable with market rents. The above market rents must be sufficient to pay for projected operating costs and any new debt service on the property. These are called “exception rents.” By statute, no more than 5 percent of the properties in the program may have exception rents.

Objectives of This Study

This study aims to assess the effectiveness of the M2M program in achieving the objectives stipulated in the authorizing legislation. Among the specific objectives of the study are:

- Determining if the M2M program has effectively addressed the problem of growing Section 8 project-based rental subsidies in properties with FHA-insured mortgages.

- Establishing if the M2M restructuring process has promoted the preservation of affordable housing units.

- Assessing the extent to which M2M has promoted capital improvements in Section 8 properties and enhanced the quality of housing provided to Section 8 tenants.

- Assessing the effectiveness of the administrative mechanisms HUD has employed to implement M2M, which include underwriting M2M transactions by Participating Administrative Entities (PAEs) under contract to OMHAR.

To address these objectives the study used three distinct data collection approaches:

- **A Process Analysis** of the administrative mechanisms put in place to implement the M2M program. This study component involved a review of all pertinent OMHAR documentation, as well as interviews with key players in the restructuring process. The key players included past and current OMHAR staff, HUD Office of Housing Staff, senior managers at PAEs, and owners of Section 8 multifamily properties. This study component addressed research questions on participant satisfaction, tenant impacts, effects of program changes over time, and PAE operations.

- **A Retrospective Statistical Analysis** of trends in participation levels, estimates of savings to the government resulting from the program, measures of program efficiency, and preliminary indications of program outcomes. This part of the evaluation used OMHAR and FHA data on properties to provide quantitative assessments of each of the study's research questions. The sample was limited to projects that entered the program by July 31, 2003.

- **A Prospective Analysis** that used a case study approach to document the restructuring process for 15 properties undergoing restructuring in 2003. This was the primary data source on the impact of M2M on tenants. This study component also analyzed the interplay of interests and incentives that shape the outcomes of the restructuring process. Case studies on each of these 15 properties appear in the second section of this report. The sample was limited to projects that entered the program by July 31, 2003.

The conclusions drawn from the data obtained from the three data collection approaches are presented below.

Overview of M2M Operations to Date

As of July 31, 2003 a total of 2,416 properties had entered the M2M process (27 percent of all FHA-insured Section 8 properties). We expect that somewhere between 1,000 and 2,000 additional properties will enter the M2M process. (An earlier study by Abt Associates estimated that approximately half the assisted stock, or about 4,500 properties had rents above local market levels. We know that approximately 2,400 properties have already entered the process, so we can assume that less than 2,000 additional properties with above market rents will enter the M2M process as their contracts expire. It is likely that the number of properties with above market rents that will enter the process will be smaller than 2,000 as some will opt out or not enter the restructuring process for other reasons. The remaining properties will have below-market rents).

Some of the characteristics of the properties that have gone through the program as of July 31, 2003, include:

- Of the 2,416 properties that entered the program, 1,187 (49 percent) had closed. This included 391 Lites and 796 Fulls. Over 95 percent of the 608 properties in the pipeline at the end of July 2003 were Fulls.

- A total of 621 had “Actions Other Than Closing” (AOTC). This includes 297 properties that were placed on OMHAR’s “Watch List.” Watch List properties have their rents reduced to market levels, but do not have their mortgages restructured. In contrast to Lites, which the PAE believes are financially sound with reduced rent but no mortgage reduction, the PAE believes that Watch List properties may experience financial difficulties at these reduced rent levels. Watch List properties may reenter the restructuring process at a later time.

  AOTCs also include 324 properties that had discontinued the restructuring process without being placed on the Watch List because they were found to be ineligible or for other reasons. The most common reason for a property being ineligible is that it was financed by state or local bonds that prohibit a M2M restructuring. Properties that are ineligible due to this reason may enter the M2M process at a time when the bond financing permits it. Properties may discontinue the process because an owner with an out-year contract expiration date elects not to move forward with the restructuring and is not required to have the rents reduced to market at the time the deal is discontinued.

- Properties that entered M2M tended to have high pre-restructuring rents. In addition, M2M properties were slightly more likely to be located in the South and in non-metropolitan areas than the properties in the portfolio as a whole.

- The Western region was significantly under-represented among properties entering M2M.

- Properties assisted under the Section 8 New Construction/Substantial Rehabilitation (NC/SR) Programs often started out with above-market rents in order to support housing development in targeted areas. Many of these properties also benefited from automatic annual increases in rents. As a result, many of these properties had high rents and were therefore more likely to enter the M2M program. In contrast, rents in the older group of Section 8 properties were often set below market levels and rent increases were granted based on actual budget needs.

- In many respects, Full properties are the best measure of M2M’s impact. These are the properties that could most probably remain financially and physically viable with reduced rents through a debt restructuring, and thus they represent the stock of properties that was preserved as a result of the program. Salient characteristics of Fulls include:

  - Fulls are more likely to be in the South and less likely to be in the West than Lites.

- Fulls are more likely to be in non-metropolitan areas, and less likely to be in central cities than Lites.

- Fulls are more likely to be serving family households than Lites.

- Compared to all other properties eligible for M2M, Fulls were more likely to be in Census tracts with higher poverty rates.

- Compared to Lites, Fulls tended to be in Census Tracts with comparatively higher vacancy rates and higher rates of poverty.

- Of the closed Fulls, 28 percent had received exception rents.

- Exception rent properties were more likely to be in poorer neighborhoods than properties that closed at market rents.

- Exception rent properties were more likely to be in non-metro areas compared to properties that closed at market rents.

Cost Savings Derived from M2M Restructurings

The study made estimates of the savings to HUD to be derived from all M2M restructurings completed as of July 31, 2003. The savings amount is based on calculating the 20-year impact of M2M-based rent reductions along with the costs associated with reducing the FHA-insured mortgages, administrative costs, and possible costs of default for Watch List properties. The base case comparison assumes that, without the program, rents would remain at their (above-market) pre-restructuring levels for the 20-year period. For the properties that had been processed through M2M as of July 2003, the average rent savings were:

- For Lites, $73 per-unit, per month, for a total of $418.7 million net present value over 20 years.

- For all Fulls, $98 per-unit, per month, ($106 for Fulls that closed at market rent and $79 for Fulls that closed with exception rents). The total net present value of expected Section 8 savings is $1.1 billion over 20 years across all Fulls.

- For Watch List Properties, $92 per month, per unit, or $273.7 million net present value over 20 years.

- These rent savings total $1.79 billion net present value over 20 years.

These projected savings have to be measured against the costs of writing down mortgages for the Fulls, possible future defaults of Watch List properties, and the costs of operating the M2M program.

Three net savings estimates were developed based on differing scenarios regarding the future financial performance of Fulls and Watch List properties that have gone through M2M. The upper-end scenario assumes that no Watch List properties will default and there will be full repayment of second and third mortgages for all Fulls. Under this scenario the present value of total expected net savings over the next 20 years for all properties that have been processed through M2M as of July 2003 would be $883 million, or $30 per-unit per-month.

A lower-end scenario assumes that all Watch List properties will default and that there will be no repayment of second and third mortgages for all Fulls. Under this scenario the present value of total expected net savings over the next 20 years for all properties that have been processed through M2M as of July 2003 would be $111 million, or $4 per-unit per-month.

A third, more realistic scenario assumes partial repayment of the seconds and thirds and no defaults of Watch List properties. Under this scenario the present value of total expected net savings over the next 20 years for all properties that have been processed through M2M as of July 2003 would be $831 million, or $28 per-unit per-month.

Processing Efficiency of the M2M Program

Since operations began in early 1999, the efficiency of the processing time for the M2M program has improved greatly. The decline in processing time appears to be associated with a number of policy changes implemented by OMHAR, including an Owner Incentive Package, changes in the M2M underwriting standards, and the personnel and organizational changes at OMHAR. Much of this gain in efficiency may also reflect the fact that M2M is a complicated program and it therefore takes time for all the relevant parties to learn and accumulate experiences.

Focusing on the M2M properties that were completed as of July 31, 2003, our analysis compared processing times of these transactions by the type of restructuring outcomes, by type of PAEs, by major processing milestones, and by timing of the restructuring in relation to OMHAR's underwriting and processing regimes.

The major findings are:

- In general, Full restructurings take more time to process than Lite restructurings. Completion time has been shortened substantially for both types of transactions.

- Lites that entered the program during the fourth quarter of 1999 had a median completion time of 245 days, while transactions that entered the pipeline since the first quarter of 2001 had a median completion time between 110 and 176 days. The median completion time was 171 days across all cohorts.

- For Fulls that closed at market rent, the median completion time was 399 days. The duration has been reduced from 550+ days for the earlier cohorts to generally within 400 days for Fulls that entered the program since the later part of 2000.

- As expected, Fulls closed at exception rent levels tend to require the longest processing time, because they generally have more issues to resolve. While the median processing time is 456 days across all cohorts for this transaction type, those that entered the pipeline since the first quarter of 2002 have a median completion time of less than 400 days.

- Regardless of restructuring type, the majority of the processing time is spent between the PAE's acceptance of the asset assignment and the submission of the restructure plan. This portion of the processing time has declined markedly over time. In contrast, there are no discernible trends for the duration between plan submission and final closing.

- Both public and private PAEs have become more efficient over time. Regardless of restructuring types, private PAEs tend to require a slightly shorter time to complete a restructuring.

Financial and Physical Viability of the M2M Properties

M2M addresses fully the issue of funding ongoing rehabilitation and capital replacement needs. This is unlike conventional market multifamily financing, which expects a resale and recapitalization every few years. It also is unlike other FHA programs, which typically have provided per-unit-per-year contributions to replacement reserves appropriate to early years of a new property, but not large enough for the 40-year mortgage term. Under M2M, as part of the underwriting for Full restructuring transactions, the property's annual reserve for replacement is calculated to ensure that ongoing repairs for the new mortgage term plus two years can be funded. In addition, the initial deposit to the replacement reserve is fully financed as part of the new mortgage. Immediate needs (first year) are also included in the transaction through a rehab escrow account. Eighty percent of these rehab needs are funded through the program, with the owner required to provide the other 20 percent. In cases where critical repairs (repair needs threatening health and safety) are identified in the Physical Condition Assessment (PCA) document during the restructuring process, property owners are required to fix those problems before closing. After closing, owners are expected to draw funds from the rehab escrow and complete other M2M-required repairs during the subsequent 12-month period.

For the Full restructurings closed through early August 2003, the average rehab escrow was \$2,244 per unit (with a median of \$1,103). Consistent with their worse physical condition, escrows for properties that closed with exception rents were higher than for properties that closed at market rent—an average of \$2,729 per unit compared with \$2,044 per unit (the median escrow amount for exception rent deals was \$2,045 per unit compared with \$950 per unit for market rent transactions). The average initial deposit to the replacement reserve is

$2,752 per unit (with a median of $2,206). The initial deposits are higher for exception rent transactions, averaging $3,367 per unit with a median of $3,000. The average is $2,512 for market rent transactions, with a median of $1,974.

Funds for rehab escrow and initial deposit to replacement reserves totaled over $114 million and $164 million so far. While the provision of these funds should have a large impact on the future viability of the restructured properties, the rehab escrow funds also represent an immediate and tangible benefit for tenants living in these HUD-assisted properties. As a result of M2M, these tenants are able to live in higher physical quality, better maintained units.

The M2M program has employed a set of underwriting standards that are specifically tailored for these properties. The standards, in theory, will foster long-term financial and physical viability. This is especially the case for the cohorts of transactions that were completed under the revised underwriting standards introduced by OMHAR in early 2002. However, at the time of this evaluation, not enough time had elapsed to allow us to examine these properties' actual long-term performance.

Our examination of the transactions that were completed in 2000 and 2001 reveals that Lite restructuring properties have the best financial performance in both the pre- and post-restructuring periods among all the outcome types. In comparison, a sizable portion of Fulls closed at exception rents and Watch List properties have values for many of the financial performance indicators in the post-restructuring period that are worrisome. Many of these projects have lower values on some financial performance indicators than they had in the pre-restructuring period. For example, some properties have had negative surplus cash and have not had sufficient income to cover operating expenses and debt service. The reason for this under-performance is not immediately clear. Since we have only one or two years' financial data for the post-restructuring period, the results may not be representative of long-term performance. An encouraging sign is that, according to data collected by the Office of Housing, the number of defaults that occurred to this portfolio of properties so far has been very small.

These properties deserve further investigation when financial statements from a longer period of operations are available. It will also be important to see if properties that were underwritten after the first couple of years of the program will perform better than earlier cohorts. It would be reasonable to expect some improvements because of greater experience in the program by all parties and because of improved guidance, training, and communications provided as a result of that experience. OMHAR made substantial efforts to assess performance in early operations and to provide timely feedback, procedural/policy changes, and re-training where warranted to improve performance.

Overview of OMHAR as the Implementation Arm of M2M

The M2M authorizing legislation stipulated that the OMHAR office should operate as an independent entity within HUD. The original legislation also stipulated that the Director of

OMHAR would report directly to the Secretary of HUD. This was changed in the reauthorization legislation of 2001 to have the Director report to the Assistant Secretary for Housing/FHA Commissioner. Even after this change, OMHAR has retained its semi-independent status. As part of this status, OMHAR employees are compensated according to the Treasury Schedule, which sets compensation at 120 percent of the rate for a given Federal position.

The clear intent of the legislation was that OMHAR should operate as a single function entity, with responsibility solely for implementing the MAHRA requirements. This administrative design appears to have been an effective means of achieving M2M programmatic goals. Observations that support this conclusion include:

- OMHAR has been successful in developing a strategy to meet the seemingly contradictory legislative goals of achieving cost savings and preserving affordable housing. This success is indicated by the projected savings described above and by the willingness of OMHAR to restructure properties even if they result in a projected net loss to the government. As of July 2003, approximately 30 percent of OMHAR's completed Fulls resulted in projected losses for HUD.

- OMHAR exhibited the flexibility needed to redesign the program as it gained operational experience. Programmatic enhancements introduced by OMHAR in 2000 and 2001 were remarkably effective in enabling the program to meet its objectives. The development of an Owner Incentive Package was particularly useful. Prior to that time there was a considerable reluctance on the part of owners to enter into negotiations for Fulls. By 2002-2003 this resistance had largely dissipated. In fact, by 2003 some owners who had completed Lite transactions were coming back into the program as Fulls.

- Given the complexity of developing financial restructurings for multifamily properties, by 2003 the restructuring processes were remarkably efficient. For most properties in the system, the discussions between OMHAR and owners were non-confrontational. In part this was due to a cadre of experienced underwriters developed at the PAE level. In addition, by 2003 OMHAR had sufficient operational experience to have developed general guidelines for most situations. By 2003, many owners were also aware of many completed Fulls that resulted in financially sound restructuring agreements.

- OMHAR, through its PAEs, has strongly promoted tenant involvement in the restructuring process. Tenant involvement was a major goal of the authorizing legislation, and OMHAR has ensured that these elements have been scrupulously observed. In some cases, PAEs schedule tenant meetings even in cases when not required to do so by regulation.

- The M2M process, as administered by OMHAR, appears to provide substantial benefits to the Section 8 tenant population. The Section 8 tenants receive the benefit of having properties retained in the program, even at a projected loss for HUD. In addition, the 12-month rehabilitation packages included as part of Fulls often provide considerable immediate physical enhancements for tenants.

Owner and Tenant Involvement in M2M

There are a number of constituencies with major stakes in the M2M process. One is the group of Section 8 owners. Another is the tenant population. The experience of these constituencies in the M2M process as of 2003 may be summarized as follows:

- By 2003 most M2M discussions were carried out by owners' representatives and not by the owners themselves. To a large extent the discussions about restructuring agreements had become routinized. OMHAR has not experienced any major differences when dealing with representatives as opposed to the owners themselves.

- Most owners had limited flexibility regarding whether to enter the program. Most properties that entered the program through 2003 retained their value only if the property remained in the Section 8 program. In general, even without the incentives offered by M2M, most owners would have had little choice but to keep their properties in the Section 8 multifamily program.

- The most common contentious issue for owners was the type and extent of repair/rehabilitation to be included in the rehabilitation escrow. While there was normally little question that these items would improve the physical condition of the property, some owners were reluctant to agree to the items and costs of repairs because the owners are required to provide 20 percent of such costs.

- The involvement of tenant support or advocacy groups has been almost non-existent. The authorizing legislation provided funds to non-profit tenant advocacy groups who would assist in protecting tenants' interests. However, the involvement of such groups in the M2M process has been minimal.

- Required tenant meetings appeared to be only moderately successful in informing tenants about the restructuring process. While the requirement for holding tenant meetings has been observed, attendance is often poor, and most tenants appear to have only a limited understanding of the restructuring process.

- The substantive input of tenants into the prioritization of initial (12-month) rehab requirements for a property appears to be modest. The property enhancements mandated for the 12 months after the closing of a Full are an immediate and tangible benefit for tenants. However, tenants appear to have limited input in deciding priorities regarding physical enhancements. Tenants' input in this area has been modest even though OMHAR and the PAEs consistently made significant efforts to solicit it.

General Conclusions and Lessons Learned

In addition to observations about current M2M operations, the project team also drew some conclusions that would apply to continuing M2M operations or similar government initiatives. These lessons drawn from the M2M experience include:

- It would be beneficial for M2M or a similar program to have the capability to look at a wider context than a single property. On the whole, the PAE underwriters have been extremely competent. However, their expertise is focused on financial issues. In certain cases, it would be useful for M2M to have the capability to look at a broader community context. This would enhance the opportunity to bring in additional community or economic development funds to a property, achieving greater value for the property and a higher level of services to tenants.

- Private PAEs, on the whole, have proved more effective than Public PAEs in implementing the program. This has been largely because the private PAEs have been able to develop staff units devoted solely to M2M. (It should be noted that a number of public PAEs have operated effectively, usually by employing experienced underwriters on a fee basis.) The historic memory of the private PAE staffs will be a critical resource for HUD as it moves to complete the remaining restructurings by September 2006.

- Exception rents have been necessary to complete a significant number of restructurings (to date over 25 percent). However, it would be beneficial if an analysis could be performed early in the restructuring process that looks at the need for the property within a broad community context. Current program requirements (and financial incentives) currently limit a PAE's ability to perform this type of analysis. However, in some cases, considerable time and expense are devoted to a restructuring before this justification analysis is performed. An analysis of a community's housing needs obtained earlier in the process might enable PAEs to identify marginal cases where the preservation of a property may not be needed in a given locality.

- The MAHRA legislation did not provide M2M with an effective method for bringing "partners" into a restructuring, even when that would appear to be the optimal strategy to provide the greatest benefit to tenants. In several cases observed during this study, a major community redevelopment effort appeared to be the best strategy to meet the needs of both tenants and the local community. Identifying partners that could be brought in to assist in such a redevelopment was not an anticipated role for either the PAEs or OMHAR. While this is not a legitimate role for the PAEs within the current program structure, this type of role might be considered for future M2M-type programs.

- The M2M process is ill-suited to address cases in which key community stakeholders, including elected officials, oppose the preservation of an affordable multifamily property. At one property observed during the study, some local stakeholders vigorously opposed the preservation of a large multifamily property. In this case there were possibilities for a compromise solution, but it was not clear what entity should conduct such negotiations. Although OMHAR and PAE staff have regularly notified local officials about restructuring efforts and the times scheduled for public meetings, OMHAR's existing mandate appears to be too narrow for it to assume responsibility for resolving conflicts on a regular basis.

- Where a significant amount of non-housing services are provided at a property, there needs to be greater involvement of the non-housing service providers. One property in this study provides a 24-hour secure housing environment for a developmentally disabled population. The facility receives major funding from social service agencies. Consideration of non-housing services is outside normal FHA processing procedures. However, in any future M2M-type program, consideration should be given to a mechanism for including these partners in negotiations.

- In assessing the justification for preservation, particularly in the cases of exception rents or a substantive net loss to the government, the process could include a more expansive analysis of housing alternatives. Many of the properties observed in this study were in small rural communities or small cities. Analysis of rental markets in such cases is normally restricted to the "built-up" areas in the vicinity. However, for a high proportion of the tenant population in such areas, the main alternatives to assisted housing are isolated rural properties, such as trailers. HUD should explore if there is a means of obtaining data on what are considered realistic housing alternatives for tenants at a specific property.

- In any future MAHRA-type legislation there needs to be consideration of more effective mechanisms for establishing the suitability of restructuring seriously deteriorated properties. Some properties observed during the study showed indications of sub-standard maintenance. Once the M2M application had been made, the PAE had the responsibility of determining if a viable restructuring package could be developed. The incentive in such cases, at the PAE level, is to see if there is any way a restructuring plan can be made to work. In a future program, it might be preferable to ask the PAE to demonstrate, with a heavy preponderance of evidence, the need to move ahead on a restructuring.

- In any future M2M-type program, consideration should be given to increasing the level of tenant input on security issues. This issue is often of paramount importance to tenants. In addition, lack of security can have a direct impact on financial performance, as it often drives up vacancy rates. As noted above, tenant input into the restructuring process has often been limited, despite OMHAR's best efforts. One possibility would be an attempt to obtain tenant input on security issues in a survey conducted separately from the mandated tenant meetings.

1. Introduction

Background

This report presents the findings from an evaluation of the Mark-to-Market (M2M) program, which Congress established to address the problem of rapidly increasing costs for the FHA-insured component of the subsidized Section 8 Project-Based Rental Assistance Program. The M2M program was authorized by the Multifamily Assisted Housing Reform and Affordability Act (MAHRA), enacted on October 27, 1997.

In September 2002, HUD's Office of Policy Development and Research (PD&R) issued a contract to Econometrica, Inc., and its subcontractor Abt Associates, Inc., to assess the progress of the M2M initiative. This report presents the findings of the Econometrica research team, derived from a variety of data collection and analysis activities undertaken from November 2002 through November 2003.

The Programmatic Background to M2M

Between the mid-1960s and mid-1980s, the Federal Government committed substantial resources for project-based rental assistance in new or substantially rehabilitated multifamily (5 units or more) properties for low- or moderate-income families. These properties were subsidized through a variety of different programs, but they were all provided with long-term subsidies for specific rental units owned by private landlords.

During a 10-year period, beginning in the mid-1960s, nearly 700,000 units were built, principally under the Section 221(d)(3) Below Market Interest Rate (BMIR) and Section 236 programs. Properties built under these programs are often referred to as "older assisted" HUD-insured multifamily properties.

In 1974, Congress enacted Section 8 "Lower Income Rental Assistance" under the United States Housing Act, a program that could be either project-based or tenant-based. Rather than providing a fixed subsidy, tenants would generally pay 25 percent of their income (later increased to 30 percent) towards their rent and the government would pay the difference. Project-based Section 8 became the new vehicle for the production of multifamily rental housing for lower income families. Between the mid-1970s and mid-1980s, HUD committed to long-term (generally 20-30 year) project-based contracts for about 650,000 units under the Section 8 New Construction/Substantial Rehabilitation (NC/SR) program.

The Section 8 NC/SR program is often referred to as "newer assisted" HUD multifamily housing. About half of the units were built in conjunction with FHA-insured multifamily mortgages. The other half was built largely with financing provided by local or State housing finance agencies (HFAs) or in rural areas provided through the Rural Housing Section 515 loan program. Section 8 NC/SR funds were also used in conjunction with the HUD Section 202 loan program to produce housing for elderly and disabled tenants.

Except for Section 202, new commitments for Section 8 NC/SR were no longer made after 1983, as the Federal housing policy shifted to reliance on the existing stock and tenant-based assistance. Since 1987, the major Federal program for the production of affordable rental housing has been the Low Income Housing Tax Credit.

At the same time as implementation of Section 8 NC/SR, a second form of project-based Section 8 assistance was implemented. This was the Section 8 Loan Management Set-Aside (LMSA) program. This program assisted tenants and stabilized projects that HUD had earlier assisted with interest rate subsidies ("older assisted" properties). Section 8 LMSA contracts were initially funded for 15-year periods. As energy prices and other operating expenses dramatically rose in the late 1970s and tenant incomes lagged, deeper project-based rental subsidies began to be provided to assist tenants and help properties remain financially solvent.

Policy Concerns

Beginning in the 1980s there was a concern that a significant number of assisted properties would be taken out of the subsidized housing market. The initial concern was with "older assisted" properties. Many owners of older assisted properties were eligible to prepay their assisted mortgages after 20 years. These properties often had below market rents, and HUD was concerned that owners would prepay their mortgages and leave the assisted stock in order to charge significantly higher market rents to unassisted tenants. To address this concern, between 1990 and 1995, HUD implemented a Preservation Incentives program and almost 100,000 units were preserved. In exchange for not prepaying their mortgages, owners were provided with financial incentives, generally in the form of higher rents and more Section 8 assistance.

In addition to maintaining the stock of affordable housing, HUD has also been concerned about the quality of that stock. Most of the HUD-assisted stock was built 20 to 30 years ago. A 1995 study documented increased capital needs of the assisted portion of this stock since 1989, which often was coupled with insufficient financial resources to address the needs.[1]

Overview of Mark-to-Market (M2M) Program Administration

The M2M program was authorized by the Multifamily Assisted Housing Reform and Affordability Act (MAHRA), enacted on October 27, 1997. A key provision of MAHRA required an independent office, created within HUD, to manage the M2M program. This was the Office of Multifamily Housing Assistance Restructuring (OMHAR). It was expected that

[1] Status of HUD-Insured (or Held) Multifamily Rental Housing in 1995. Abt Associates Inc. Final Report prepared for the U.S. Department of Housing and Urban Development (May 1999).

projects would enter the program when their original Section 8 contracts expired in the late 1990s and early 2000s. The legislation, as amended, stipulated that OMHAR would sunset on September 30, 2004. HUD's authority to enter into M2M agreements continues through September 30, 2006, to allow for completion of processing on the last projects.

OMHAR was set up as a semi-independent entity within HUD and the M2M program became fully operational in 1999. However, day-to-day responsibility for arranging restructuring agreements with individual owners was not the responsibility of OMHAR staff, but rather of a network of Participating Administrative Entities (PAEs). The PAEs could be public or private sector organizations with experience in working with residents of low-income housing projects as well as expertise in underwriting and mortgage finance.

The M2M program itself has the following two specific goals:

- First, the M2M program is designed to reduce Section 8 subsidies in projects with FHA insured mortgages that have project-based Section 8 rents greater than market rents. The program authorizes HUD to reduce Section 8 rents to market rent levels in these projects.

  In some cases, the project will remain viable with the reduced rents, without further action by OMHAR. These are called "Lite" transactions. The processing by the PAE is limited and no long-term use agreement is obtained.

  In many cases, however, a simple rent reduction would result in a default because a project would no longer be able to pay its expenses and debt with the reduced income. M2M therefore authorizes partial or full payments of claim from the Insurance Fund to reduce the size of the first mortgage debt. By reducing the monthly mortgage payment to the point where market rents can adequately cover it (and appropriate project expenses), the Section 8 subsidy is reduced *and* the project remains viable. These types of transactions are called "Fulls." The processing by the PAE is quite substantial and a 30-year Use Agreement, requiring that the property continue to provide affordable housing, is obtained from the owner.

  As a practical matter, in a Full transaction, the existing FHA-insured first mortgage is paid off in its entirety and a new, generally much smaller mortgage, is put in its place. In most, but not all, cases, the new mortgage is also FHA-insured. In standard cases, the amount of the claim payment is not forgiven; rather, the project carries this amount as additional debt in second and/or third mortgages which are payable only to the extent funds are available over time or at the time the project is sold or refinanced.

- The second goal of the M2M program is the preservation of affordable rental housing where it is needed. To this end, three particular features should be noted in reading this report:

  - M2M provides for current project repairs where needed, through a rehabilitation escrow, which provides that those repairs be completed after closing. These repairs may include items necessary to bring the property up to a reasonable non-luxury standard, such as by the installation of air conditioning in areas where all the comparable properties are air-conditioned.

- M2M also provides for ongoing deposits to the reserves for replacement that are designed to assure that the property remains sound during the entire term of the new mortgage. These are nearly always much greater than were required under the existing HUD mortgage.

- Where a property is needed in the jurisdiction in order to satisfy affordable housing needs, and, even after a full payment of claim, the property cannot be made viable with market rents, M2M is also able to provide above-market rents sufficient to pay for projected operating costs and any new debt service needed on the property. These are called "exception rents." By statute, no more than 5 percent of the properties in the program may have exception rents that exceed 120 percent of the applicable Fair Market Rents (FMR).

Study Objectives

The goal of this study is to evaluate the implementation of the M2M program in terms of cost effectiveness and participant satisfaction. This includes an assessment of the financial costs and benefits of the program. Claims on the FHA fund and program administration are the main financial costs, Section 8 reductions are the main financial benefits, and preservation of assisted housing is the main non-financial benefit. An important aspect of the cost estimate is determining what the costs would have been without the program. In other words, what is the baseline against which the costs and savings are measured? What would happen without the M2M program? Would Section 8 continue at current levels? Would all Section 8 project-based assistance end and would tenants instead receive vouchers? Would properties default?

Along with the measurable financial outcomes of the program are a number of less quantifiable benefits, including participant satisfaction (PAEs, property owners, lenders and residents), as well as long-term preservation of affordable rental housing.

One focus of the evaluation is to provide information on how the program has performed to date so that lessons can be applied to the remaining term of the program. However, OMHAR is set to cease operations in 2004, with the entire Mark-to-Market Program set to sunset in 2006. Thus, an equally important focus of the evaluation is to inform future policy decisions relating to affordable housing and housing subsidies. These lessons can be applied to future HUD programs that address policy issues such as dealing with troubled or defaulted properties and maintaining the financial and physical viability of stock that is not currently troubled.

Nine specific research topics were addressed through three primary analysis activities. The research topics are:

- Comparisons of rent restructurings with full restructurings in terms of costs, viability and processing time, including impacts of changes in HUD procedures throughout the life of OMHAR.

- Types of projects (size, unit type, population, location, owner types) that are likely to opt for and be accepted for rent restructuring versus full restructuring.

- Types of projects (size, unit type, population, location, owner type) that are likely to close. Other factors considered included the need for rehabilitation, type of PAE, and mortgage characteristics (HUD held, bond financed).

- Does the process assure that the properties remain financially and physically viable as affordable rental properties?

- What types of properties (size, unit type, population, owners, location) choose not to participate or are rejected by the program, and what happens to these properties?

- How have the tenants been affected by the restructuring, if at all? Does restructuring cause tenants to move? Are they being fully informed of the consequences of the program on their residency?

- Have changes in HUD's procedures from the beginning of FY 2001 to the end of FY 2002 led to quicker restructurings, more savings, or more full restructurings? Are there any new trends based on new legislative requirements? What has been the effect of policy changes (such as the owner incentive package) on the restructuring process? What are the reasons that some owners do not cooperate with the M2M process or refuse to close deals?

- Based on financial analysis, how does the effectiveness of public versus private PAEs compare?

- Based on preservation goals, how do public PAEs compare to private PAEs?

Methodology and Data Overview

The research design answered the research questions through three distinct types of data collection and analysis:

- **A process analysis (the Process Study)** of the administrative mechanisms put in place to implement the M2M program. The goal of the process study was to obtain stakeholder input regarding the OMHAR process. The primary data collection methodology was interviews with a wide range of participants in the restructuring process including current and past OMHAR staff, PAE staff, and HUD Office of Housing staff. The interviews were supplemented by a review of a range of OMHAR documents. This portion of the study addresses the research questions on participant satisfaction, tenant impacts, effects of changes in process over time, and PAE issues.

- **A retrospective statistical analysis (the Retrospective Study)** to measure trends in participation levels (e.g., number of eligible properties entering the program and their outcomes), estimate savings to the government resulting from the program, evaluate the efficiency of program operations, and provide preliminary indications of program outcomes. This part of the evaluation used a wide range of OMHAR and FHA data on properties to provide quantitative assessments of each of the study's research questions.

- **A prospective analysis (the Prospective Study)** to examine "typical" OMHAR-administered restructurings. This component of the evaluation employed a case-study approach that documented the restructuring process for 15 properties undergoing restructurings in 2003. It was the primary source of information on tenants and the interplay of interests and incentives that shape the outcomes of the restructuring process.

Organization of the Report

The report is presented in two sections. The remainder of the first section is organized as follows:

- Chapter Two presents the results of the process analysis, documenting the evolution of the administrative process and procedures established by OMHAR.

- Chapter Three presents the findings of the retrospective statistical analysis of participation in the M2M process.

- Chapter Four presents the analysis of estimates of projected savings to HUD derived from the M2M restructurings completed to date.

- Chapter Five presents the analysis of the efficiency of the program operations.

- Chapter Six examines the program outcome regarding the goal of preserving affordable housing stock.

- Chapter Seven presents a cross-site summary analysis of the data obtained through study of 15 multifamily properties undergoing restructurings in 2003.

The second section contains the 15 detailed case studies for the properties included in the Prospective Study component.

2. Process Analysis of the Mark-to-Market Program

Introduction

This Chapter presents results of the Process Study component of the Mark-to-Market (M2M) assessment. The objectives established for this component are as follows:

- Identify the non-financial costs and benefits associated to date with the M2M process.
- Identify problems or issues that have significantly reduced the efficiency of the M2M process.
- Develop recommendations for enhancements to any future M2M-like Federal program.

Data obtained through the Process Study also inform the Retrospective Study (Chapters 3 through 6). Data for the Process Study were obtained through the following steps:

- A review of the program documentation developed by OMHAR, including its Operating Procedures Guide, policy directives, and training materials.
- A review of assessments of the M2M process conducted by the General Accounting Office (GAO) and HUD's Inspector General's Office.
- Key informant interviews with current and past senior OMHAR staff, including both headquarters and regional staff.
- Key informant interviews with senior staff at eight of the Participating Administrative Entities (PAEs) that serve as OMHAR's underwriting mechanism.
- Key informant interviews with senior staff of the financial advisor that has supported OMHAR throughout the evolution of the M2M initiative.
- Key informant interviews with senior staff at HUD's Office of Housing who have been involved in the initiative.
- Key informant interviews with a number of owners of Section 8 multifamily properties that have had extensive experience both with the Section 8 program and with the M2M restructuring process.

Our discussion begins with a summary of the development of the M2M program and the "problem" that the M2M legislation was intended to address. We then discuss the evolution of the policies and procedures OMHAR has employed to implement the M2M legislation, followed by general conclusions about the implementation of M2M drawn from our analysis of OMHAR's procedures and our key informant interviews.

Background

Project-based Section 8 assistance was initiated in the 1970s to promote private-sector investment in affordable housing. If private-sector owners agreed to construct or rehabilitate multifamily units to HUD specifications, the owners could enter into 20-year use agreements with HUD. These agreements provided assurance of rent subsidies paid by HUD (with an included annual adjustment factor that was set to be no less than zero each year.) In many cases the rents specified in the 20-year use agreements were above market in a given community. This rent differential was justified as an incentive to promote the construction not only of additional affordable housing, but affordable housing that was qualitatively superior to housing constructed by Public Housing Agencies (PHAs) in the 1950s and 1960s. The annual adjustment factor tended, in many cases, to further increase the disparity between the subsidized rents and market rents in a given locality.

By the late 1980s, more than 800,000 units in approximately 8,500 multifamily projects had been financed with mortgages insured by the FHA and supported by project-based Section 8 housing assistance payments contracts. A typical property development arrangement was to establish a General Partnership for construction of one or more properties in a given locality. In many cases there was an identity of interest (i.e., some overlap in ownership) between the ownership group and the entity that provided on-site property management services. The "peaking" of Section 8 construction in the late 1970s and early 1980s resulted in the creation of a national cohort of owners with long histories of program participation. A high proportion of these owners still had control of properties when the M2M program was implemented.

By the late 1980s it was known that the Department would be facing a major policy dilemma in the late 1990s when many FHA-insured Section 8 properties would be coming to the end of their 20-year contract terms. The HUD analyses projected that if the contracts were renewed with the existing rental adjustment factor, the increase in rental subsidy costs would rapidly become unsupportable within HUD's budget limitations. However, simply freezing the level of rent subsidies or reducing the subsidies to market levels could have serious programmatic consequences. A reduction in subsidies could cause some owners to leave the program or put some properties at financial risk, including those with federally insured mortgages. In either case, the stock of affordable housing could be reduced, placing low-income households at risk of homelessness or massive rent increases, as well as potentially representing a large Federal cost in the form of defaulted FHA-insured mortgages. The creation of the M2M program was an attempt to find a solution to this policy dilemma.

Demonstration Program

Recognizing the potentially dire consequences of reducing subsidy costs, both to tenants and to the FHA fund, without additional relief, Congress enacted a mortgage restructuring demonstration program for Fiscal Year 1996. A modified version of the program was authorized for Fiscal Years 1997 and 1998. The objective of this initiative was to obtain the voluntary agreement of Section 8 owners to enter into a new use agreement that would reduce above-market rents while providing financial incentives for owners to keep their properties in the Section 8 portfolio. The owners' two primary incentives were restructured FHA-insured mortgages that reduced expenses and grants to make substantial physical improvements to the properties. More than 100 properties underwent restructurings in this demonstration program.

The Multifamily Assisted Housing Reform and Affordability Act (MAHRA)

Beginning in 1996, concern was expressed in Congress that results from the demonstration program would not be available soon enough to address the "peaking" of 20-year Section 8 contract expirations.

This Congressional concern resulted in passage of the Multifamily Assisted Housing Reform and Affordability Act (MAHRA), enacted on October 27, 1997. MAHRA established the institutional and policy framework for M2M. The main components of that framework are presented below.

While focusing on the same procedural steps as the demonstration program, subsidized rent reduction and financial restructuring, the MAHRA legislation introduced some key new elements into the strategy for solving the problem of above-market Section 8 rent subsidies. These included:

- Rent reductions and associated financial restructurings were to be managed by an independent office created within HUD. This was the Office of Multifamily Housing Assistance Restructuring (OMHAR). In the original MAHRA legislation it was stipulated that the Director of OMHAR should report directly to the Secretary of HUD. (In the 2001 reauthorization this stipulation was changed, and OMHAR's Director subsequently reported to the Assistant Secretary for Housing.) OMHAR's sole function was the negotiation of restructured financial agreements with Section 8 property owners to continue project-based subsidized housing.

- Owners needed to enter the program if the owner wished to remain in the Section 8 program. Any Section 8 property with above-market subsidized rents would, at the expiration of a Section 8 contract, have to enter into a restructuring agreement that reduced the subsidized rents to market or near-market levels.

- While the reduction of rental subsidies was the primary goal of the initiative, it was not the sole aim. The preservation of affordable housing was another major legislative goal. There were two mechanisms for this. The first was to underwrite properties at market rents while assuming that current and future repairs to the property would be made. The second was a provision for exception rents, which could be set at up to 120 percent of the given Fair Market Rent in a given locality. Exception rents would be granted where there was a clear demonstrated need for the subsidized housing property and above-market rents were necessary to maintain the financial viability of the property.

- Lead responsibility for negotiations with individual owners was not given to OMHAR staff, but rather to a network of Participating Administrative Entities (PAEs). The PAEs needed to demonstrate experience working with residents of low-income housing projects as well expertise in multifamily restructuring and multifamily financing. The legislative history of this provision gave a clear preference to State and local housing agencies to be the primary organizations to perform the development and negotiation of the restructuring plans.

- Tenants were to be involved in the restructuring process. The legislation included provisions for required tenant input once a restructuring negotiation began. In addition, the legislation provided for funding of up to $10 million for tenant advocacy and local community groups that would provide information to tenants at a property involved in restructuring negotiations.

- When a PAE and OMHAR determined that an existing owner was not qualified to continue operating a property, preference was to be given to tenant or community-based nonprofit organizations as alternative owners.

- Properties that had originally been financed by bonds issued by State or local housing finance agencies were exempt from the program. Such properties would be able to retain the rents at the higher level stipulated by the pre-MAHRA formula. These properties represented approximately 7 percent of the existing Section 8 portfolio.

The key provisions of MAHRA clearly indicated a legislative intent to reduce the role of a “traditional player” in the M2M restructurings. This traditional player was HUD’s Office of Housing, responsible for managing the contracts of Section 8 properties. At the same time, the preference for State and local housing agencies as PAEs was clearly an attempt to retain a public sector perspective in the program. In addition, the legislation intended to promote greater participation of nonprofit entities in the ownership and management of Section 8 properties.

Interviews with State and local housing agency staff indicated that they put a heavy emphasis on the structural rehabilitation facet of the program. In their view, the reduction in rental subsidies provided an opportunity to devote a high proportion of the rental savings to needed physical improvements.

Although the legislation indicated that the newly created OMHAR would have sole responsibility for restructuring, it did not specify how OMHAR was to coordinate its activities with the Office of Housing. The Office of Housing retained responsibility for managing Section 8 properties until contract expirations. The Office of Housing would retain some level of oversight while a property was negotiating a restructuring agreement and then would resume management responsibility once a restructuring agreement was concluded. Deciding how these parallel responsibilities were to be coordinated was one of the initial issues to be addressed as OMHAR began operations and established procedures.

Initial Organizing of OMHAR, 1998

The MAHRA legislation explicitly stated that OMHAR was to function as an independent entity, originally reporting directly to the HUD Secretary. The Demonstration Program continued to operate as a separate initiative in the Office of Housing. Once authorized, OMHAR had to develop a completely new organizational structure and begin restructuring contracts that were to expire on or after October of 1998. It took virtually the entire year of 1998 to make OMHAR a functioning organization.

The key steps in the process were:

- Recruiting a Director and professional staff.
- Establishing contracts with public and private sector entities that would serve as PAEs.
- Establishing rules and procedures that would provide guidance to the PAEs in their negotiations with owners.
- Specifying procedures for referral of properties from the Office of Housing to OMHAR.

Recruitment of Staff

Even before the OMHAR organization was in place, senior HUD officials made a key decision to operate the M2M program entirely separately from the ongoing demonstration program. Until the close of the demonstration program in 2000, there was no coordination of activities between the two staffs. The two restructuring efforts ran on separate, but parallel tracks.

Ira Peppercorn, OMHAR's first Director, was confirmed in the fall of 1998. HUD already had begun setting up operations and recruiting professional staff. As a recruitment incentive, OMHAR staff was to be paid according to the "Treasury Schedule"; that is, 120 percent of the standard pay scale for a given Federal position. The use of this schedule was stipulated in MAHRA. In addition, OMHAR received budget resources to set up offices outside the HUD headquarters building in Washington, DC.

Professional staff was recruited from Federal and State agencies as well as private-sector organizations. Within the public sector, staff was recruited from agencies that had experience in dealings with troubled properties, mortgage finance, and underwriting. These included HUD's Office of Housing, Fannie Mae, and the Department of the Treasury. A number of the professional staff that came to OMHAR had formerly worked for the Resolution Trust Corporation (RTC).

OMHAR was also provided a budget to obtain ongoing contractual support for financial advisory services, including financial modeling and information technology resources. A heavy level of contractor support has continued throughout OMHAR's history.

Thus, at the onset of the M2M program, OMHAR was provided the regulatory authority and necessary funding to operate largely independently of existing HUD program offices and data centers. Many informants felt that the level of financial commitment and flexibility was a major reason for OMHAR's ability to establish operations within a short timeframe.

Participating Administrative Entities (PAE)

In 1998 OMHAR also began negotiating with organizations that could serve as PAEs. Following the intent of the MAHRA legislation, a great deal of this effort was focused on State and local housing agencies. This proved to be a long process, with the last agreement with a public PAE not signed until 2000. (OMHAR negotiated agreements with 42 public entities, but this number was significantly reduced in later years.)

In these negotiations, it became clear that there were differences between OMHAR and State agency staff on the program's main objectives. OMHAR perceived its mission as reducing future pressures on Section 8 discretionary funds and ensuring the financial stability of properties that remained in the Section 8 program. Many State and local agencies saw the restructurings as an opportunity to significantly rehabilitate Section 8 properties and also move a portion of the Section 8 portfolio from private to nonprofit or tenant ownership.

Procedures Guide

In addition to staff recruitment during 1998, OMHAR also spent that year developing a detailed Procedures Guide. This document was intended to set the underwriting standards for negotiations with individual property owners by the PAEs. A key feature of this document was OMHAR's determination that it had legislative authority to negotiate two types of restructuring agreements: Fulls, and Lites.

Full mortgage restructurings involve resetting rents to market levels and reducing mortgage debt to permit a positive cash flow. For this type of restructuring the PAEs are required to develop plans that reduce the property's FHA-insured mortgage as well as the rents. Under such an agreement the owner receives a renewal of the Section 8 contract at a reduced subsidy level and is required to maintain the property as affordable housing for 30 years. The owner also enters into a 20-year Section 8 use agreement.

OMHAR also maintained that it had the authority to negotiate another type of restructuring agreement, the Lite. In this type of agreement, there is no restructuring of the property's financing. The rents are reduced to market levels, and the owner agrees to a five-year renewal of the Section 8 contract. In such cases, it is the PAEs responsibility to ensure that the rent reduction does not impair the owner's ability to operate the property on a sound financial footing. Owners opting for a Lite retained a greater amount of flexibility for the future use of their property. When agreeing to a Lite restructuring, an owner was required to accept Section 8 for only 5 years (as opposed to 20 for Fulls). After 5 years as a Lite the owner could explore the possibility of moving the property to the unassisted sector, if, perhaps, there had been an improvement in the rental market.

Procedures for the Office of Housing

In its first year of operation, OMHAR also finalized procedures for referring properties from the Office of Housing to the M2M program. These procedures stipulate that four months prior to a Section 8 expiration date, an owner wishing to remain in the program must submit a request for a contract renewal and a rent comparability study. Based on the analysis of the rent comparability data, local HUD offices had the option of renewing a Section 8 contract if rents were at or below market. If rents were determined to be above market levels (or the owner took the option of electing to go to OMHAR without a comparability study), the HUD local office was authorized to renew the contract for one year (at above-market rents) and then forward the request to OMHAR to negotiate a restructuring agreement. OMHAR would then assign the property to a PAE to negotiate the agreement. These procedures have remained essentially constant throughout the operation of the M2M program, although most owners have chosen to rely on HUD analyses rather than conduct their own rent comparability studies.

The M2M Process

Although the underwriting guidelines for M2M restructurings have evolved over time, the core administrative steps have remained essentially the same. For a Full restructuring the key steps in the restructuring process are:

- OMHAR receives a referral from the Office of Housing for a property that meets the criteria for participation in M2M.
- OMHAR assigns the property to a Participating Administrative Entity (PAE) that will have lead responsibility for developing the restructuring agreement.
- PAE obtains all requisite due diligence materials from owner of the property.
- PAE schedules and facilitates an initial tenant meeting that informs tenants of the purposes of the restructuring and requests their input regarding needed physical enhancements and/or on-site management improvements.

- PAE coordinates third-party rent comparability study, to establish current market rent levels for a given locality (owners may submit their own rent comparability studies).

- PAE coordinates third-party Physical Condition Assessment (PCA) of the property. This study documents if there are any health or environmental hazards at the property. The study also documents both the short-term and long-term physical needs of the property.

- Working with data provided by the owner as well as data from the rent comparability study and PCA, the PAE develops a M2M Financial Plan for the property. The Plan is based on software developed by OMHAR. This software model forecasts the cash flow requirements of the property for 20 years based on the rent subsidy level deemed appropriate by the PAE. The model also takes into account the predicted operating expenses of the property as well as its capital needs.

- PAE schedules and facilitates a second tenant meeting. This meeting focuses on the critical capital repairs or enhancements that have been included in the Plan.

- After review(s) by OMHAR, the PAE submits to the owner a formal Restructuring Plan. This Plan specifies the HUD-subsidized rent levels for each category of unit, critical rehabilitation items that must be completed in the first 12 months of the Plan, plus the amount that must be maintained in the property's Reserve for Replacement. The Plan also presents the financial restructuring proposed by OMHAR that normally includes a major pay down of an existing First mortgage, plus issuance of FHA-insured Second and Third Mortgages.

- Assuming agreement by the owner, the restructuring agreement moves to closing. Once an agreement is closed, oversight of the property once again becomes the responsibility of HUD's Office of Housing.

The First Phase of OMHAR Restructuring, 1999-2001

OMHAR was not able to engage in restructuring negotiations as quickly as originally anticipated. Significant numbers of properties were not referred to PAEs until mid-1999. The first completed restructuring agreement, a Lite, was completed in December 1999. The first Full restructuring was completed in June 2000.

Overall, OMHAR's production in the first two full years of operation did not meet the expectations of Congress. A GAO report issued in August 2001 noted that OMHAR had completed restructurings for only 41 percent of the 1,558 properties that had been referred to it through June 15, 2001. Only 21 percent of these restructurings were Fulls. Processing time for completed Fulls was close to 500 days.

A number of factors contributed to the slow rate of completions, particularly for Fulls. These include:

- A steep learning curve for how to evaluate a proposal for a Full restructuring. The original version of the M2M Procedures Guide had necessarily been constructed prior to restructuring activities. It took some time to obtain an information base of operational data needed to provide guidance for underwriting. The lack of precedents meant that OMHAR asked for many revisions after submission of an agreement by a PAE. PAEs could not anticipate the types of underwriting issues that OMHAR staff would identify as they reviewed initial draft agreements.

- A lack of outreach, particularly to the owner community. There was a natural reluctance (especially given earlier legislation imposing a moratorium on prepayments) for owners to voluntarily enter into long-term use agreements that could significantly reduce the amount of their rental subsidies. There were indications that some owners were attempting to draw out negotiations in the hope that some of the legislation's provisions would be rescinded or that a "better deal" could be negotiated. It required some time for OMHAR to solicit direct input from the owner community.

- A poor level of coordination and communication with the Office of Housing. The number of referrals was dependent on the actions of Housing staff in HUD field Offices, and in some regions the number of referrals was significantly below what had been anticipated. There was no regular sharing of information between OMHAR and HUD staff regarding specific properties or owners. Many informants indicated that there was some resentment on the part of some Office of Housing staff, attributed to the OMHAR staff's relative unfamiliarity with the Section 8 Program and the premium salaries paid to OMHAR staff. In addition, Office of Housing staff had concerns about restructuring agreements, especially with owners considered "problem owners," negotiated independently. Such owners had been cited in the past by Housing staff for failing to maintain the level of quality of services stipulated in their use agreements. These properties would eventually be the Office of Housing's responsibility to administer. For its part, in its first years of operation, OMHAR appeared to see little need to draw on the expertise of Office of Housing staff, either in the development of procedures or in the details of specific negotiations.

- A wide variation in the capabilities and efficiencies of the PAEs. In particular, OMHAR had concerns about the performance of a significant number of the public PAEs. In part, this may have been due to the differing programmatic objectives of the public PAEs and OMHAR. However, the most common factor mentioned by informants was the inability of Public PAEs to develop internal staff units totally devoted to the M2M process. Many of the Public PAEs, because of their size, were assigned only a few properties, and PAE staff was only intermittently involved with M2M procedures and ongoing OMHAR guidance. This increased the time necessary for completing each restructuring.

By the early part of 2000, OMHAR management realized that the organization was not meeting expected production goals. There was some concern on the part of OMHAR that its operating authority might not be extended beyond September 30, 2001. To address these concerns, OMHAR held a series of meetings in the spring and summer of 2000 with major stakeholders in the program. These included representatives from owner organizations, State and local housing agencies, and nonprofit groups with a longstanding interest in subsidized rental housing.

The outcome of these meetings was the first major revision to the original program design, the Owner Incentive Package (OIP). The major element in this package was a provision that owners could receive monthly capital recovery payments to provide a recovery of capital and a return on the owner's required payments for property rehabilitation and restructuring transaction costs. The owner's contribution to the closing and rehabilitation costs is repaid with interest over 7-10 years. In addition, owners would be able to receive an Incentive Performance Fee (IPF), which could be equal to 3 percent of the effective gross income of a property. This fee was to be the first priority drawn annually while any subordinate debt was outstanding. In addition, the owner was entitled to receive up to 25 percent of any surplus cash.

There was general agreement among all categories of informants that development of the OIP was a major step towards increasing the rate and number of Full completions. Under this formula, an owner could expect a reasonable return on any major rehabilitation investments made at the time of the closing of a Full restructuring. Prior to the development of the OIP, there was general agreement that owners saw little opportunity for recovering capital investments. Owner reluctance to enter into Full agreements prior to the OIP is indicated by the small number of completed Fulls prior to 2001 and their lengthy processing time (over 500 days). All categories of respondents agreed that without the OIP, OMHAR would never have been able to reach the production level of completed Fulls it achieved in 2002 and 2003.

After the implementation of the OIP, the pace of Full restructures picked up dramatically. The view of all OMHAR informants was that without those incentives, M2M would probably not have realized any significant volume.

Congressional concern about the relatively slow pace of restructures led to a request for a GAO report on the progress OMHAR had made to date, including a recommendation regarding extending OMHAR's authority to operate past September 30, 2001. The GAO report recommended that OMHAR's authority be extended. The primary reasons for this recommendation were:

- Moving M2M personnel out of OMHAR would seriously reduce the efficiencies OMHAR was beginning to obtain after two years of operational experience.

- Given the specialized expertise required to conduct the property underwriting, it appeared most effective to continue an office solely devoted to this function and with the needed dedicated resources (such as the financial advisor contractor staff) to oversee restructuring transactions.

However, in order to facilitate coordination with the Office of Housing, the GAO recommended that OMHAR subsequently be required to report to the Assistant Secretary for Housing. Under this arrangement, OMHAR would still be able to act largely independently in setting out procedures and OMHAR staff would retain their premium salaries.

To increase owner cooperation, GAO recommended that OMHAR be given authority to make rehabilitation grants to ensure that properties with major rehabilitation needs could be made financially viable under an OMHAR-negotiated restructuring. Under these grants the owner was required to provide only 20 percent of the funds. In many cases this offered the owners an opportunity to leverage Federal funds to make major improvements to their properties.

These recommendations were largely incorporated in a Mark-to-Market Extension Act of 2001. The Act extended OMHAR's operational authority through September 30, 2004, and gave HUD the authority to continue restructuring activities through September 30, 2006.

The Second Phase of OMHAR Restructuring, 2001-2003

Following passage of the Extension Act, OMHAR's operations passed into a phase in which many of the operational problems appeared to have been overcome. Improved performance indicators included:

- Increased productivity in completing restructurings. By late 2002 and throughout 2003, OMHAR was completing on average 30 restructurings each month. The majority of these were now the more complex Full restructurings.

- Decreased processing time for restructurings. In 2002-2003, Full restructurings were taking an average of 11 months. Lite restructurings now averaged 5 months. This was close to a 50-percent reduction in processing time, compared to the first 2 years of operations.

- Increased volume of referrals for Full restructuring from the HUD field offices. The number of Lite restructurings dropped dramatically. By 2003, they represented only about 10 percent of OMHAR's active portfolio. Thus, the restructurings completed in 2002 and 2003 represent properties with long-term contracts with the Section 8 program.

Interviews with both owners and underwriters indicated greater confidence in the long-term financial viability of restructurings completed in 2002-2003, compared with those completed earlier in the program.

OMHAR has operated under three different Directors. The first Director was able to craft and implement the OPG, which was needed to make the program truly operational. Interim leadership after his departure maintained strong focus on operations while continuing to clarify and refine policy. In May 2002, Charles (Hank) Williams became Director and has expanded the outreach-to-owners effort, fully supported the emphasis on both production and transaction quality, and improved communications and support between OMHAR and Housing.

Williams made a major effort to develop linkages with the Office of Housing. This included regular meetings between Housing and OMHAR staff at the headquarters level, as well as greater participation of Housing Office field staff in some restructuring negotiations. There is general agreement that by 2003 the level of cooperation and coordination between the Office of Housing and OMHAR had improved markedly.

These outreach efforts appeared to improve OMHAR's operational effectiveness by increasing the number and speed of property referrals and improving the ability of OMHAR and the PAEs to find solutions to site-specific problems with help from Office of Housing staff.

During the period 2001-2003, OMHAR staff was also able to improve the effectiveness of several of its major operational resources. These improvements included:

- Continuous improvement in the Excel-based "underwriting model" that is a decision support tool used by PAEs and OMHAR staff to organize and present key data on each property, to judge how best to restructure each property, and to record comments about how these decisions were made. Although not a "model" in the technical sense, because all decisions are made by the user, this decision support tool is credited with playing a key role in supporting OMHAR's quality assurance efforts.

- Improved quality assurance through a variety of training and technical assistance efforts. Conversely, some early Fulls—completed when PAEs and other program participants were less experienced—may have difficulty meeting their as-underwritten objectives.

- Enhancement, during 2003, to the methodology for calculating financial savings. The methodology adopted at that time is based on a variant of the "underwriting model" and allows a more accurate, property-specific estimate of future 2nd and 3rd mortgage payments than the savings methodology used previously.

- A greater reliance on private-sector PAEs. Even with the legislatively mandated preference for public PAEs, private PAEs have always played a major role in OMHAR's restructuring efforts. In the first years of the program they handled approximately 65 percent of all properties. By 2003 approximately 90 percent of all properties were being handled by private PAEs. Although designated "private," these organizations have had considerable histories of involvement with the public sector. More than half of the private PAEs had worked with the Resolution Trust Corporation (RTC) on the handling of "distressed properties." Other PAEs have had considerable experience in the use of housing bond financing.

The private PAEs have provided several operational advantages: they had professional staff with a good understanding of the underwriting issues surrounding the refinancing of multifamily properties; they are large enough to devote staff full-time to the M2M effort; and the private PAEs have been willing to accept fees considerably lower than those requested by public PAEs. The expertise developed by these PAEs by 2003 was so considerable that over 90 percent of the public PAEs remaining in the program had a private PAE as a partner organization.

- Continuing refinement and clarification of the underwriting standards employed by OMHAR. There are two unique features in the M2M process: first, the operating income of a property must be set as the rents to be derived from a market rent level, whatever the expenses or rehabilitation requirements of a property; and secondly, the underwriting principles employed in a restructuring must lend some confidence that a property can operate on a sound footing over the course of a 20-year use agreement. In addition, the underwriting standards as of 2003 had taken into account a number of major “spikes” in operating costs, such as the rise in insurance rates after 9/11.

M2M now addresses the issue of reduced operating income through the partial or full payment of a claim that will be executed on an existing first mortgage. This payment “pays down” most or all of the existing balance on the first mortgage. The obligations in the restructured financial package reduce the long-term obligations of the owner compared to the pre-existing debt structure. In recent years, OMHAR has decided to employ conservative expense estimates to determine a Net Operating Income. For example, OMHAR now employs higher estimates of likely vacancy rates and bad debts than would be used for standard FHA loans. These conservative estimates can be combined with a lengthy historical record of actual expenses to determine if a given rent level will be able to support operating expenses.

All Full packages now include a Reserve for Replacement (RfR) account. This is an escrow account from which funds are to be drawn to address capital replacement and maintenance needs. In determining the RfR estimates, OMHAR has also evolved to a more conservative underwriting standard. These estimates are now based on a 20-year cycle of capital replacement requirements, rather than the 12-year estimates for standard FHA loans or the 7- to 15-year estimates provided for conventional loans.

The amount of the projected partial claim payment is also affected by the size of the immediate (12-month) rehabilitation requirements, identified mainly through Physical Condition Assessments conducted for each Full. These are deemed to be the rehabilitation requirements necessary to bring the property to a standard appropriate for its original use in the rental market. As of 2003, the amounts required for these critical requirements varied widely, from $200 per unit to nearly $10,000 per unit.

OMHAR’s underwriters believe that the refined underwriting standards have enabled the program to make progress toward two core objectives of the MAHRA. First, the underwriting standards lend confidence that owners will be able to operate Section 8 properties through the 20-year use agreement, even with significantly reduced rental subsidies. Secondly, the inclusion of the RfR estimates for 20 years ensures properties will be reasonably maintained over the same period.

In 2003, OMHAR instituted another underwriting procedure that provided yet another cushion in Full restructurings. This was the inclusion of "payables" as a standard expense item in a closing. Payables are non-standard expense items included on an owner's balance sheet at the time of a restructuring, such as remaining balances on installed rehabilitation items, special tax levies, and other extraordinary expenses. Deleting such items from a balance sheet at the time of closing increased the predictive value of the financial model developed for the property. Underwriter comments indicated that the inclusion of payables significantly enhanced the level of owner cooperation in the restructuring negotiations.

OMHAR in 2003-2004

At the time of the project's data collection period (March-November 2003), the M2M initiative was operating as a "mature" program. All of the key players in the process (including OMHAR staff, PAE underwriters, and the owner community) had a clear understanding as to how the process worked. For the most part, negotiations between owners and the PAE were not contentious, but focused on issues at the margin, such as the specific items to be included in the 12-month rehabilitation package. Thus, the M2M program appeared to be meeting key objectives of the MAHRA legislation: reducing the level of future Section 8 expenditures, while placing a significant number of Section 8 properties on a sound financial footing.

The operation of the M2M program did show one major divergence from the programmatic "vision" posited in MAHRA. The level of public sector and nonprofit involvement in the restructuring effort remained low. As mentioned above, in 2003 public sector PAEs were involved in less than 10 percent of active restructurings. In addition, the anticipated involvement of tenant organizations and nonprofits as owner/managers had not materialized. A major barrier to the involvement of nonprofits was the relatively large "upfront" costs associated with the restructurings, particularly for the initial rehabilitation requirements and other transaction costs. Unless there was a major change in the types of owners or entities requesting restructurings, the ownership cadre of Section 8 multifamily properties looked to remain much the same as when restructuring began in earnest in 1998.

However, even though M2M was a mature process in 2003, there remains a significant challenge for the program. The operating authority for OMHAR ends on September 30, 2004. HUD's authority to complete restructurings continues through September 30, 2006. In September 2004, there will still be a considerable number of Section 8 properties requiring restructurings. OMHAR estimates the number to be between 2000 and 3000. In 2003, OMHAR staff began to develop a Strategic Plan—a road map for moving the restructuring function back to the Office of Housing. At the time of this report, however, there was no detailed blueprint for this difficult transition.

The uncertainties associated with this situation had already begun to affect OMHAR's performance. OMHAR lost its ability to hire permanent staff in September 2003. This promises to become a severe limitation over the next year, as senior staff leaves the program. Anticipating OMHAR's dissolution in September 2004, in the summer of 2003 several key staff members who had been instrumental in the development of OMHAR already had left the agency for the private sector. This trend will likely continue and accelerate through September 2004.

It is unlikely that HUD will be able to retain the services of senior staff whose previous careers were in the private sector. In an era of staff limitations for HUD generally, the Office of Housing will have difficulty in placing such individuals in "slots" with acceptable levels of compensation. HUD has already issued a policy directive stipulating that these individuals cannot automatically bring their OMHAR grade and compensation levels to another HUD office.

The likelihood that much of the "historical memory" of OMHAR will be lost in a transition could have a significant negative impact on the restructuring effort from 2004 through 2006. There will be two sources of historical memory that can be transferred to a unit within the Office of Housing. One is the staff of the contractor organizations that have supported OMHAR, almost from its beginning. The other would be the senior managers and underwriters at those PAEs that have negotiated significant numbers of restructurings, particularly since 2001.

General Conclusions

As a result of the Process Study, the project team reached some general conclusions regarding operations of the M2M process and OMHAR. These conclusions are as follows:

- The M2M process has been effective in preserving affordable housing. Particularly as the program has operated in 2002 and 2003, it is possible to state that this is one of the program's primary goals. The PAE underwriters normally try to make a case for a restructuring even when the need for a property could appear to be marginal (see the discussion in Chapter 7). There are few instances where the entrance of a property into M2M results in that property leaving the Section 8 program.

- As a "mature" program in 2002 and 2003, the M2M process is putting in place financial arrangements that appear to be financially sound. Concern was expressed by both owners and PAE staff regarding some of the restructurings completed in the first operational years of OMHAR. These properties may require some type of regular monitoring of financial performance over the next several years.

- The programmatic enhancements introduced by OMHAR in 2000 and 2001 (particularly the Owner Incentive Package) were remarkably effective in enabling the program to reach its objectives. Prior to that time there was a considerable amount of reluctance on the part of owners to enter into negotiations for Fulls. By 2002-2003, this resistance had largely dissipated. In fact, by 2003 some owners who had completed Lites were considering the option of coming back into the program to negotiate a Full. These owners noted that the Full restructurings as completed in 2003 appeared to ensure the ongoing financial viability of the Section 8 properties.

- The private PAEs have proved more effective than public PAEs, largely because private PAEs have been able to develop staff units devoted solely to M2M. Their effectiveness has been demonstrated by the comparative efficiency of their processing time, and the volume of cases they can handle at a given point in time. It should be noted that a number of public PAEs have become effective in negotiating M2M agreements, usually by employing experienced underwriters on a fee basis. This cadre of private and successful public PAEs has developed a detailed understanding of the M2M process. This level of staff expertise will need to be drawn on once OMHAR ceases to operate as of September 2004. Without this "historic memory" it is difficult to see how the M2M process could be operated effectively by the Office of Housing beginning in October 2004.

- Exception rents appear to be a necessary tool to complete a significant number of restructurings (see a discussion of several cases in Chapter 7). The most recent data show that over 25 percent of properties receive exception rents. In the cases we have studied, the use of exception rents appears, in most cases, to be warranted by local conditions. It would be beneficial if Rental Assistance Assessment Plans (RAAPs) could be conducted early in the restructuring process. The RAAPs are justification for exception rents. In some cases, considerable time and expense are devoted to a restructuring before this justification analysis is performed. If the RAAP data were obtained earlier in the process, PAEs might be able to identify marginal cases where a property may not be needed in a given locality.

- The M2M process appears to provide substantial benefits to the tenant population. Section 8 tenants receive the benefit of retaining their existing residence, and the 12-month rehabilitation packages included in Fulls often provide considerable immediate physical enhancements. Overall, the current Section 8 tenants appear well-served by the program.

- The level of direct tenant involvement in the process has been minimal. In particular, tenant organizations have been only sporadically involved in restructuring negotiations. The "public-sector" orientation of the MAHRA legislation has not become a reality. This is true both of the level of tenant involvement and the participation of public-sector organizations in the ownership and management of Section 8 properties.

- It would be beneficial for the M2M program to have the capability to incorporate a wider context than a single property. On the whole, the PAE underwriters are extremely competent, although their expertise is focused on financial issues. In a significant number of cases, it would be useful for M2M participants to consider a broader community context. This could include such items as the plans of local housing authorities or the city's redevelopment plans. This would enhance the opportunity to attract additional community or economic development funds to a property.

3. Participation in the Mark-to-Market Program

Introduction

The objective of this Chapter is to identify characteristics of the FHA-insured Section 8 properties that have entered the Mark-to-Market (M2M) program. Our analysis sought to determine if those properties had any set of characteristics that differentiated them from FHA-insured Section 8 properties that did not enter the program. The chapter also compares the characteristics of properties based on their outcomes after they entered the M2M program: properties that opted for Full compared with Lite restructuring, properties that completed the process compared with those that did not, and Fulls that closed at market rents compared with Fulls that closed with exception rents.

Our analysis applied to all properties that had entered the M2M program through July 31, 2003. This includes properties whose cases were closed and those that were still in the pipeline at that time. The data for our analyses were drawn from administrative and tracking databases maintained by OMHAR and HUD's Office of Housing. For each assessment we compared the characteristics of different sets of properties using cross tabulations. Regression models were also applied in order to isolate the effects of specific characteristics on the outcome (e.g., entering M2M) for a given set of properties. Results of the regression analysis are presented in the appendix to this chapter.

The remaining sections of this chapter present the following comparative analyses:

- A comparison of the property, owner, and location characteristics of M2M properties with other Section 8 properties and properties that left the program.

- A comparison of properties that opted for a Lite restructuring versus those that completed a Full restructuring.

- A comparison of properties that successfully completed the M2M process versus those properties that entered the program but did not complete a rent restructuring (the Watch-List properties).

- A comparison of properties that received M2M exception rents versus those that completed an M2M restructuring at market-level rents.

- A comparison of the demographic, financial, and physical condition of properties that completed a Full restructuring versus other properties in the Section 8 portfolio.

We begin our presentation with a summary of the status of all FHA-insured properties as of July 31, 2003.

Status of Participating FHA-Insured Properties in the M2M Process

Figure 3.1 shows the distribution of all 9,070 FHA-insured assisted properties by status as of the end of July 2003. As of that date, about one quarter of the stock (a total of 2,416 properties or 27 percent) had entered the M2M process. The remaining three quarters of the stock had not entered the program as of July 31, 2003. This includes 1,096 properties (12 percent of the stock) that opted out of the assistance programs, and 537 properties (6 percent of the stock) that were "marked up to market" (in other words they had their rents raised to market levels with the goal of preserving them as assisted properties).

It is not clear what portion of the remaining 5,021 properties (55 percent of the stock) will ultimately enter the M2M process. A rough estimate is that approximately somewhere between 1,000 and 2,000 additional properties (20 to 40 percent of the stock that has not entered yet, and 10 to 20 percent of the total stock) will still enter the M2M process. An earlier study by Abt Associates estimated that approximately half of the assisted stock, or about 4,500 properties had rents above local market levels.[2] We know that approximately 2,400 properties have already entered the process, so we can assume that some number under 2,000 additional properties with above market rents will enter the M2M process as their contracts expire. It is likely that the number of properties with above market rents that will enter the process will be smaller than 2,000 as some will opt out or not enter the restructuring process for other reasons. The remaining properties would not be eligible due to below market rents.

As shown in Figure 3.2, through the end of July 2003, 2,416 properties entered the M2M program. Of those 2,416 properties, 1,187 (49 percent) have closed, including 391 as Lite restructurings (33 percent of all closed properties) and 796 as Full restructurings (67 percent of closed properties). Another 608 properties (25 percent of all properties that entered the program) were still in the pipeline on July 31, 2003. Nearly all active pipeline properties (96 percent) were Fulls. A total of 621 had "Actions Other Than Closing" (AOTC). This includes 297 properties that were placed on the Watch List and 324 that had discontinued the restructuring process without being placed on the Watch List because they were found to be ineligible (192) or for other reasons (132). Like Lites, Watch List properties have their rents reduced to market levels, but do not have their mortgages re-written. However, in contrast to Lites, the PAE believes that these properties may have financial difficulties at these reduced rent levels. Watch List properties may re-enter the restructuring process at a later time, while discontinued properties may not.

Figure 3.3 provides further details on properties that entered the process as Full restructurings. A total of 796 Full restructurings have closed, including 572 with market rents and 224 with exception rents. Another 398 properties that entered the process as Fulls have ended the process with an AOTC. This includes 197 properties that were placed on the Watch List (102 because the owner refused to execute a restructuring commitment that was issued by the PAE, 44 because OMHAR determined that the restructuring plan was not financially feasible, 41 because the owner was not cooperative and no restructuring plan was issued by the PAE, 10 because the owner was barred from restructuring because of financial or managerial improprieties), and 201 properties that were found to be ineligible or otherwise

[2] *Status of HUD-Insured (or Held) Mutlifamily Rental Housing in 1995*, HUD PD&R, May 1999).

were discontinued from the process (79 with rents at or below market, 38 with a conflict between State/local financing documents and the restructuring process, 9 for which the owner prepaid the mortgage, and 75 for other reasons).

Figure 3.4 provides further information on properties that entered the process as Lite restructurings. A total of 391 Lite restructurings have closed, including 188 Tier 1 transactions and 203 Tier 2 transactions.[3] Another 223 properties that entered the process as Lites have ended the process with an action other than closing (AOTC). This includes 100 properties that were placed on the Watch List (because OMHAR or the PAE recommended Full restructuring but the owner refused) and 123 properties that were found to be ineligible or otherwise were discontinued from the process (75 with rents at or below market, 10 for which OMHAR or the PAE decided not to renew the Section 8 contract, and 38 for other reasons).

[3] As described in Chapter 6 OMHAR has established two forms of Lite transactions—the Lite Tier 1 and the Lite Tier 2. If, when using data on current rents and current expenses for the property the DSCR is greater or equal to 1.2 the property can be processed as a Lite Tier 1 transaction which requires less analysis than a Tier 2. If the DSCR is equal to or greater than 1.1 but less than 1.2, the property can be processed as a Tier 2 Lite. If the DSCR is less than 1.1 the property has to be processed as a Full restructuring or not at all.

Figure 3.1

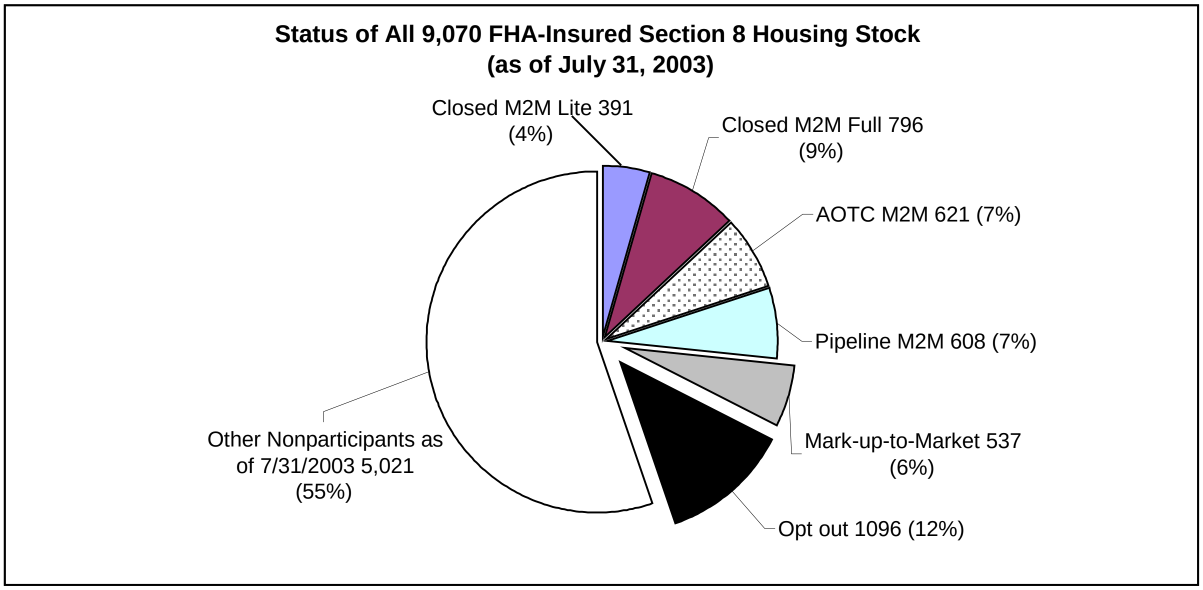


Figure 3.2

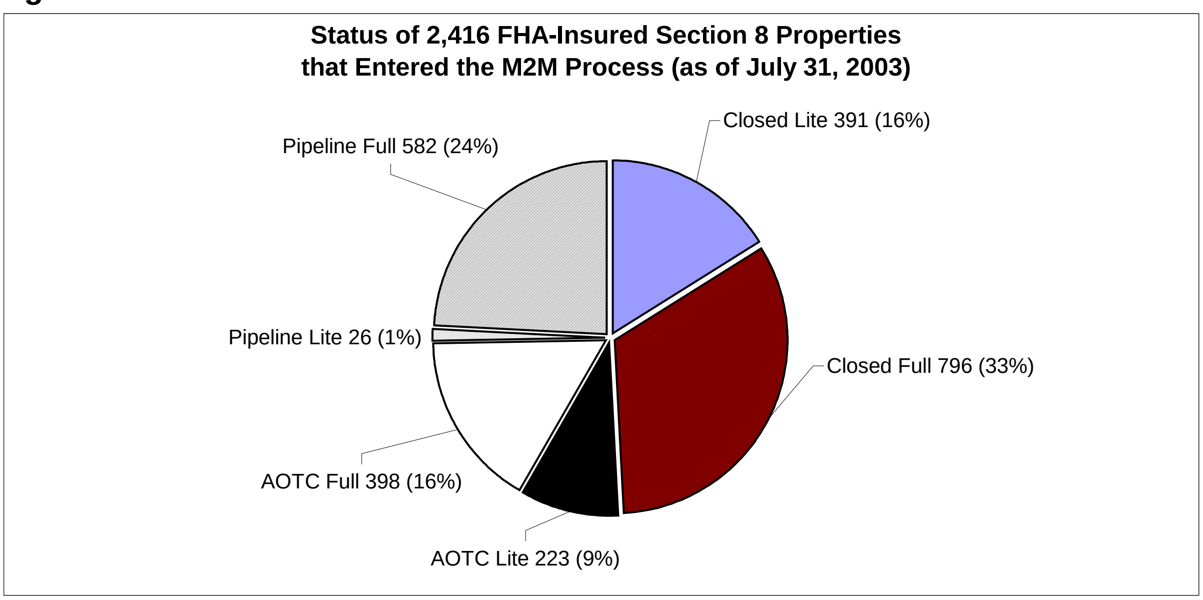


Figure 3.3

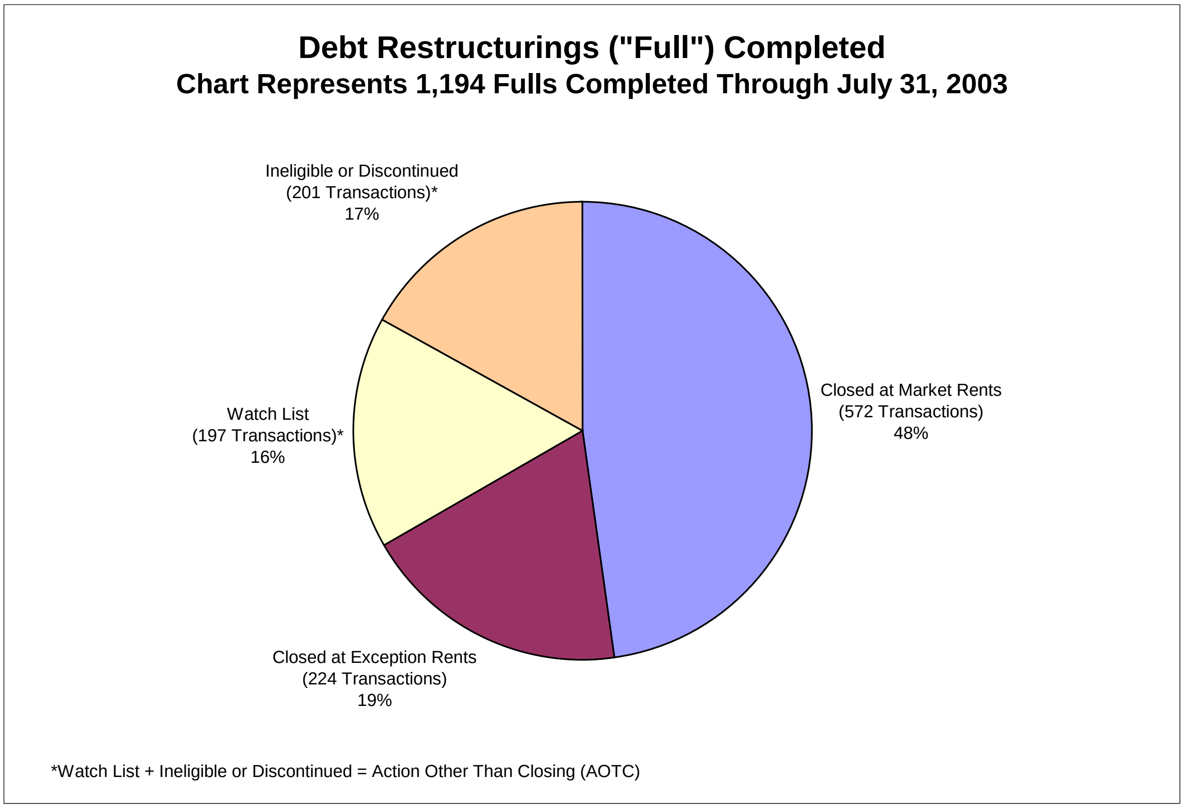
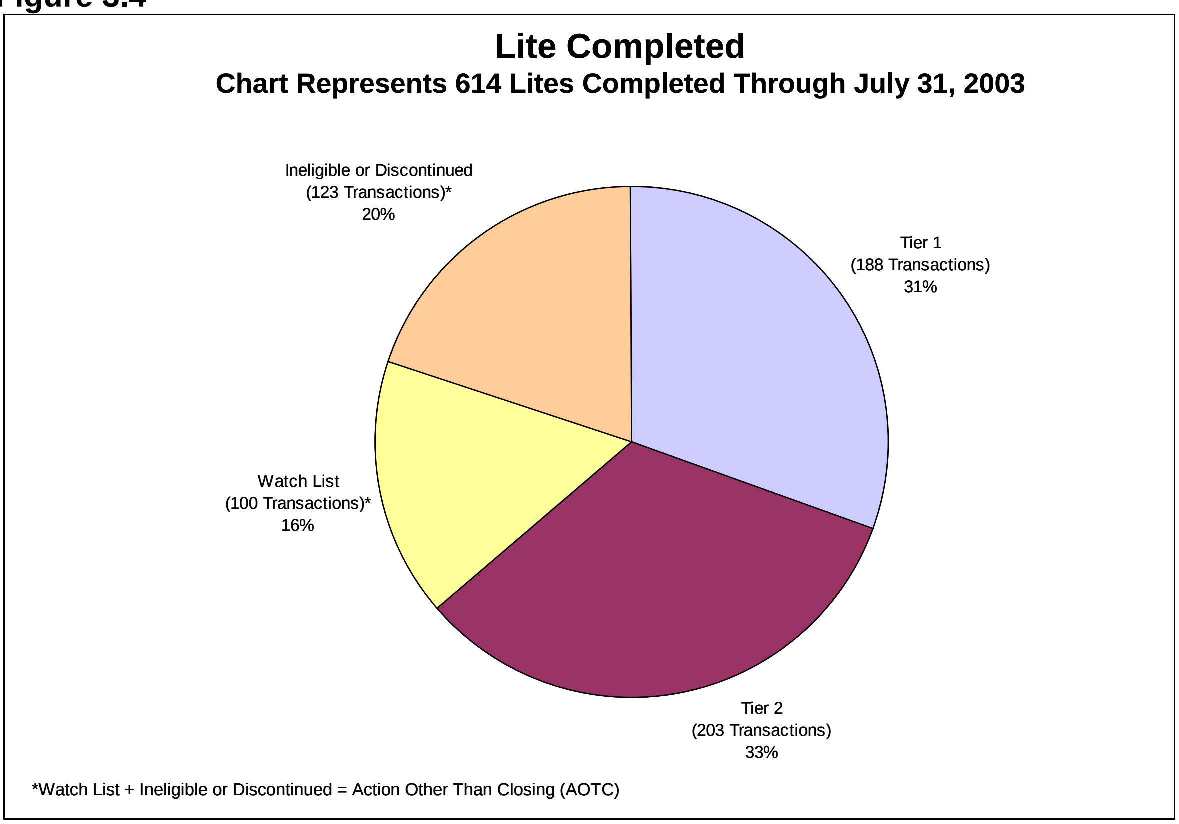


Figure 3.4



Participants in the M2M Program Compared with Non-Participants

This section compares the locations, property characteristics and tenant characteristics for properties that entered the M2M program with those that did not enter the program. A property may not have entered the M2M program for several reasons. The property may not be eligible for M2M because the contract rent is below the market rent. Alternatively, a property with above market rents may not have entered the program because the current Section 8 contract has not yet expired. Finally an owner can decide to Opt Out of the program regardless of contract rent level relative to market. It is not possible to say if the reason for non-participation is 1) because rents are above market levels or 2) whether the contract has not yet expired, because market rents are not available in the HUD data files, and the field for contract expiration only lists the upcoming expiration date (if a contract was recently renewed, only the next expiration date is available). This section therefore compares the characteristics of properties that entered the program (regardless of outcome) with all those that did not enter the program as of July 31, 2003, regardless of the reason, unless we know explicitly that the reason for non-entry is that the owner indicated an intention to Opt Out.

For all of the following analyses we present tables that provide averages for key property characteristics by property type. Additional variables and distributions of the variables are presented in the appendix to this chapter. Table 3.1 provides definitions and data sources for the variables used in the comparisons.

Table 3.1
Variables Used in Analysis

Variable Name	Definition	Variable Source
Region	Includes indicator variables for each of the four Census regions: Northeast, Midwest, West and South. Based on the State in which property is located.	Real Estate Management System (REMS)
Metro location	Includes three possibilities: central city, suburb, and non-metro. Suburb is defined as the non-central city part of a Metropolitan Statistical Area (MSA).	REMS and Census Bureau
Total Units	Continuous variable noting total number of units in the property.	REMS
Percent 3+ BR units	Continuous variable noting percent of units in the property with 3 or more bedrooms (range 0-100)	REMS
Elderly/disabled	Indicator variable for a property that is designated to serve the elderly or disabled.	REMS
High-rise, or mixed building type including high-rise	Indicator variable for projects that include any high-rise buildings.	REMS and Real Estate Assessment Center (REAC)

Table 3.1 *(Continued)*
Variables Used in Analysis

Variable Name	Definition	Variable Source
Property age	Continuous variable based on the first occupancy date of the development	REMS
Owner/developer/mortgage sponsor type	Three ownership types: profit motivated, limited dividend, and non-profit.	REMS and REAC
Tract Vacancy rate	Continuous variable, overall vacancy rate in the property's Census tract (range 0-100).	2000 Census
Tract poverty rate	Continuous variable, poverty rate in the property's Census tract (range 0-100).	2000 Census
Tract Rent-to-income ratio	Continuous variable, median tract rent divided by median tract household income in the property's tract (range 0-100).	Calculated from 2000 Census data
REAC Financial Performance Score	Continuous variable. REAC financial performance score for most recent year available.	REAC
REAC Physical Inspection Score	Continuous variable. REAC overall physical inspection score for most recent year available.	REAC
Percent capital deficiencies	Continuous variable, measures the percent of defect items discovered during the REAC inspection that require large capital outlays (range 0-100).	Special tabulation of the REAC data
Pre-Restructuring Rent-to-FMR Ratio	Continuous variable (range 0-100). Pre-restructuring Section 8 contract rent, divided by the Fair Market Rent (FMR) of the property's location.	REMS
Unpaid principal balance per unit	Continuous variable.	REMS and F-47 (The Multifamily Insurance System (MFIS))

The statute requires that properties with above market rent enter the M2M program. Therefore, we expect a primary difference between program entrants and non-entrants to be having rents above market levels. We expect program entrants to be located in the types of locations where program rents have risen more rapidly than market levels, i.e., where program rents are high relative to the Fair Market Rent (FMR) used to measure market rent levels in the Housing Choice Voucher program. Because rents in properties assisted under the Section 8 New Construction/Substantial Rehabilitation (NC/SR) Programs (termed "Newer Assisted" in the tables) often started out at above market levels in order to encourage housing development in targeted areas, and generally had annual increases in rents through the annual adjustment factor, we would expect more Newer Assisted properties to enter the program.[4] In contrast, rents in the "Older Assisted" properties were often set below market levels and rent increases were granted based on actual budget needs.

Our expectation is that a primary driver for opting out of the Section 8 program is that properties that can be profitable in the unsubsidized market. This would include those properties in better neighborhoods, in better physical and financial condition, and those that have below-market rents at the time of contract expiration. Also there may be an expectation that non-profit owners are more likely to want to preserve the housing as affordable, so we may expect to see more Opt-Outs among profit-motivated properties. Non-profits are also generally precluded from prepaying their "older assisted" mortgages.

As can be seen from Table 3.2,[5] there are differences between properties that entered the M2M program and those that did not enter the program (excluding those with owners who expect to Opt-Out). These differences include the following:

- As expected, program entrants had higher pre-program rents compared with non-entrants, averaging 129 percent of FMR, compared with 101 percent for non-entrants. (As noted above, the data file does not include market rents. As a proxy, we compare pre-program rent to the local FMR.)

- Program participants tend to be assisted under the Section 8 NC/SR Program. These properties often started out with above market rents, which were approved in order to make sure the properties were financially viable. Rents continued to increase through the application of the AAF, which was never less than zero. Some of the other observed differences between entrants and non-entrants result from the differences between newer and older assisted properties, and are not drivers of participation. For example, program participants tend to be newer, to have profit-motivated owners, and to have higher per-unit unpaid balances on their mortgages compared with non-participating properties.

- The remaining differences may be driven by differences in the types of properties for which rents are above market. Properties that enter the M2M program are more likely to be in non-metro areas (30 percent of entrants are in non-metro areas compared with 20 percent of non-participants) and in the South (40 percent of entrants are in the South compared with 32 percent of non-participants). In these areas, market rents may not have been climbing as rapidly as in other areas, thus properties with consistently rising rents based on AAF adjustments will have higher rents relative to FMR.

- Entrants tend to be in Census tracts with slightly higher indicators of distress. They have slightly higher Census tract vacancy rates (average 10 percent versus 8 percent), slightly higher poverty rates (average 26 percent versus 22 percent), and slightly higher concentrations of minority households (average 41 percent versus 38 percent). On the other hand, the homeownership rate is slightly higher in entrant tracts (average

[4] The annual adjustment factor (AAF) could not be less than zero, thus rents could remain unchanged in a particular year if the AAF was set to zero that year.
[5] Tables with additional details on the characteristics of properties by type are presented in the appendix to this chapter.

49 percent versus 46 percent). Overall, these are likely to be locations where market rents may not have been climbing as rapidly.

- M2M properties tend to be smaller on average (85 units versus 108), perhaps linked to their non-metro and southern locations or to the fact that the Section 8 NC/SR properties are smaller on average than the older assisted properties.

- Program REAC scores are similar between entrants and non-participants, indicating similar physical and financial condition.

- Program entrants have lower average percentages of elderly households (average 27 percent versus 36 percent), and higher percentages of households headed by female single parents compared with non-participants (28 percent versus 24 percent).[6]

[6] Because tenant characteristics are missing for some cases and because tenant characteristics are correlated with property characteristics they were excluded from the regressions.

Table 3.2
Characteristics of Program Participants and Non-Participants

	Opt-Out		Entered Program		Non-Participants Except Opt Out	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	**1,096**		**2,416**		**5,558**	
Number of Units	**122,837**		**205,993**		**601,145**	
Location						
Census region						
Northeast	125	11%	515	21%	1,089	20%
Midwest	302	28%	583	24%	1,634	29%
South	337	31%	971	40%	1,772	32%
West	332	30%	347	14%	1,063	19%
Metro Location						
Central City	559	51%	1157	48%	2,903	52%
Balance of Metro (Suburb)	401	37%	528	22%	1,551	28%
Non-metro	136	12%	732	30%	1,104	20%
Tract Characteristics						
Proportion of Vacant Hsg Units Average		8%		10%		8%
Homeownership Rate Average		47%		49%		46%
Poverty Rate Average		18%		26%		22%
Rent-to-Income Ratio Average		21%		22%		22%
Percent Minority Average		32%		41%		38%
Property Characteristics						
Development Size						
Average Number of Units	112		85		108	
Unit Size						
Average number of bedrooms per unit	1.82		1.77		1.70	
Density						
Proportion of 3+bedroom units		19%		20%		19%
Occupancy Type						
Family	956	87%	1646	68%	3,867	70%
Elderly/disabled	140	13%	770	32%	1,691	30%
Building Type						
High-rise/elevator	138	13%	622	26%	1,486	27%
Other	958	87%	1794	74%	4,072	73%
Age Average	26		23		26	
HUD Program Type						
Older Assisted	767	70%	702	29%	3,249	58%
Newer Assisted	329	30%	1714	71%	2,309	42%
Mortgage Sponsor Type						
Profit Motivated	518	47%	1314	54%	1,996	36%
Limited Dividend	446	41%	876	36%	2,125	38%
Non-Profit	72	7%	217	9%	1,299	23%
Other	61	6%	9	0%	138	2%
Mortgage Financed Type						
State HFA Bond Financed	17	2%	199	8%	487	9%
FHA-Insured Only	1079	98%	2217	92%	5,071	91%

Table 3.2 *(Continued)*
Characteristics of Program Participants and Non-Participants

	Opt-Out		Entered Program		Non-Participants Except Opt Out	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	**1,096**		**2,416**		**5,558**	
Number of Units	**122,837**		**205,993**		**601,145**	
REAC Financial Performance Score Average	63		66		68	
REAC Physical Inspection Score Average	78		80		81	
Per Unit Unpaid Principal Balance (UPB) Average	$15,954		$23,054		$18,687	
Change in REAC Capital Deficiency Score						
Decrease or No Change	694	63%	1578	65%	3,624	65%
Increase	402	37%	838	35%	1,934	35%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio Average		89%		129%		101%
Tenant Characteristics						
Number of Properties	N.A.	N.A.	**2,118**		**5,355**	
Number of Units	N.A.	N.A.	**178,635**		**575,545**	
Length of Residence (years) Average	N.A.	N.A.	4.76		5.22	
Household Size Average	N.A.	N.A.	2.03		1.94	
Percent Elderly Household Average	N.A.	N.A.		27%		36%
Percent Disabled Household Average	N.A.	N.A.		15%		13%
Percent Female-headed Single Parent Household with Children Average	N.A.	N.A.		28%		24%
Percent Racial/ethnic Minority-headed Household Average	N.A.	N.A.		55%		52%

Note: Tenant data were only available for a portion of the stock. Tenant data were not available for opt out properties

As Table 3.2 shows, there are even more pronounced differences when participating properties are compared with properties that have owners who expect to leave the program through opting out. These differences include the following:

- Consistent with the expectation that Opt-Outs will be in neighborhoods where they can be profitable at market rents, they are more common in suburban areas and not very common in non-metro areas. Thirty-seven percent of Opt-Out properties were in suburbs compared with 22 percent for program entrants and 28 percent for non-participants. Only 12 percent were in non-metro areas, compared to 30 percent for participants.

- Similarly, Opt-Outs tend to be in tracts with lower poverty rates and lower concentrations of minority-headed households. (An average of 18 percent poverty and 32 percent minority compared with 26 and 41 percent, respectively, for participants).

- Opt-Outs are more likely to occur in the West where average market rents are high in many areas. It appears that program rent adjustments did not keep pace with the rapid increases in market rents in this region.

- Opt-Out properties are larger on average (112 units) and are more likely to be designated as family occupancy (87 percent). Consistent with the prevalence of family designation, Opt Outs had larger units—on average 1.82 bedrooms, compared with 1.7 for non-participants and 1.77 for entrants.

- Opt-Out properties tend to be older and to have been assisted under the Section 8 LMSA program. These properties consistently had budget-based rent increases that did not keep up with market rents in hot markets.

- As expected, very few of the Opt-Outs have non-profit owners (only 7 percent, compared with 23 percent of other non-participating properties). Entrants also have few, but that is because they tend to be “newer assisted” properties.

- They are less likely to be financed through State HFA-financed bonds.

- Although we may have expected the condition of Opt-Out properties to be better than others, we find that REAC scores are similar between entrants, non-participants and Opt-Out properties.

- Opt-Out properties have lower outstanding mortgage balances.

- Rents relative to FMR are much lower in Opt-Out properties (average 89 percent), further increasing the motivation to Opt Out.

- Tenant data are not available for properties that Opt-Out of the program. Data are thus missing for a large share of this group of properties and are not presented.

In summary, the table shows that, as expected, properties that enter the M2M program are properties with high rents relative to FMR. They tend to be in the South and in non-metro areas and in slightly more distressed neighborhoods. Program participants tend to have higher concentrations of families compared with non-participants. Their financial and physical conditions are similar to those of non-participants.

Properties that decide to Opt Out of the Section 8 program tend to be in better neighborhoods than either participants or non-participants. They are more likely to be in the West and in suburban areas. Their rents tend to be below market levels. We do not have information on tenant characteristics, but property characteristics indicate that the types of properties that Opt Out have larger units than other properties and are very likely to be family properties.

Closed Fulls Versus Closed Lites

This section compares the locations, property characteristics and tenant characteristics of properties that closed as Lites rather than Fulls. An owner might prefer to go through a Lite rather than a Full restructuring process if he or she believes that the property can remain viable at market rents even without any reduction in monthly mortgage payments. The advantages to the owner in closing as Lite are that the process is simpler and therefore quicker and that the use agreement covers a much shorter period (Table 3.3).

Table 3.3
Characteristics of Closed Properties – Closed Lites and Fulls

	All Closed		Closed Lite		Closed Full	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	**1187**		**391**		**796**	
Number of Units	**104,852**		**37,256**		**67,596**	
Location						
Census region						
Northeast	239	20%	71	18%	168	21%
Midwest	252	21%	78	20%	174	22%
South	540	45%	146	37%	393	49%
West	155	13%	95	24%	60	8%
Metro Location						
Central City	486	41%	197	50%	289	36%
Balance of Metro (Suburb)	280	24%	108	28%	172	22%
Non-metro	421	35%	86	22%	335	42%
Neighborhood (Census Tract) Characteristics						
Proportion of Vacant Hsg Units Average		10%		9%		10%
Homeownership Rate Average		52%		48%		54%
Poverty Rate Average		26%		24%		28%
Rent-to-Income Ratio Average		21%		22%		21%
Proportion of Racial/Ethnic Minorities Average		38%		40%		37%
Property Characteristics of Closed Properties						
Development Size						
Average Number of Units	88		96		85	
Unit Size						
Average number of bedrooms per unit	1.78		1.68		1.84	
Density						
Proportion of 3+bedroom units	250	21%	71	18%	178	22%
Occupancy Type						
Family	788	66%	254	65%	535	67%
Elderly/disabled	399	34%	137	35%	261	33%
Building Type						
High-rise/elevator	301	25%	116	30%	185	23%
Other	886	75%	275	70%	611	77%
Age Average	24		26		23	
HUD Program Type						
Older Assisted	389	33%	197	50%	192	24%
Newer Assisted	798	67%	194	50%	604	76%

Table 3.3 ***(Continued)***
Characteristics of Closed Properties – Closed Lites and Fulls

	All Closed		Closed Lite		Closed Full	
	Number	**Percent**	**Number**	**Percent**	**Number**	**Percent**
Number of Properties	**1187**		**391**		**796**	
Number of Units	**104,852**		**37,256**		**67,596**	
Mortgage Sponsor Type						
Profit Motivated	659	56%	178	46%	481	60%
Limited Dividend	394	33%	160	41%	234	29%
Non-Profit	127	11%	53	14%	74	9%
Other	6	1%	0	0%	6	1%
Mortgage Financed Type						
State HFA Bond Financed	80	7%	10	3%	70	9%
Other	1107	93%	381	97%	726	91%
Most Recent REAC Financial Performance Score Average	68		74		65	
Most Recent REAC Physical Inspection Score Average	81		84		80	
Per Unit Unpaid Principal Balance (UPB) Average	$20,244		$15,515		$22,567	
Change in REAC Capital Deficiency Score						
Decrease or No Change	768	65%	242	62%	526	66%
Increase	419	35%	149	38%	270	34%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio Average		128%		119%		133%
Tenant Characteristics						
Properties	**1135**		**384**	**34%**	**751**	**66%**
Units	**99,597**		**36,691**		**62,906**	
Length of Residence (years) Average	4.52		4.70		4.43	
Household Size Average	2.01		1.90		2.07	
Percent Elderly Household Average		29%		36%		25%
Percent Disabled Household Average		15%		14%		16%
Percent Female-headed Single Parent Household with Children Average		28%		25%		29%
Percent Racial/ethnic Minority-headed Household Average		51%		54%		50%

Note: Tenant data were only available for a portion of the stock.

Our main hypothesis is that properties that are in better financial and physical condition will be able to close as Lites and will not need the additional supports provided by the mortgage restructuring, including the ability to finance additional repairs. Other differences between the two groups will be driven by the types of properties that are likely to be in better condition (e.g. newer properties).

Another hypothesis is that properties with higher pre-program rents relative to market would have a harder time just reducing rents without reducing mortgage costs because the percentage reduction in revenues would be higher. Thus, we might expect properties with higher pre-restructure rent-to-FMR ratios to be more likely to undergo Full restructurings and, therefore, for properties assisted under the Section 8 NC/SR Program (which have higher rents) to be more likely to undergo Full restructuring.

As can be seen from Table 3.3 above, there are some differences between properties that closed as Fulls compared with Lites. These include the following:

- The data support the hypothesis that properties in better financial and physical condition are more likely to close as Lites. Average physical and financial REAC scores are higher for Lites than for Fulls. The average physical score for Lites was 84 compared with 80 for Fulls, and the average financial score was 74 for Lites and 65 for Fulls.

- Fulls have higher pre-restructuring rents relative to FMR. The average rent to FMR for Fulls was 133 percent, compared with 119 percent for Lites.

- Consistent with this, Fulls are more likely to be Newer Assisted properties. More than three quarters of all Fulls (76 percent) were Newer Assisted. Lites were evenly distributed by assistance type.

- Consistent with a higher concentration of Newer Assisted properties, Fulls have higher per-unit unpaid principal balances on their mortgages.

- Fulls tend to be in the South and in non-metro areas. Lites tend to be in the West, and they tend to be under-represented in non-metro areas.

- Fulls tend to be in Census tracts with higher vacancy rates, higher poverty rates, and higher rent-to-income ratios compared with Lites. The racial distributions are similar in areas with Fulls and Lites.

- Consistent with being in the South and in non-metro areas, Fulls on average are smaller properties, with larger concentrations of large units, though the occupancy types were similar.

- In general, tenant characteristics were similar in properties that closed as Fulls and Lites. Some minor differences include: a slightly larger average household size and a slightly higher percentage of single female-headed families with children for Fulls. Lites had a higher percentage of elderly households and had slightly higher percentages of minority heads of household.

Closed Fulls – Market Rent and Exception Rent Properties

Properties that undergo a Full restructuring generally close at market rents. However, exception rents can be requested if the PAE determines that the loss of the project would adversely impact the tenants and the community (for example, by displacing tenants who would have serious difficulty finding comparable housing), and if the project's rents are insufficient to support operating expenses and capital needs. If the exception rent is above 120 percent of FMR, the transaction must be approved by OMHAR.

As of July 31, 2003, 796 properties closed as Full restructurings, including 572 at market rent and 224 with exception rents. On average, the post-restructure rent is about 19 percent above market rent for the exception rent deals. Twenty-seven percent had rents between market and 110 percent of market, 37 percent had rents between 110 and 120 percent of market, 31 percent had rents between 120 and 150 percent of market, and 4 percent of exception rent deals had rents greater than 150 percent of market.

In Table 3.4 below we describe the characteristics of properties that have closed at market rent or at exception rents. We would expect exception rents to be required in properties that need substantial repairs, especially in neighborhoods with low relative rents, where market rents do not support the costs.

As can be seen in the table, there are only a few factors that differ between exception-rent and market-rent transactions. Some differences between market-rent and exception-rent properties include:

- As expected, market rent properties were generally in better condition prior to entering the program, as evidenced by higher REAC financial and physical scores. (The average physical score for market rent properties was 81 compared with 77 for exception-rent properties, and the average financial score was 66 for market-rent properties compared with 61 for exception rent properties).

- Exception-rent properties were in slightly worse neighborhoods, as illustrated by the slightly higher vacancy and poverty rates.

- Market rent properties are more common in the South.

- Exception rents are more common in non-metro areas and less common in suburban areas.

- Exception rent properties tend to be smaller than those that close at market rents. They are also more likely to have family occupancy.

- Exception rent properties were more likely to be assisted through the older assistance programs, while market-rent properties were more likely to be assisted through the Section 8 NC/SR Program.

- Tenant characteristics were similar across the two types of properties. The only differences are that market rent properties have higher concentrations of elderly households, but lower concentrations of households with disabled members.

Table 3.4
Characteristics of Closed Fulls – Market Rent versus Exception Rent

	All Fulls		Full at Market		Fulls at Exception Rent	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	796		572		224	
Number of Units	67596		50311		17285	
Location						
Census region						
Northeast	168	21%	116	20%	52	23%
Midwest	174	22%	120	21%	54	24%
South	393	49%	294	51%	99	44%
West	60	8%	42	7%	18	8%
Metro Location						
Central City	289	36%	206	36%	83	37%
Balance of Metro (Suburb)	172	22%	134	23%	38	17%
Non-metro	335	42%	232	41%	103	46%
Neighborhood (Census Tract) Characteristics						
Proportion of Vacant Hsg Units Average		10%		9%		12%
Homeownership Rate Average		54%		54%		54%
Poverty Rate Average		27%		26%		31%
Rent-to-Income Ratio Average		21%		21%		21%
Proportion of Racial/Ethnic Minorities Average		37%		37%		38%
Property Characteristics of Closed Fills						
Development Size						
Average Number of Units	85		88		78	
Unit Size						
Average number of bedrooms per unit	1.8		1.8		1.8	
Density						
Proportion of 3+bedroom units	178	22%	128	22%	50	22%
Occupancy Type						
Family	535	67%	373	65%	162	72%
Elderly/disabled	261	33%	199	35%	62	28%
Building Type						
High-rise/elevator	185	23%	144	25%	40	18%
Other	611	77%	428	75%	184	82%
Age Average	23		23		24	
HUD Program Type						
Older Assisted	192	24%	107	19%	86	38%
Newer Assisted	604	76%	465	81%	138	62%
Mortgage Sponsor Type						
Profit Motivated	481	60%	367	64%	115	51%
Limited Dividend	234	29%	156	27%	78	35%
Non-Profit	74	9%	44	8%	30	13%
Other	6	1%	5	1%	1	0%
Mortgage Financed Type						
State HFA Bond Financed	70	9%	51	9%	19	8%
Other	726	91%	521	91%	205	92%
Most Recent REAC Financial Performance Score Average	65		66		61	

Table 3.4 *(Continued)*
Characteristics of Closed Fulls – Market Rent versus Exception Rent

	All Fulls		Full at Market		Fulls at Exception Rent	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	796		572		224	
Number of Units	67596		50311		17285	
Most Recent REAC Physical Inspection Score Average	80		81		77	
Per Unit Unpaid Principal Balance (UPB) Average	$22,567		$23,596		$19,938	
Change in REAC Capital Deficiency Score						
Decrease or No Change	526	66%	379	66%	147	66%
Increase	270	34%	193	34%	77	34%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio Average		133%		132%		136%
Tenant Characteristics						
Properties	**751**		**538**	**72%**	**213**	**28%**
Units	**62,906**		**46,399**	**74%**	**16,507**	**26%**
Length of Residence (years) Average	4.43		4.6		4.0	
Household Size Average	2.07		2.1		2.1	
Percent Elderly Household Average		25%		27%		20%
Percent Disabled Household Average		16%		15%		18%
Percent Female-headed Single Parent Household with Children Average		29%		29%		29%
Percent Racial/ethnic Minority-headed Household Average		50%		50%		51%

Note: Tenant data were only available for a portion of the stock.

Closed Versus Watch List Properties

As noted above, not all properties that enter the M2M program complete the program by closing with either a Lite or a Full restructuring. Among the 2,416 properties that entered the program through the end of July 2003, 621 had “Actions Other Than Closing” (AOTC). There are two groups of properties that are categorized as AOTC. The first includes 324 properties that discontinued the restructuring process, either because they were found to be ineligible (192) or for other reasons (132). The second group includes the 297 properties that were placed on the Watch List. Properties were placed on the Watch List because the owner refused to execute a restructuring commitment that was issued by the PAE (102) or because the owner was not cooperative and no restructuring plan was issued by the PAE (141). In 100 of these latter cases the PAE felt that a Full restructuring was required, but the owner refused. Thus, the PAE’s analysis indicated that these properties do not have sufficient resources to cover costs without a restructuring, but the owner was only willing to accept a Lite restructuring. In some cases OMHAR determined that no restructuring plan was financially feasible (44), and in other cases (10) no plan was offered because the owner was barred from the process due to financial or managerial problems. We can expect that at least a portion of the Watch List properties are at risk of future default unless they choose to enter the program at a later time. In order to provide information on the types of properties that are at risk, this section compares closed properties with those on the Watch List.

Table 3.5 shows some differences between closed and Watch List properties. These include the following:

- Watch list properties are more likely to be in the Midwest, while closed properties are more concentrated in the South.

- Watch list properties are more concentrated in central cities, while closed properties are more likely to be in suburbs and non-metro areas.

- Watch list properties are smaller than closed properties.

- Watch list properties tend to have larger units. They also are more likely to be designated for family occupancy.

- Relatively few Watch List properties have non-profit owners.

- Watch list properties are more likely to be Older Assisted compared with closed properties.

- A key difference between closed and Watch List properties is that Watch List properties are in worse financial and physical condition than closed properties, as is indicated by lower REAC scores. This suggests that at least a portion of these properties will have financial or physical troubles in the years to come. (The average financial score for Watch List properties was 63, and the average physical score was 76. In contrast, the average financial score was 86, and the average physical score was 81 for closed properties).

- Watch List properties have lower concentrations of elderly-headed households and higher concentrations of female-headed single-parent households with children. Watch list properties also have higher concentrations of minority-headed households.

In summary, the group of properties that remains at risk following the M2M program includes many properties in central cities, serving family households. These properties are in worse condition compared with closed properties, further underscoring their risky status.

Table 3.5
Characteristics of Watch List Versus Other Closed (Fulls and Lites) Properties

	Watch List		All Other Closed	
	Number	Percent	Number	Percent
Number of Properties	**297**		**1187**	
Number of Units	**23234**		**104852**	
Location				
Census region				
Northeast	60	20%	239	20%
Midwest	105	35%	252	21%
South	90	30%	540	45%
West	42	14%	155	13%
Metro Location				
Central City	160	54%	486	41%
Balance of Metro (Suburb)	51	17%	280	24%
Non-metro	87	29%	421	35%
Tract Characteristics				
Proportion of Vacant Hsg Units Average		11%		10%
Homeownership Rate Average		48%		52%
Poverty Rate Average		26%		26%
Rent-to-Income Ratio Average		22%		21%
Percent Minority Average		41%		38%
Property Characteristics				
Development Size				
Average Number of Units	78		88	
Unit Size				
Average number of bedrooms per unit	1.85		1.78	
Density				
Proportion of 3+bedroom units		22%		21%
Occupancy Type				
Family	229	77%	788	66%
Elderly/disabled	68	23%	399	34%
Building Type				
High-rise/elevator	66	22%	301	25%
Other	231	78%	886	75%
Age Average	25		24	
HUD Program Type				
Older Assisted	129	43%	389	33%
Newer Assisted	168	57%	798	67%
Mortgage Sponsor Type				
Profit Motivated	150	50%	659	56%
Limited Dividend	127	43%	394	33%
Non-Profit	19	6%	127	11%
Other	1	0%	6	1%
Mortgage Financed Type				
State HFA Bond Financed	18	6%	80	7%
Other	279	94%	1107	93%
REAC Financial Performance Score Average	63		68	
REAC Physical Inspection Score Average	76		81	
Per Unit Unpaid Principal Balance (UPB) Average	$19,341		$20,244	

Table 3.5 *(Continued)*
Characteristics of Watch List Versus Other Closed (Fulls and Lites) Properties

	Watch List		All Other Closed	
	Number	Percent	Number	Percent
Number of Properties	**297**		**1187**	
Number of Units	**23234**		**104852**	
Change in REAC Capital Deficiency Score				
Decrease or No Change	196	66%	768	65%
Increase	101	34%	419	35%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio Average		122%		128%
Tenant Characteristics				
Number of Properties	**281**		**1135**	
Number of Units	**21,541**		**99,597**	
Tenant Data				
Length of Residence (years) Average	4.38		4.5	
Household Size Average	2.15		2.0	
Percent Elderly Household Average		21%		29%
Percent Disabled Household Average		14%		15%
Percent Female-headed Single Parent Household with Children Average		32%		28%
Percent Racial/ethnic Minority-headed Household Average		59%		51%

Note: Tenant data were only available for a portion of the stock.

Fulls Versus All Other Properties

A key goal of the M2M program is preserving affordable rental housing. The main group of properties that is being preserved as a result of the program is the group that closed as Fulls. Properties that closed as Lites could have survived at market rents without the M2M program. Properties that are on the Watch List may not be preserved as affordable housing, because a portion of these properties may default. Thus, this section compares properties that closed as Fulls with the remaining properties (excluding Opt-Outs, which left the assisted stock).

Table 3.6 shows that the types of properties being preserved through the program have the following characteristics:

- Virtually half (49 percent) of all Fulls are in the South and only 8 percent are in the West. In contrast, among the other properties only a third (32 percent) are in the South and 19 percent are in the West.

- Fulls are more likely than other properties to be in non-metro areas and less likely to be in central cities.

- The only Census tract characteristics that vary between Fulls and other properties are homeownership rates and poverty rates. Fulls are in tracts with higher homeownership rates and higher poverty rates, perhaps reflecting that they are more likely to be in non-metro areas.

- Consistent with their non-metro and southern locations, Fulls are considerably smaller than other properties, averaging 85 units (compared with 105 units on average for other properties).

- Fulls are much more likely to be Newer Assisted (78 percent, compared with 44 percent for other properties) and are much more likely to have profit-motivated owners (60 percent compared with 38 percent for other properties). They are much less likely to have non-profit owners (9 percent compared with 21 percent for other properties).

- Physical and financial conditions were similar across the groups of properties, as indicated by similar REAC scores.

- Fulls have lower concentrations of households headed by elderly members and higher concentrations of female-headed single-parent households.

In general terms, the group of properties that is being preserved as a result of the M2M program are more likely to be in non-metro areas, mainly in the South, and to be serving family households.

Table 3.6
Property Characteristics – Fulls Versus All Others

	Fulls		All Others Except Opt Out and Pipe Line	
	Number	Percent	Number	Percent
Number of Properties	**796**		**6,570**	
Number of Units	**67,596**		**690,469**	
Location				
Census region				
Northeast	168	21%	1,278	19%
Midwest	174	22%	1,911	29%
South	393	49%	2,122	32%
West	60	8%	1,259	19%
Metro Location				
Central City	289	36%	3,439	52%
Balance of Metro (Suburb)	172	22%	1,796	27%
Non-metro	335	42%	1,335	20%
Tract Characteristics				
Proportion of Vacant Hsg Units Average		10%		9%
Homeownership Rate Average		54%		47%
Poverty Rate Average		28%		22%
Rent-to-Income Ratio Average		21%		22%
Percent Minority Average		37%		39%
Property Characteristics				
Development Size				
Average Number of Units	85		105	
Unit Size				
Average number of bedrooms per unit	1.84		1.71	
Density				
Proportion of 3+bedroom units		22%		19%
Occupancy Type				
Family	535	67%	4,554	69%
Elderly/disabled	261	33%	2,016	31%
Building Type				
High-rise/elevator	185	23%	1,757	27%
Other	611	77%	4,813	73%
Age Average	23		26	
HUD Program Type				
Older Assisted	192	24%	3,683	56%
Newer Assisted	604	76%	2,887	44%
Mortgage Sponsor Type				
Profit Motivated	481	60%	2,510	38%
Limited Dividend	234	29%	2,519	38%
Non-Profit	74	9%	1,403	21%
Other	6	1%	139	2%
Mortgage Financed Type				
State HFA Bond Financed	70	9%	536	8%
Other	726	91%	6,034	92%
REAC Financial Performance Score Average	65		68	

Table 3.6 *(Continued)*
Property Characteristics – Fulls Versus All Others

	Fulls		All Others Except Opt Out and Pipe Line	
	Number	Percent	Number	Percent
Number of Properties	**796**		**6,570**	
Number of Units	**67,596**		**690,469**	
REAC Physical Inspection Score Average	80		81	
Per Unit Unpaid Principal Balance (UPB) Average	$22,567		$18,695	
Change in REAC Capital Deficiency Score				
Decrease or No Change	526	66%	4,269	65%
Increase	270	34%	2,302	35%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio Average		133%		104%
Tenant Characteristics				
Number of Properties	**751**		**6,315**	
Number of Units	**62,906**		**660,037**	
Length of Residence (years) Average	4.43		5.14	
Household Size Average	2.07		1.95	
Percent Elderly Household Average		25%		35%
Percent Disabled Household Average		16%		13%
Percent Female-headed Single Parent Household with Children Average		29%		24%
Percent Racial/ethnic Minority-headed Household Average		50%		53%

Note: Tenant data were only available for a portion of the stock.

4. Program Savings

Introduction

This chapter estimates potential future savings to the Federal Government derived from all completed Mark-to-Market (M2M) transactions as of July 31, 2003. Our estimates are based on comparisons of costs associated with M2M restructurings (e.g., FHA claims and administrative costs) with potential savings. The savings estimates include Section 8 and any repayments to second and third mortgages that may offset claims costs to the FHA fund.

Our analysis has the following three distinct components:

- The first component provides estimates of savings to be derived from M2M restructurings compared to the costs of program implementation. This comparison results in three estimates of total savings. The first is an upper limit that assumes the most optimistic outcomes for the financial performance of the M2M properties. The second is a lower limit that assumes the most pessimistic outcomes for the financial performance of the same properties. The third estimate, corresponding to estimates reported by OMHAR is in between the two extremes and presents a more realistic estimate of the financial performance of the properties.

- The second component of the analysis identifies property characteristics that are associated with savings in Lite restructurings.

- The third component examines property characteristics that are associated with savings in Full restructurings.

The first component of the analysis presents details on the total estimates of costs and savings across property types and presents details on the components of costs and savings. The second and third components provide cross tabulations that identify characteristics associated with savings separately for Lite and Full restructurings. Results of multivariate regressions that disaggregate a set of possible cost determinants, such as type of owner or size of the property, are presented in the appendix to this chapter.

The remainder of this chapter is organized as follows:

- Total savings and costs resulting from the M2M program.

- Factors affecting savings for Lites.

- Factors affecting savings for Fulls.

Total Savings and Costs Resulting From the Mark-to-Market Program

The following are components of costs and savings that affect the M2M total results:

- Savings associated with reduced Section 8 rents. For Lites, the only program impact is the reduced Section 8 rents.

- Partial payment of claim and expectations regarding repayments of second and third mortgages. For Fulls there are savings associated with reduced Section 8 rents and also costs associated with FHA claims. In order to ensure that the post-restructuring mortgage is supportable with reduced rents, as part of a Full restructuring, a portion of the FHA mortgage is placed in a subordinate position, generally a second or third mortgage,[7] resulting in a partial payment of claim. The portion that is written off is then converted to a second (and sometimes a third) mortgage. The second and third mortgages may be repaid over time if the property generates sufficient revenue. In calculating the costs associated with a Full restructuring, we make various assumptions about the proportion of the partial payment of claim that is offset by repayments to the second and third mortgages.

- For Watch List properties there are savings associated with reduced Section 8 rents. Because rents are reduced without associated reductions in mortgage payments, there are no immediate costs due to FHA claims, but possible costs associated with future mortgage defaults of these properties.

- Administrative costs and PAE costs are not presented for specific properties, but are added to the overall estimate of program costs.

Section 8 Savings

The key component of savings to the Federal Government resulting from the M2M program is reductions in the Section 8 rents. Table 4.1 shows the distribution of rent reductions per unit across the types of transactions. The data on Section 8 savings for each project were provided by OMHAR, based on the pre-restructuring and post-restructuring rents and the number of Section 8 units. The annual savings are assumed to start in the year following closing and are expected to continue for 20 years.

The estimate of savings is dependent on the baseline case used for comparison. Under the scenario presented here, the baseline case for comparison assumes that the Section 8 program subsidies would continue at their pre-restructuring level for the next 20 years (without any annual adjustment). If we assumed in contrast, that without M2M, rents would have been set

[7] For certain non-profit owners the portion of the mortgage that is not supportable by the new mortgage is written off.

to pre-restructuring prevailing market levels upon current contract expiration, then estimated savings resulting from rent reductions would be virtually erased. On the other hand, if we assumed that Section 8 rents would increase based on historic trends, the estimate provided would be an underestimate of total savings.

As shown in the table, the average per-unit-month reduction in rent for Lite restructurings was $73, with a median of $56. This represents an average 11-percent decrease in rents. Rent reductions were higher for Full restructurings and for Watch List properties. Across all Full restructurings, the average rent reduction was $98 (15 percent) and the median was $80 (also 15 percent). Rent reductions in properties that closed at market rents averaged $106 per unit month (17 percent), with a median of $87 (16 percent). Despite their above-market rents after closing, Fulls that closed with exception rents nonetheless had reduced rents on average. The mean and median savings were $79 and $68, respectively (11 percent and 13 percent). Rent reductions were also high for Watch List properties—the average was $92 per unit month (14 percent), with a median of $69 (12 percent). Rent reductions are presented graphically for both dollars of rent reduction (in Figure 4.1) and as a percent of pre-restructure rent (in Figure 4.2).

Table 4.1
Savings and Cost Components of Completed Lite Restructurings and Full Restructurings

	Lite Restructuring	Full Restructuring			Watch List
		Closed At Mkt Rent	Exception Rent	All	
Rent Reduction (Per-Unit Month)					
Average	$73	$106	$79	$98	$92
Median	$56	$87	$68	$80	$69
Min	$1	$1	-$113	-$113	$1
Max	$364	$610	$594	$610	$395
Rent Reduction as % of Pre-restructuring Rent					
Average	11%	17%	11%	15%	14%
Median	10%	16%	13%	15%	12%
Min	0%	1%	-23%	-23%	1%
Max	38%	49%	41%	49%	53%
Partial Payment of Claims (Per-Unit)					
Average	N.A.	$17,099	$18,384	$17,437	N.A.
Median	N.A.	$16,200	$19,408	$16,556	N.A.
Min	N.A.	$885	$2,555	$885	N.A.
Max	N.A.	$74,564	$42,051	$74,564	N.A.
Partial Payment of Claims as a Percentage of Unpaid Principal Balance (Per-Unit)					
Average	N.A.	74%	95%	80%	N.A.
Median	N.A.	78%	99%	86%	N.A.
Min	N.A.	1%	52%	1%	N.A.
Max	N.A.	120%	108%	120%[a]	N.A.
Present Value of Expected Recoveries					
Average	N.A.	$7,339	$6,710	$7,162	N.A.
Median	N.A.	$6,815	$6,307	$6,714	N.A.
Min	N.A.	$0	$0	$0	N.A.
Max	N.A.	$28,669	$19,193	$28,669	N.A.
Present Value of Expected Recoveries of 2nd and 3rd Mortgages as % of Partial Payment of Claims (PPC)					
Average	N.A.	48%	42%	46%	N.A.
Median	N.A.	46%	40%	44%	N.A.
Min	N.A.	0%	0%	0%	N.A.
Max	N.A.	100%	100%	100%	N.A.

[a] In some cases partial payment of claim figures include repair escrows. Thus, in rare cases the estimate of PPC can be larger than the outstanding mortgage balance.

Figure 4.1

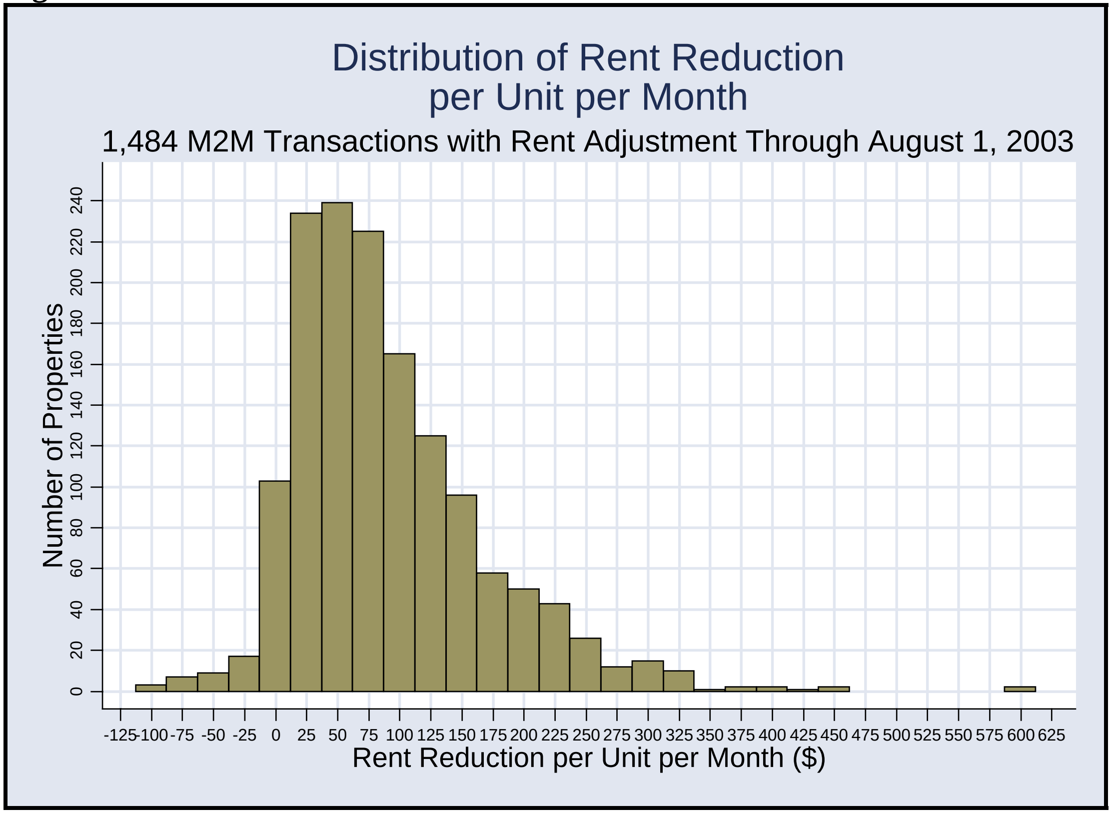


Figure 4.2

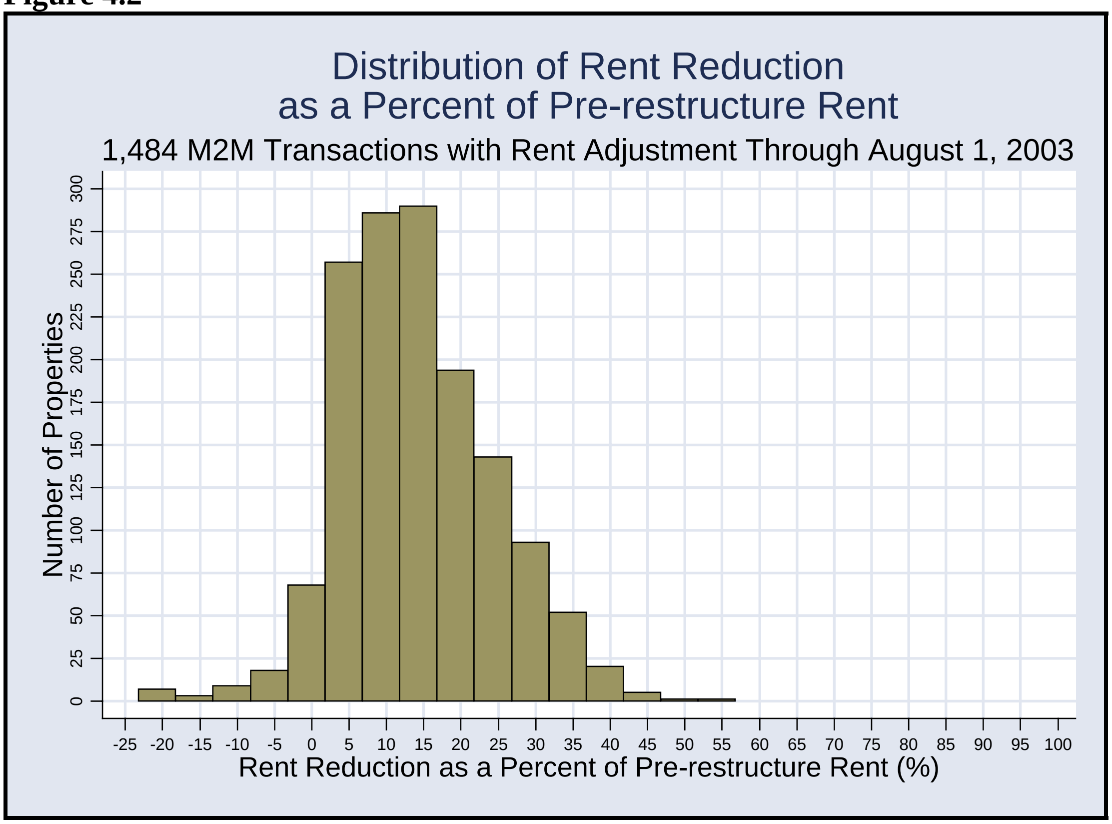


Table 4.2 shows the net present value of total rent reductions across property types for all properties that have closed through July 31, 2003, for the next 20 years. The table shows that total rent reductions for all Lites resulted in savings of $418.7 million. Fulls resulted in total savings of $1.1 billion. Rent reductions for Watch List properties resulted in aggregate savings of $273.7 million.[8] Thus, the net present value of rent reductions over the next 20 years totals $1.79 billion.

Partial Payment of Claim and Savings for Full Restructuring Properties

For Lite properties, the entire cost/savings (aside from PAE fees and administrative costs) results from the rent reduction. For Fulls, there are also costs associated with the partial payment of claim (PPC), which are partly offset by future repayments of the second and third mortgages. For Watch List properties, there is an additional cost of default for a portion of these properties that may not be financially viable with reduced rents and no offsetting partial payment of claim on the mortgage.

Table 4.1 above shows the magnitude of the partial payment of claim for Full restructurings. (This is also shown graphically in Figure 4.3 in dollar amounts per unit and in Figure 4.4 as a percent of unpaid principal balance).[9] The average pre-restructuring outstanding mortgage for the Fulls was $22,567 per unit ($23,596 for those that closed at market rent and $19,938 for those that closed with exception rents). The average partial payment of claim across all Fulls was $17,437 ($17,099 for market rent transactions and $18,384 for exception rent transactions). The average mortgage claim was 74 percent for market-rent transactions and 95 percent for exception-rent transactions.

There is an expectation that at least a portion of second and third mortgages will be repaid, reducing the overall impact of the partial payments of claim. As discussed below, there is a range of possible values for the repayment (ranging from a low that assumes that none will be repaid to a high that assumes that all will be repaid). It is most likely that the true amount will be somewhere in between the two extremes. Table 4.1 shows OMHAR's expectations regarding the present value of recoveries. The average expected repayment is $7,162 per unit. This represents about 46 percent of the partial payments of claims. (Present values of expected recoveries are presented graphically in Figure 4.5. Recoveries as a percent of PPC are shown in Figure 4.6.)

[8] The Watchlist properties are categorized as Full Watchlist or Lite Watchlist depending on whether they entered the program as a Lite or a Full.

[9] The total number of Full restructurings that closed through July 31, 2003 was 796. Only 699 of these had non-zero partial payments of claim. There are two situations that could lead to a zero PPC. Any balances from a project's pre-restructure Residual Receipts and Reserve for Replacement accounts are used to offset the claim against the HUD insurance fund. Thus, a M2M transaction could end up with a zero PPC if the project had a large pre-restructure balance from these accounts. The second situation that could lead to a zero PPC is if the pre-restructure mortgage is HUD-held. Figures 4.3, 4.4, and 4.6 include only the properties that had non-zero PPCs. Figure 4.5 is based on the savings analysis conducted for the Full Restructurings. It is based on 790 of the 796 closed Full transactions. The analysis excludes 6 transactions for which cost information was incomplete in the OMHAR MIS at the time of the analysis. (The "OMHAR savings" file provided by HUD only included 790 Fulls.)

Table 4.2
Total Rent Reductions by Property Type

FY of Completion	Lite	Full Closed At MKT Rent	Full Closed At Exception Rent	Total Fulls	Lite Watchlist	Full Watchlist	Total Watchlist	Total All
2000	$264,987,251	$2,494,144	$17,078	$2,511,222	$54,075,390	$5,992,333	$60,067,723	$327,566,196
2001	$117,071,702	$299,419,829	$97,218,380	$396,638,209	$13,454,077	$73,145,702	$86,599,779	$600,309,690
2002	$23,988,953	$335,351,509	$78,305,690	$413,657,199	$9,250,752	$63,189,620	$72,440,372	$510,086,524
2003 (thr. 7/31/2003)	$12,713,580	$217,203,869	$70,167,924	$287,371,793	$12,049,510	$42,497,582	$54,547,092	$354,632,465
Total	$418,761,486	$854,469,350	$245,709,073	$1,100,178,423	$88,829,730	$184,825,238	$273,654,968	$1,792,594,877

Figure 4.3

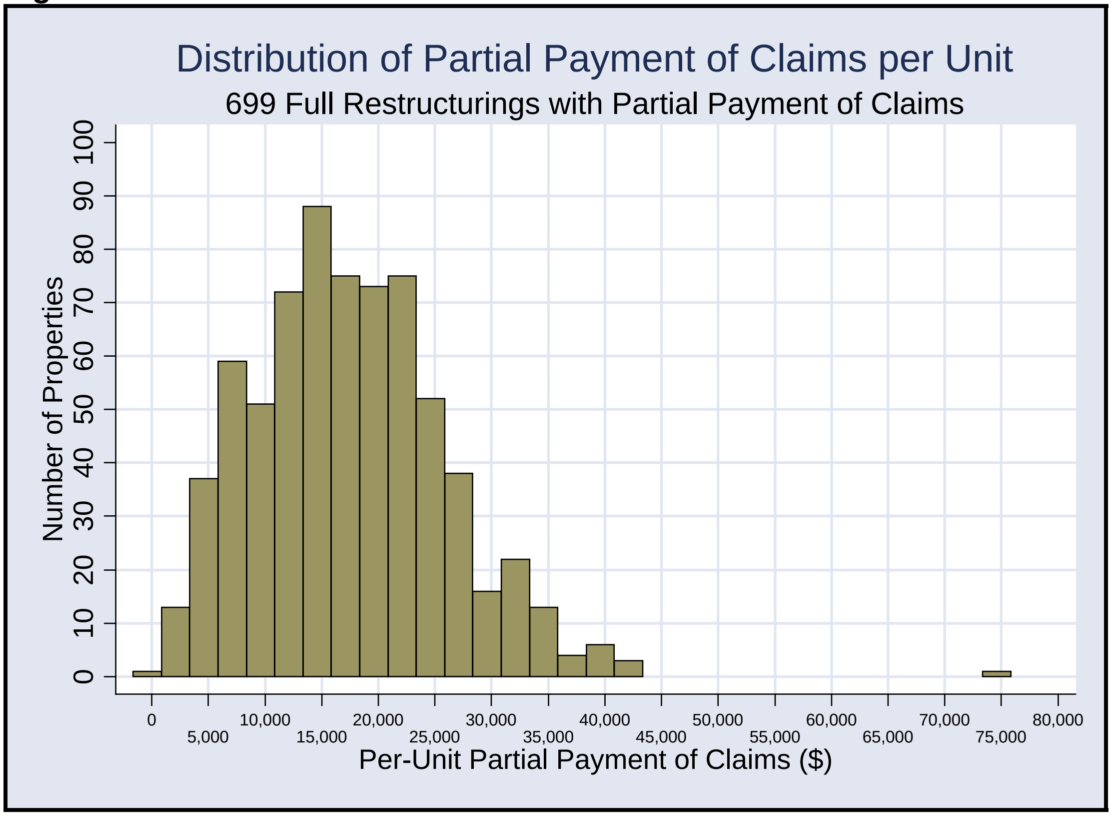


Figure 4.4

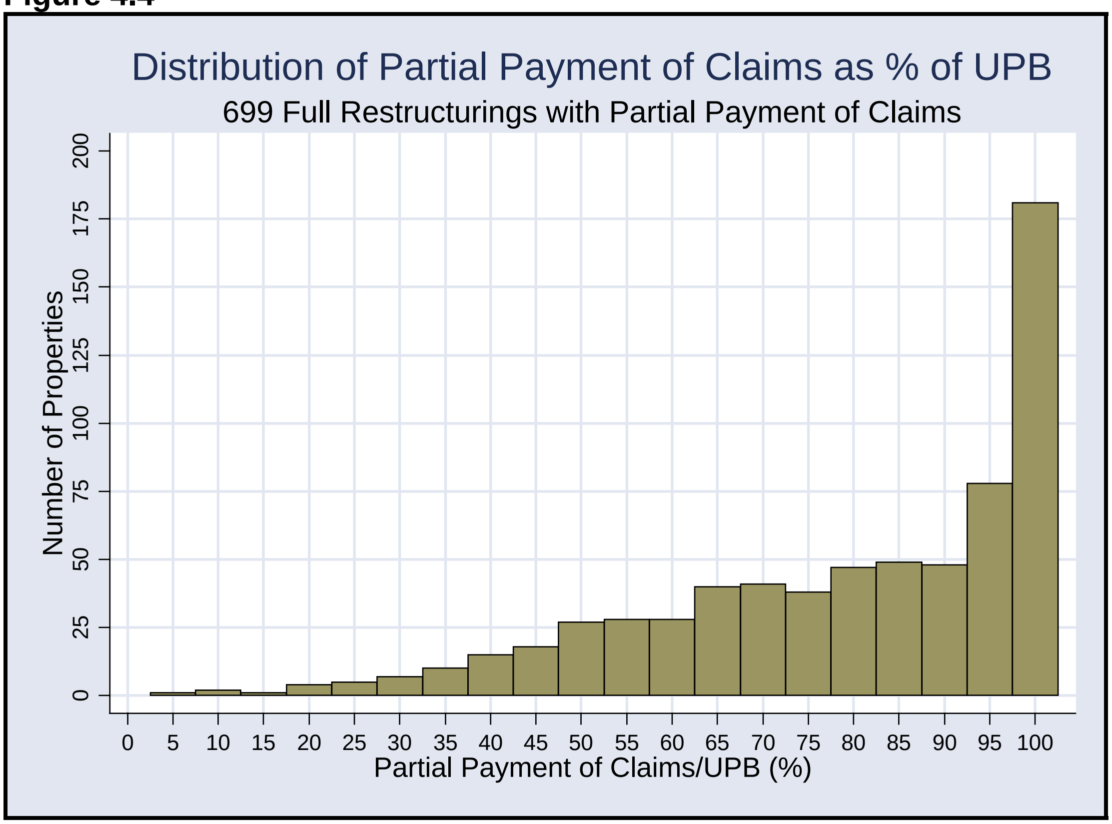


Figure 4.5

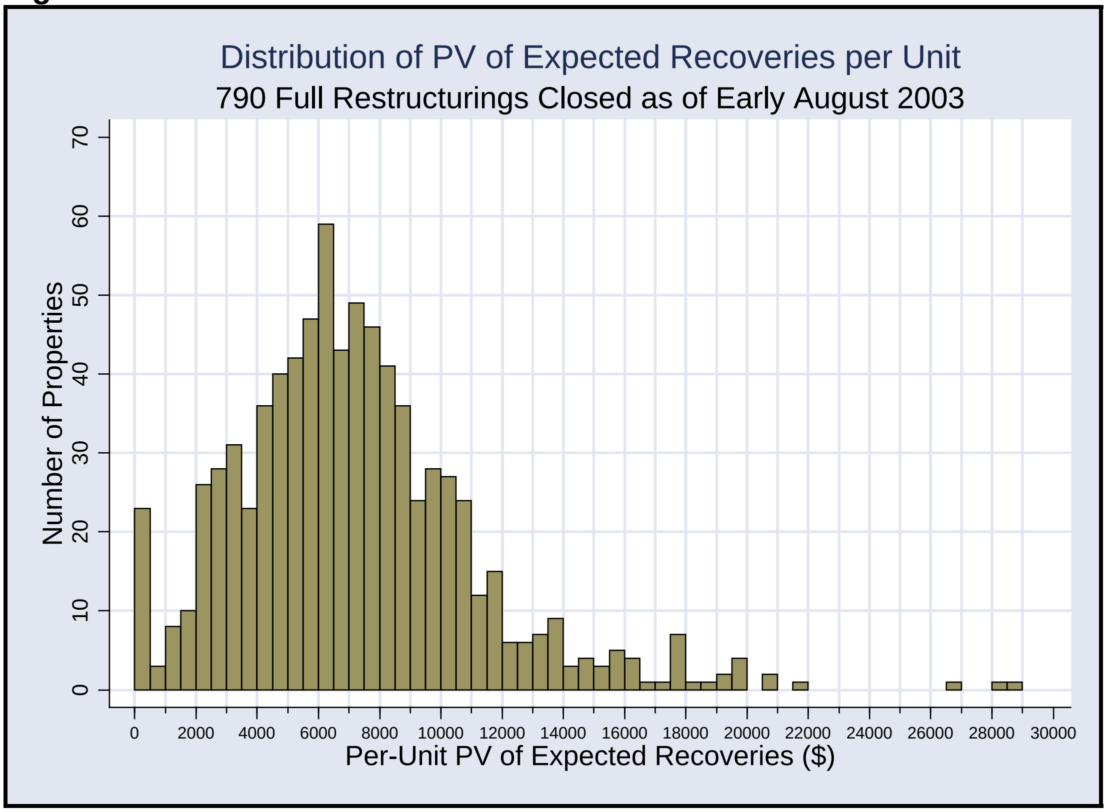
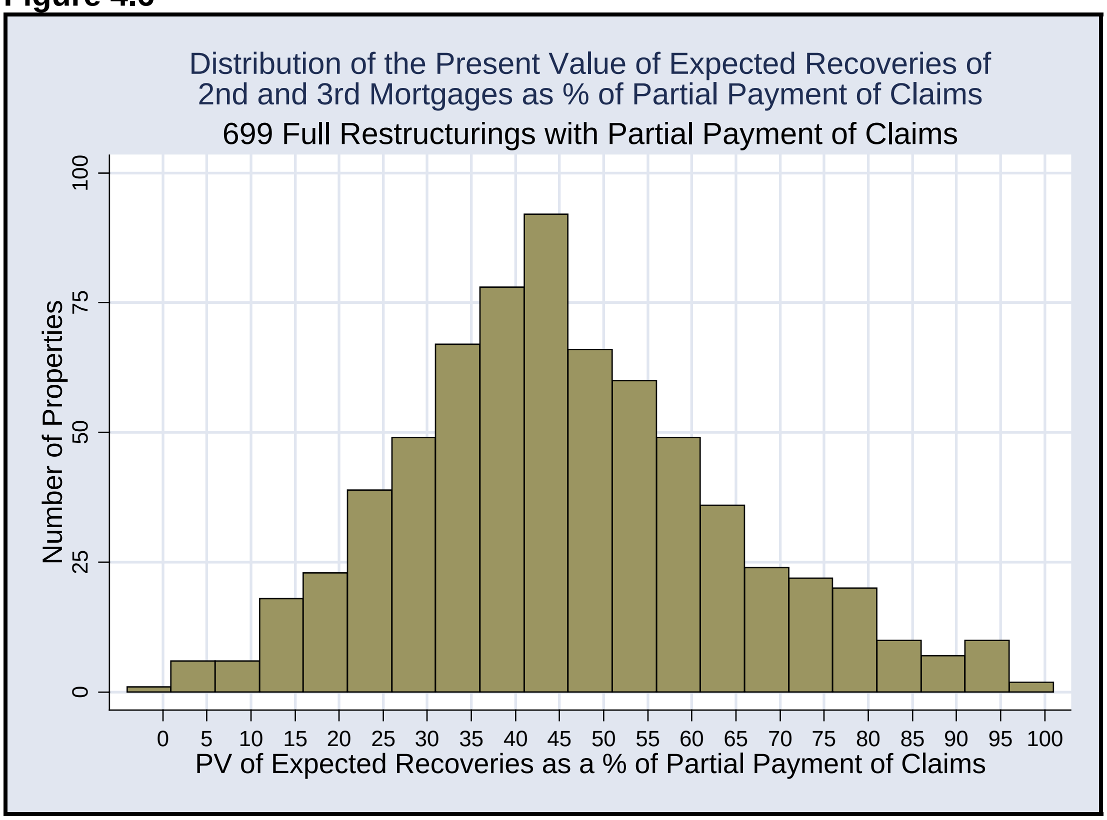


Figure 4.6



The data on partial payments of claim, and expected recoveries were provided by OMHAR. The methodology used for developing estimates of partial payment of claim and recoveries is as follows:

- Second and Third mortgage recoveries start in the year after closing. The Excel workbook estimates recoveries by year, during the term of the loans. The workbook estimates the principal balance on the note due upon maturity, limited to 80 percent of the PAE-determined and OMHAR-approved estimate of residual value of the property at that time.

- OMHAR's calculation does not have a general assumption regarding the repayments of the 2nd and 3rd mortgages. Rather the repayments amount for each property for each year is determined by the size of the post-M2M cash flow of the property, which is an output of the OMHAR Underwriting Model worksheet. For the purposes of estimating 2nd and 3rd mortgage recoveries, the workbook assumes that any negative Surplus Cash amounts from the most recent audited financial statements would remain after the M2M closing. Post-M2M cash flow is first applied to erasing the Surplus Cash deficit and then if any cash flow remains it is applied to IPF, 2nd mortgage payment, and the owner, in accordance with the transaction as closed.

- Small amounts for IRP and out-year Section 8 funds may be recaptured by HUD (typically, these resources are fully utilized in the restructure, but for some transactions, a portion or all of the funds are to be recaptured by HUD).

- For cash flows occurring in the current or prior years, no discount factor is applied. Cash flows occurring in future years are discounted at a long-term discount rate provided by OMB. This rate varies by the year in which the analysis is made. The rate for FY 2003 was 5.05 percent, and the rate for FY 2004 is 4.94 percent.[10]

In order to estimate the costs and savings associated with the program for Fulls, we need to make assumptions regarding the repayment of the second and third mortgages that are issued as part of the restructuring process. We present three scenarios. Under the upper limit scenario we assume that all of the seconds and thirds are repaid. The present value of full recoveries of the second and third mortgages is presented in Table 4.3 by fiscal year of completion. A second scenario, the lower limit scenario assumes that none of the seconds or thirds is repaid. Under this scenario the expected present value of repayments is zero. In reality, repayments will be some place in between these two extremes. Table 4.4 presents OMHAR's estimate of the present value of repayment by fiscal year of completion. This scenario assumes that a portion of the seconds and thirds will be repaid. The estimates are based on property characteristics.

[10] OMHAR developed this methodology in consultation with OMB. Charles Wilkens of the Compass Group provided details on the methodology used.

Table 4.3
Present Value of Full Recoveries of 2nd and 3rd Mortgages

FY of Completion	Full Closed at MKT Rent	Full Closed at Exception Rent	All Fulls
2000	$1,479,099	$148,533	$1,627,632
2001	$110,276,187	$25,549,073	$135,825,260
2002	$168,870,488	$43,940,212	$212,810,700
2003 (thru. 7/31/2003)	$118,591,462	$67,354,058	$185,945,520
Total	$399,217,235	$136,991,876	$536,209,111

Table 4.4
OMHAR's Estimates of Present Value of Recoveries of 2nd and 3rd Mortgages

FY of Completion	Full Closed at MKT Rent	Full Closed at Exception Rent	All Fulls
2000	$1,140,773	$86,081	$1,226,854
2001	$100,756,027	$20,587,209	$121,343,236
2002	$159,006,106	$37,526,682	$196,532,788
2003 (thru. 7/31/2003)	$110,076,577	$54,948,035	$165,024,612
Total	$370,979,484	$113,148,006	$484,127,490

Table 4.5 shows the estimate of total savings (or costs) resulting from the Full restructurings, excluding administrative and PAE costs. This takes into account the total rent reductions, partial payments of claim and the recoveries of the second and third mortgages under the three alternative scenarios: 1) the seconds and thirds are repaid in full, 2) a portion of the seconds and thirds are repaid (in keeping with OMHAR's estimates), and 3) none are repaid. It is likely that the actual savings will be between the first and third scenarios. As can be seen from the table, if second and third mortgages are repaid in full, net savings resulting from the Fulls would total about $520 million. At the other extreme, if there are no repayments of these mortgages, the Fulls will end up costing about $15 million. Under the intermediate scenario, the Fulls will result in a net savings to the government of over $468 million. Under any scenario, properties that close at market rents will result in savings. The exception-rent properties will result in savings if, in fact, all seconds and thirds are repaid, but will result in net losses if they are not.

Table 4.5
Net Savings Resulting From Closed Fulls

Upper Bound Scenario—Assumes All Seconds and Thirds are Repaid

FY of Completion	Full Closed at MKT Rent	Full Closed at Exception Rent	All Fulls
2000	$1,133,285	-$462,778	$670,507
2001	$178,262,005	$60,698,487	$238,960,492
2002	$184,638,325	$21,974,903	$206,613,228
2003 (thru. 7/31/2003)	$91,956,565	-$17,469,803	$74,486,762
Total	$455,990,180	$64,740,809	$520,730,989

Intermediate Scenario—Assumes that a Portion of Seconds and Thirds are Repaid Based on OMHAR Estimates

FY of Completion	Full Closed at MKT Rent	Full Closed at Exception Rent	All Fulls
2000	$794,960	-$525,230	$269,730
2001	$168,741,844	$55,736,623	$224,478,467
2002	$174,773,943	$15,561,372	$190,335,315
2003 (thru. 7/31/2003)	$83,441,680	-$29,875,826	$53,565,854
Total	$427,752,427	$40,896,940	$468,649,367

Lower Bound Scenario—Assumes No Repayments of Seconds and Thirds

FY of Completion	Full Closed at MKT Rent	Full Closed at Exception Rent	All Fulls
2000	-$345,813	-$611,311	-$957,124
2001	$67,985,817	$35,149,414	$103,135,231
2002	$15,767,837	-$21,965,310	-$6,197,473
2003 (thru 7/31/2003)	-$26,634,897	-$84,823,861	-$111,458,758
Total	$56,772,943	-$72,251,066	-$15,478,123

Defaults and Savings for Watch List Properties

When properties are placed on the Watch List, rents are reduced to market levels but the mortgage is not restructured. Watch List properties are in a vulnerable position—incomes are reduced but costs are not reduced, and no funds are provided to address any outstanding physical issues. Watch List properties can enter the restructuring process at a later time, but those that do not may face financial hardship and may possibly default. To estimate the potential costs of this group of properties to the FHA fund, we divided Watch List properties into three categories, based on likelihood of default, using a methodology adapted from one developed by HUD.[11] Under this methodology, cash flow is calculated assuming:

[11] The methodology was developed by Judy May of the Office of Housing.

- Rents are reduced to market level.

- Operating costs are based on historical costs (for the most recent year of available data, usually 2002).

- Vacancies are based on historical rates (for the most recent year of available data, usually 2002).

- Required mortgage payment was calculated using data from REMS on mortgage balance, term, and interest rate.

The first group includes 38 properties that can cover ongoing operating expenses as well as mortgage costs, even with the reduced rents. The second group includes 122 properties that can cover operating costs and a portion of mortgage costs with the reduced rents. The third group includes 137 properties that cannot cover operating costs with the reduced rents. In order to arrive at an estimate of the cost of default, we have made some simplifying assumptions. We assume that no properties in the group that can cover costs with reduced rents will default. We assume that all properties in the third group (i.e., those that cannot even cover operating costs) will default right away. We present two scenarios regarding the second group. The upper bound scenario assumes that none of this group will default, and the lower bound scenario assumes that all will default. We thus present upper and lower bounds on the estimate of the total savings for the Watch List properties. Given experience to date that many Watch List properties are in fact returning to the restructuring process and few are defaulting, we do not expect a large number of defaults going forward. Savings equal rent reductions minus claims. (See Table 4.6)

Table 4.6
Net Savings Resulting From M2M Watch List Properties

Scenario #1: Upper Bound Scenario—Assumes "at Risk" Watch List Properties Never Default

FY of Completion	Rent Reductions Lite Watchlist	Rent Reductions Full Watchlist	Rent Reduction- All Watchlist	Potential Claims from Group 3 Watchlist Properies	Potential Claims from Group 2 Watchlist Properties	Total Potential Claims from Watchlist	Total Costs/ Savings
2000	$54,075,390	$5,992,333	$60,067,723	$13,705,168	$0	$13,705,168	$46,362,555
2001	$13,454,077	$73,145,702	$86,599,779	$46,280,009	$0	$46,280,009	$40,319,770
2002	$9,250,752	$63,189,620	$72,440,372	$55,679,003	$0	$55,679,003	$16,761,369
2003 (thru 7/31)	$12,049,510	$42,497,582	$54,547,092	$50,928,828	$0	$50,928,828	$3,618,264
Total	$88,829,730	$184,825,238	$273,654,968	$166,593,008	$0	$166,593,008	$107,061,960

Scenario #2: Lower Bound Scenario—Assumes All "at Risk" Watch List Properties Default Immediately

FY of Completion	Rent Reductions Lite Watchlist	Rent Reductions Full Watchlist	Rent Reduction-All Watchlist	Potential Claims from Group 3 Watchlist Properies	Potential Claims from Group 2 Watchlist Properties	Total Potential Claims from Watchlist	Total Costs/ Savings
2000	$54,075,390	$5,992,333	$60,067,723	$13,705,168	$43,617,406	$57,322,574	$2,745,149
2001	$13,454,077	$73,145,702	$86,599,779	$46,280,009	$45,555,071	$91,835,080	-5,235,301
2002	$9,250,752	$63,189,620	$72,440,372	$55,679,003	$46,560,058	$102,239,061	-$29,798,689
2003 (thru 7/31)	$12,049,510	$42,497,582	$54,547,092	$50,928,828	$100,397,841	$151,326,669	-$96,779,577
Total	$88,829,730	$184,825,238	$273,654,968	$166,593,008	$236,130,376	$402,723,384	-$129,068,416

The rent reductions for the Watch List properties that have had their rent reduced to date result in total savings of $273.6 million. The two extremes for costs of default for the Watch List properties are $166.6 million and $402.7 million. In aggregate, Watch List properties will have an impact on savings ranging from a savings of $107 million to a loss of $129 million.

Total Savings

In addition to the direct savings and costs associated with the restructurings, the entire M2M program includes additional costs—i.e., the administrative costs of running OMHAR and payments to the PAEs for completing the restructurings.

Table 4.7 shows OMHAR costs for 1999 through 2003. Over the course of five years, a total of $163 million was spent on administrative costs, including salaries and staff expenses, operating expenses, ITAG/OTAG grants, and PAE costs. These costs are not necessarily attributable to specific properties, so in order to calculate overall program savings these costs are subtracted from the estimates of total savings presented above.

Table 4.7
Office of Multifamily Housing Assistance Restructuring (OMHAR)
Summary of OMHAR Costs to Date—Through July 31, 2003

	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003 July 31, 2003	TOTAL
Salaries and Expenses						
Salaries	$1,713,575	$7,871,433	$9,954,847	$9,212,339	$7,165,252	**$35,917,446**
Travel	75,875	423,823	332,537	260,218	136,173	**1,228,626**
Other Services (Contracts)	190,710	292,962	209,248	68,320	82,843	**844,083**
Other Expenditures (supplies & printing)	34,996	76,808	76,770	44,093	5,695	**238,362**
Total S&E	$2,015,156	$8,665,026	$10,573,402	$9,584,970	$7,389,963	**$38,228,517**
Contracts (FHA Fund)	$1,383,062	$4,079,194	$7,478,058	$8,765,061	$10,082,742[a]	**$31,788,117**
Total Staff & Operating Costs	$3,398,218	$12,744,220	$18,051,460	$18,350,031	$17,472,705	**$70,016,634**
Grants						
Section 514 (ITAG/OTAG)	$2,250,000	$3,496,840	$3,477,689	$4,184,360	$1,135,957	**$14,544,846**
PAE Compensation	$ -	$14,196,665	$22,768,885	$24,667,027	$16,950,044	**$78,582,621**
Total Costs – OMHAR	$5,648,218	$30,437,725	$44,298,034	$47,201,418	$35,558,706	**$163,144,101**

[a] The increase for FY 03 for Contracts (FHA Fund) is attributable to the increased activity in the Portfolio Management and Cash Management Contracts.

Table 4.8 shows the aggregate savings resulting from the first five years of OMHAR's operations. This includes rent reductions, partial payments, Net Present Value (NPV) of expected repayments of second and third mortgages, potential defaults of Watch List properties, and administrative costs for OMHAR. Depending on the assumptions regarding the repayments of the seconds and thirds for Full restructurings and the outcomes for Watch List properties, the NPV of overall savings over the next 20 years ranges from a low of $111 million under the lower bound assumptions (or $4 per unit per month) to a high of $883 million under the higher bound assumptions (or $30 per unit per month). Under the intermediate scenario the net present value of total savings is $831 million over the next 20 years (or $24 per unit per month).

Table 4.8
Net Savings Resulting From M2M Program

Scenario #1: Upper Bound Estimate–Assumes "at Risk" Watch List Properties Never Default and Full Recoveries of 2nd and 3rd Mortgages

FY of Completion	Lite	All Fulls	All Watch List	OMHAR Costs	Total Savings/(Costs)
1999	$0	$0	$0	$5,648,218	-$5,648,218
2000	$264,987,251	$670,507	$46,362,555	$30,437,725	$281,582,588
2001	$117,071,702	$238,960,492	$40,319,770	$44,298,034	$352,053,930
2002	$23,988,953	$206,613,228	$16,761,369	$47,201,418	$200,162,132
2003	$12,713,580	$74,486,762	$3,618,264	$35,558,706	$55,259,900
Total	$418,761,486	$520,730,989	$107,061,960	$163,144,101	$883,410,334

Scenario #2: Intermediate Scenario—Assumes "at Risk" Watch List Properties Never Default and Recoveries of 2nd and 3rd Mortgages as Expected by OMHAR for Fulls

FY of Completion	Lite	All Fulls	All Watch List	OMHAR Costs	Total Savings/(Costs)
1999	$0	$0	$0	$5,648,218	-$5,648,218
2000	$264,987,251	$269,730	$46,362,555	$30,437,725	$281,181,811
2001	$117,071,702	$224,478,467	$40,319,770	$44,298,034	$337,571,905
2002	$23,988,953	$190,335,315	$16,761,369	$47,201,418	$183,884,219
2003	$12,713,580	$53,565,854	$3,618,264	$35,558,706	$34,338,992
Total	$418,761,486	$468,649,367	$107,061,960	$163,144,101	$831,328,712

Scenario #2: Lower Bound Estimate—Assumes all "at Risk" Watch List Properties Default Immediately and No Recoveries of 2nd and 3rd Mortgages for Fulls

FY of Completion	Lite	All Fulls	All Watch List	OMHAR Costs	Total Savings/(Costs)
1999	$0	$0	$0	$5,648,218	-$5,648,218
2000	$264,987,251	-$957,124	$2,745,149	$30,437,725	$236,337,551
2001	$117,071,702	$103,135,231	- $5,235,301	$44,298,034	$170,673,598
2002	$23,988,953	-$6,197,473	-$29,798,689	$47,201,418	-$59,208,627
2003	$12,713,580	-$111,458,758	-$96,779,577	$35,558,706	-$231,083,461
Total	$418,761,486	-$15,478,123	-$129,068,416	$163,144,101	$111,070,846

Factors Affecting Savings for Lites

Table 4.9 presents findings regarding the factors that are correlated with savings in the Lite transactions. Savings in these transactions equal the value of the rent reductions. The table presents the average savings by property characteristics and describes the characteristics of properties with below-average and above-average savings.

Savings are driven by the extent to which pre-restructuring rents are above market levels. Thus, we expect to find that high savings properties are those with characteristics associated with high pre-program rents relative to FMR.

Key factors relating to savings for Lites are the following:

- As expected, savings are higher for properties with higher pre-restructure rents relative to FMR. The average savings for properties with rents below FMR are $7,609 per-unit, while the savings for properties with rents above 150 percent of FMR are $19,054 per unit.

- Average savings are highest for properties in the Northeast (averaging $16,292 per unit over 20 years) and lowest in the Midwest, (averaging only $8,036 per unit over 20 years).

- Savings are highest for central city properties (averaging $13,358 per unit) and lowest for non-metro properties, (averaging $9,219).

- There are few observed differences in savings based on Census tract characteristics. The only observed differences are in homeownership rates, which are higher in low-savings tracts, and probably associated with non-metro locations.

- Savings tend to be slightly higher in smaller properties and in properties with smaller units. However, savings are lower in elderly/disabled properties.

- Savings are slightly higher in Newer Assisted properties compared with Older Assisted properties.

Table 4.9
Factors Affecting Savings for Lite Transactions

	Average Savings Across All Lites of this Type	Lite Average Savings = $12,143	
		Savings Above Average	Savings Below Average
Number of Properties	**385**	**147**	**238**
Number of Units	**35,870**	**13,439**	**22,431**
Average Savings	**$12,143**	**$22,928**	**$5,482**
Location			
Census region			
Northeast	$16,292	27%	13%
Midwest	$8,036	14%	24%
South	$11,391	32%	42%
West	$13,575	27%	22%
Metro Location			
Central City	$13,358	56%	46%
Balance of Metro (Suburb)	$12,313	29%	27%
Non-metro	$9,219	16%	26%
Neighborhood (Census Tract) Characteristics			
Average Proportion of Vacant Housing Units		8%	8%
Average Homeownership Rate		45%	51%
Average Rent-to-Income Ratio		23%	21%
Average Proportion of Racial/Ethnic Minorities		45%	37%
Average Poverty Rate		25%	23%
Property Characteristics			
Average Development Size (Number of Units)		91	94
Average Unit Size (N number of bedrooms per unit)		1.62	1.72
Proportion of 3+bedroom units		16%	20%
Occupancy Type			
Family	$12,365	62%	66%
Elderly/disabled	$11,690	38%	34%
Building Type			
High-rise/elevator	$11,557	38%	24%
Other	$13,508	62%	76%
Age			
Average		25.9	26.5
HUD Program Type			
Older assisted	$11,873	46%	54%
Newer assisted	$12,265	54%	46%
Mortgage Sponsor Type			
Profit Motivated	$11,282	47%	45%
Limited Dividend	$11,535	37%	43%
Non-Profit	$14,877	17%	12%
Other	N.A.	0%	0%
Mortgage Financed Type			
State HFA Bond Financed	$10,058	2%	3%
Other	$12,199	98%	97%
Average Per Unit Unpaid Principal Balance (UPB)		$17,556	$14,158
Average Most Recent REAC Financial Performance Score		72	73
Average Most Recent REAC Physical Inspection Score		86	86

Table 4.9 ***(Continued)***
Factors Affecting Savings for Lite Transactions

	Average Savings Across All Lites of this Type	Lite Average Savings = $12,143	
		Savings Above Average	Savings Below Average
Number of Properties	**385**	**147**	**238**
Number of Units	**35,870**	**13,439**	**22,431**
Average Savings	**$12,143**	**$22,928**	**$5,482**
Pre-restructure Sec. 8 Contract Rent to FMR Ratio			
Average		129%	113%
Rent < FMR	$7,609	9%	29%
FMR< Rent <= 150% of FMR.	$12,624	72%	68%
Rent greater than 150% of FMR	$19,054	19%	3%
Change in REAC Capital Deficiency Score			
Decrease or No Change	$12,362	65%	60%
Increase	$11,294	35%	40%
PAE Type			
Public	$11,287	39%	45%
Private	$12,785	61%	55%
Restructuring Type			
Closed at Market Rent	$12,143	100%	100%
Closed at Exception Rent	N.A.	N.A.	N.A.

- Savings are similar for properties with profit-motivated and limited-dividend owners and are higher for properties with non-profit owners.

- Savings do not differ based on REAC scores.

- High-savings properties have higher unpaid principal balances on their mortgages.

- Savings are slightly higher for properties that were restructured by private PAEs ($12,785) compared with public PAEs ($11,287).

Factors Affecting Savings for Fulls

Table 4.10 presents findings regarding factors that appear to drive savings in the Full transactions. Savings occur when the net present value of the rent reduction and anticipated repayments of the second and third mortgage exceed the partial payment of claim. For this analysis we use the intermediate estimate of savings that relies on OMHAR's expectations regarding repayments of second and third mortgages. As shown in the table, there is an anticipated net loss for 30 percent of the closed Full transactions.

The table presents the average savings by property characteristics and describes the characteristics of above-average, below-average, and negative-savings properties.

Key factors relating to savings for Fulls are as follows:

- As with Lites, average savings are highest for properties in the Northeast, averaging $15,315 per unit over 20 years. Nearly half (47 percent) of high-savings Fulls are in the Northeast. Again, as with Lites, savings were lowest in the Midwest, averaging $1,896. Savings in the South averaged $2,750, and 59 percent of all transactions with losses occurred in the South.

- Savings are highest for suburban properties, averaging $8,023 per unit, and lowest for non-metro properties, averaging $2,673. Savings for central city properties averaged $7,781 per unit.

- There are no significant differences in savings based on Census tract characteristics.

- Savings tend to be higher per unit in larger properties and in properties with smaller units and smaller concentrations of large units. They also tend to be higher in elderly and non-high-rise properties.

- Savings are higher in Older Assisted properties (average $8,222) compared with Newer Assisted properties (average $4,997).

- Savings are highest for properties with limited-dividend owners ($10,256 on average) and lowest for properties owned by profit-motivated owners ($3,286 on average). Savings average $7,225 for properties with non-profit owners.

- Higher financial REAC scores are associated with higher savings. (Savings average $12,106 per unit for properties with financial REAC scores above 80, compared with $1,924 for properties with scores of 40 or lower).

- Physical REAC scores were not associated with savings.

- As expected, savings are higher for properties with higher pre-restructure rents relative to FMR. The average savings for properties with rents below FMR is $342, while the savings for properties with rents above 150 percent of FMR is $11,063 per unit.

- Savings are higher for properties that were restructured by private PAEs ($6,059 compared with $3,976).

- Not surprisingly, properties that close at market rents have much higher average savings compared with exception-rent properties. The average savings for market-rent properties is $7,649 compared with $652 for exception-rent properties.

Table 4.10
Factors Affecting Savings for Full Transactions

	Average Savings Across All Fulls of this Type	Full Positive Savings Average Savings = $11,098		
		Savings Above Average	Savings Below Average	Negative Savings (Loss)
Number of Properties	**790**	**192**	**361**	**237**
Number of Units	**67,065**	**18,219**	**30,840**	**18,006**
Average Savings	**$5,674**	**$22,480**	**$5,044**	**-$6,981**
Location				
Census region				
Northeast	$15,315	47%	17%	7%
Midwest	$1,896	9%	24%	28%
South	$2,750	32%	53%	59%
West	$8,950	12%	6%	6%
Metro Location				
Central City	$7,781	44%	34%	32%
Balance of Metro (Suburb)	$8,023	30%	21%	16%
Non-metro	$2,673	26%	45%	52%
Neighborhood (Census Tract) Characteristics				
Average Vacancy Rate		8%	8%	9%
Average Homeownership Rate		44%	55%	59%
Average Rent-to-Income Ratio		24%	21%	20%
Average Proportion of Racial/Ethnic Minorities		48%	34%	33%
Average Poverty Rate		30%	27%	26%
Property Characteristics				
Average Development Size (Number of Units)		95	85	76
Average Unit Size (Number of bedrooms per unit)		1.76	1.80	1.96
Proportion of 3+bedroom units		20%	21%	25%
Occupancy Type				
Family	$5,492	67%	62%	74%
Elderly/disabled	$6,142	33%	38%	26%
Building Type				
High-rise/elevator	$3,565	40%	23%	10%
Other	$12,876	60%	77%	90%
Age Property Age		23.9	23.4	22.6
HUD Program Type				
Older assisted	$8,222	32%	23%	18%
Newer assisted	$4,997	68%	77%	82%
Mortgage Sponsor Type				
Profit Motivated	$3,286	46%	62%	71%
Limited Dividend	$10,256	45%	26%	23%
Non-Profit	$7,225	9%	12%	6%
Other	$5,432	0%	1%	0%
Mortgage Financed Type				
State HFA Bond Financed	$7,706	11%	9%	8%
Other	$5,477	89%	91%	92%
Average Per Unit Unpaid Principal Balance (UPB)		$24,198	$22,022	$22,290

Table 4.10 *(Continued)*
Factors Affecting Savings for Full Transactions

	Average Savings Across All Fulls of this Type	Full Positive Savings Average Savings = $11,098		
		Savings Above Average	Savings Below Average	Negative Savings (Loss)
Number of Units	**67,065**	**18,219**	**30,840**	**18,006**
Average Savings	**$5,674**	**$22,480**	**$5,044**	**-$6,981**
Average Most Recent REAC Financial Performance Score		71	64	55
Average Most Recent REAC Physical Inspection Score		83	83	80
Average Pre-restructure Sec. 8 Contract Rent to FMR Ratio		146%	132%	125%
Rent < FMR	$342	4%	8%	14%
FMR< Rent <= 150% of FMR.	$4,592	57%	71%	72%
Rent greater than 150% of FMR	$11,063	40%	21%	14%
Change in REAC Capital Deficiency Score				
Decrease or No Change	$6,094	66%	66%	66%
Increase	$4,935	34%	34%	34%
PAE Type				
Public	$3,976	11%	20%	22%
Private	$6,059	89%	80%	78%
Restructuring Type				
Closed at Market Rent	$7,649	80%	81%	52%
Closed at Exception Rent	$652	20%	19%	48%

5. Analysis of Program Efficiency

Introduction

This chapter examines the efficiency of the Mark-to-Market (M2M) program over time. Efficiency is measured by the length of processing time—the shorter the time, the greater the efficiency.

Efficiency questions center around the processing time for carrying out the major stages of the restructuring process. The following questions regarding program efficiency are addressed in this chapter:

- How do Lite restructurings and Full restructurings differ in terms of processing time?
- How did the changes in HUD/OMHAR procedures throughout the life of OMHAR affect processing time?
- How do the public and private PAEs differ in terms of efficiency measured as processing time?

In this chapter, we first provide the background to concerns over the program's efficiency and describe some key policy changes brought about by OMHAR designed to reduce processing time. The second section discusses our analytic approach and its limitations. Findings regarding the change in processing speed over time are presented in the subsequent three sections. Our analysis compares processing times by the type of restructuring outcome, the major processing milestone, the type of PAE, and the timing of the restructuring in relation to OMHAR's underwriting and processing regimes. The last section provides a summary and conclusions.

Background

Since its inception, a major focal point of the M2M program has been the efficiency of its operation. Housing industry groups and policy makers raised concerns that it took too long to complete a transaction, especially for Full restructurings.[12] The explanation is that, in general, Full restructures are more complex and involve more steps to complete than Lite restructures. Observers have also noted that the unwillingness of some property owners to cooperate in the restructuring tends to prolong the processing time.

In particular, many owners have been reluctant to agree to Full restructurings because of the cash they must contribute to address the property's rehabilitation needs and the long-term use agreement that accompanies a Full restructure. Other factors attributable to the slow

[12] See "HUD to Streamline MF Restructuring" in *National Mortgage News*, July 17, 2000. *Multifamily Housing: Issues Related to M2M Program Reauthorization*, GAO report to Congressional Committees, July 2001.

processing time that are often mentioned by industry groups include the extensive requirements contained in the program's operating procedures guide, OMHAR's detailed review process for the restructuring plans PAEs have submitted, and the lengthy negotiations between OMHAR and some of the public PAEs during the early stage of program implementation.[13]

In response to these bottlenecks, OMHAR made several policy changes that aimed to increase the program's efficiency, participation, and output. One important change was the implementation of an Owner Incentive Package in the fall of 2000. The incentive package allows owners to receive monthly Capital Recovery Payments (CRP), designed to provide a reasonable return on the investment the owners must make to cover 20 percent of the rehabilitation and transaction costs. The incentive package allows owners to receive an Incentive Performance Fee (IPF) of up to 3 percent of effective gross income if the owner demonstrates sound management practices. It also allows owners to finance 100 percent of the initial deposit to a property's replacement reserve and 80 percent of certain reasonable transaction costs.[14] CRP and IPF made the M2M restructuring outcome more attractive to the owners and, therefore, speeded up the acceptance and execution of the restructuring plan. Our "process analysis" interviews with many of the stakeholders reinforced this conclusion.

Two more recent policy changes may have also affected processing time. One is the change in the M2M underwriting standard related to the "expense cushion" introduced in March 2002. A more rigorous standard makes the program more attractive to the owners because they feel more confident about their properties' long-term financial viability. This may speed up the acceptance and execution of the restructuring plan by the owners. Also, key personnel and organizational changes were made at OMHAR by the Director appointed in May 2002. These changes were intended to lead to more efficient operation of the OMHAR staff.

Methodology

To address the efficiency questions, this chapter examines the processing time of a total of 1,385 M2M transactions that were completed through early August 2003 with information on critical tracking dates from OMHAR's MIS. This pool of properties includes 391 closed Lite restructurings, 98 completed Lite Watch List projects, 520 Full restructurings that were closed at market rent, 200 projects that were closed at exception rent, and 176 completed Full Watch List projects.[15] Projects that were determined by OMHAR to be ineligible for M2M or

[13] As pointed out in the 2001 GAO report, during the time-consuming process of OMHAR's contract negotiations with some public PAEs, a significant number of properties entered into program. Consequently, OMHAR had a large volume of properties to assign to the PAEs at one time, which resulted in processing delays and the need for Section 8 contract extensions at above market rents for a large number of the properties.

[14] For details, see Chapter Three of the Mark-to-Market Program Operating Procedures Guide, which can be downloaded from the OMHAR web site.

[15] A Lite transaction is considered completed when OMHAR approved PAE's Lite recommendation and justification (Form 10.2). For a Full transaction, the loan closing date is the completion date. A Watch List property is considered completed when its rent is marked down to the market level and OMHAR officially informs the owner that OMHAR is placing the property on the Office of Housing's Watch List. The difference between Lite and Full Watch List is entirely based on the owner's initial selection of restructure type when a

that have discontinued the restructuring process for other reasons were not included in this analysis.

To study the change in efficiency over the course of OMHAR's history, we sort completed transactions into "entering cohorts" based on the time that each came into the OMHAR processing pipeline. This allows us to see whether projects that entered the pipeline after the most significant HUD/OMHAR policy changes are, on average, processed faster than those in the earlier era. The left-hand-side panel of Table 5.1 shows how these properties are distributed according to their entering cohort year and quarter. It highlights the fact that the vast majority of the Lite transactions completed to date entered the pipeline early on, mostly during calendar year 1999 and first half of year 2000. Full transactions, on the other hand, tended to enter the pipeline in the later years. Among those Fulls closed at both market and exception rents, 298 entered during 2001, compared to 63 that entered during 1999 and 269 that entered during 2002. The decreasing number of completed transactions during the later part of 2002 and 2003 reflects that projects that entered the pipeline during this period have not yet completed the restructuring process.

The number of projects still active as of the summer of 2003 is shown in the right-hand-side panel of Table 5.1. There are very few active Lites. However, there are a substantial number of active Fulls, especially for the more recent cohorts. This sample truncation represents a major methodological challenge for our processing time analysis. For the Lites and the older cohorts of Fulls, we are able to observe the completion time for the vast majority of these projects, truncating only a few with extremely long processing time. For the recent cohorts of Fulls (especially those that entered the program since the 1st quarter of 2002), we are truncating many projects, especially those with longer processing time.

The implication is that our analysis will show a downward-biased processing time for the recent cohorts of Fulls. To mitigate this sample truncation problem, we focus our analysis on the median processing time. This, however, does not eliminate the bias entirely. Therefore, readers should discount our processing time estimate for the cohorts of Fulls that entered the pipeline since 2002. Sample truncation for the Lites is slight and can be ignored.

property enters the M2M pipeline. Regardless of the owner's initial selection, OMHAR has determined that a mortgage restructure is required for these properties but they failed to complete the restructure process.

Table 5.1
Distribution of Completed and Active M2M Transactions by Entering Cohort (as of August 1, 2003)

Completed M2M Transactions							Active M2M Transactions	
Entering Cohort (Calendar Year and Quarter)	Lite	Lite Watchlist	Full Closed at Market Rent	Full Closed at Exception Rent	Full Watchlist	All	Lite	Full
1999 Q2	0	0	1	0	0	1	0	0
1999 Q3	83	15	30	19	9	156	0	2
1999 Q4	72	6	9	4	7	98	0	0
1999 Total	155	21	40	23	16	255	0	2
2000 Q1	101	30	62	23	28	244	0	0
2000 Q2	52	5	58	16	21	152	0	2
2000 Q3	29	2	41	10	14	96	0	2
2000 Q4	10	4	51	8	8	81	0	0
2000 Total	192	41	212	57	71	573	0	4
2001 Q1	15	6	63	14	14	112	0	9
2001 Q2	9	5	72	30	17	133	0	15
2001 Q3	8	3	57	25	19	112	0	20
2001 Q4	1	3	24	13	13	54	0	9
2001 Total	33	17	216	82	63	411	0	53
2002 Q1	1	7	21	17	12	58	0	40
2002 Q2	1	4	13	9	8	35	0	39
2002 Q3	1	3	9	10	4	27	0	45
2002 Q4	5	1	6	2	2	16	0	67
2002 Total	8	15	49	38	26	136	0	191
2003 Q1	3	2	3	0	0	8	2	139
2003 Q2	0	2	0	0	0	2	8	128
2003 Total	3	4	3	0	0	10	10	267
Grand Total	391	98	520	200	176	1,385	10	767

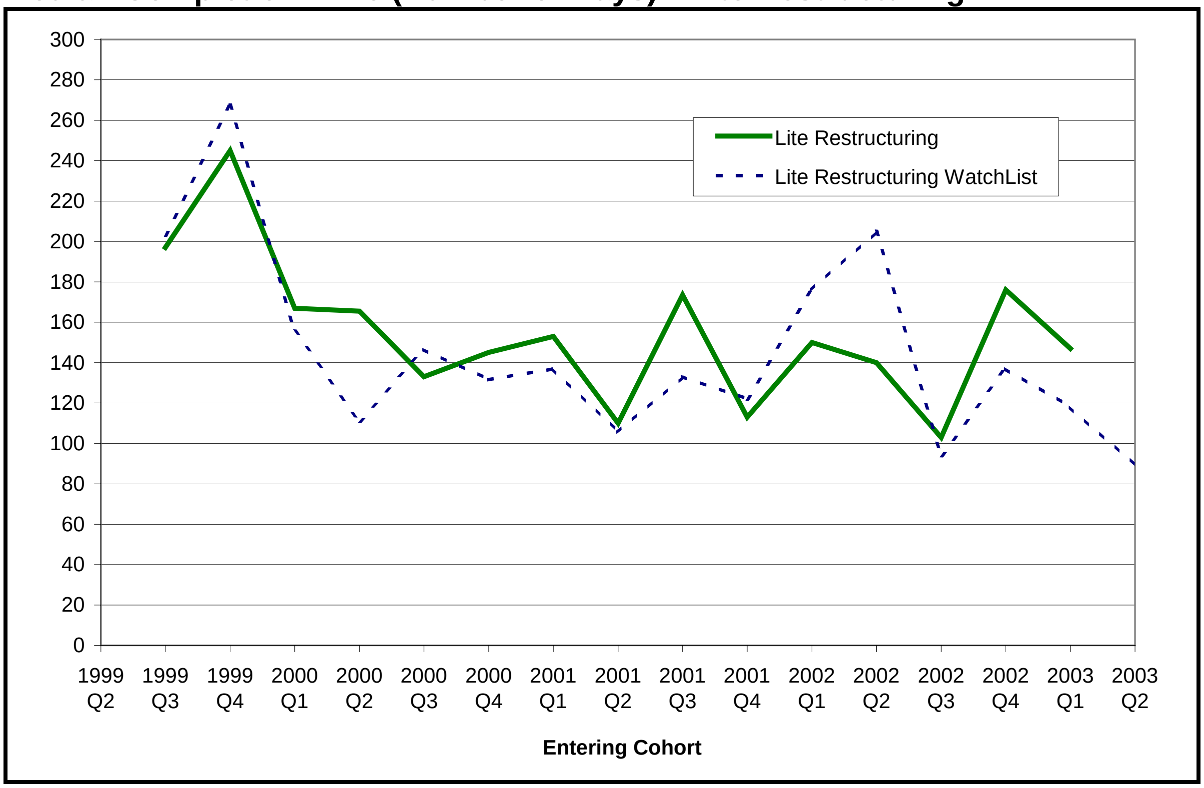
For the purpose of this analysis, we define performance efficiency as the time duration (days elapsed) between the date that a PAE accepts the asset assignment from OMHAR and the completion date. A major milestone in this process is the date when the restructuring plan is completed by the PAE and submitted to OMHAR for approval. Thus, in addition to examining the total processing time, we also partition the completion time into two parts—duration from assignment acceptance to plan submission and duration from plan submission to completion.

A study conducted by the GAO indicates that, as of June 15, 2001, PAEs spent an average of 199 days to complete a Lite restructure, while it took an average of 432 days to complete a Full restructure. The average processing time for a PAE to submit a mortgage restructuring plan to OMHAR was 164 days for Lites and 312 days for Fulls. As for the time OMHAR spent reviewing the plans once they were submitted by PAEs, on average it took 35 days for Lites and 120 days for Fulls. GAO's analysis, however, did not examine how processing time varies across PAE type, nor did it investigate whether the program's efficiency has improved after OMHAR implemented measures to address the various bottlenecks.[16]

Total Completion Time

Figure 5.1 presents, by entering cohort, our analysis of the trend of median completion time for the Lite restructurings. Analysis is performed separately for the regular Lites and Lite Watch List transactions. Overall, it clearly shows that completion time has been reduced substantially over time. This is true for both regular Lites and Watch List Lites. For example, the median completion time is 245 days for the completed Lites that entered the program during the fourth quarter of 1999, while transactions that entered the pipeline since the first quarter of 2001 had median completion times between 110 and 176 days. The median completion time across all cohorts is 171 days.

Figure 5.1
Median Completion Time (Number of Days)—Lite Restructuring



The trend of processing time for the Watch List Lites follows a similar pattern, with median completion time across all cohorts of 157 days. While in general Watch List Lites require fewer days to complete than regular Lites, the median processing time jumped noticeably for projects that entered the pipeline during the first six months of 2002. However, median processing time came down again for transactions in the subsequent cohorts. While the

[16] *Multifamily Housing: Issues Related to M2M Program Reauthorization.* GAO report to Congressional Committees, July 2001.

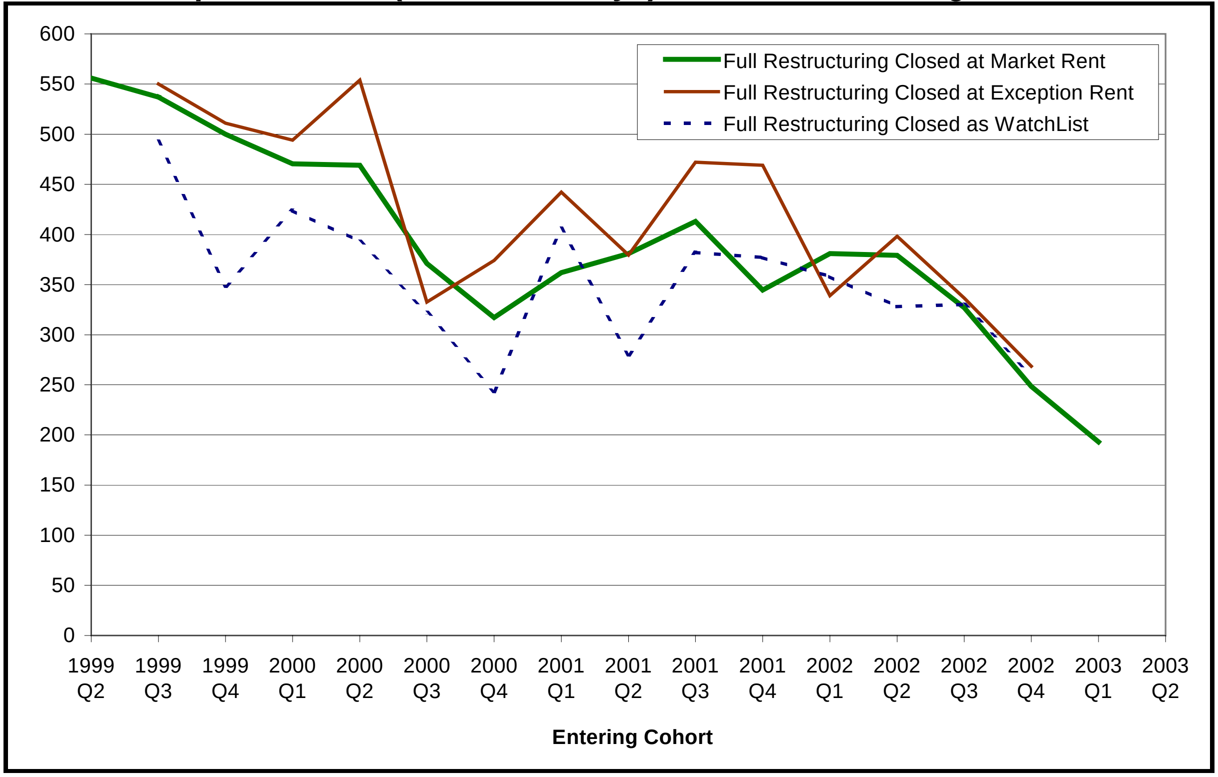
reason for this spike in processing time is unknown, it is most likely related to some special processing circumstances of those few transactions rather than a change in the HUD/OMHAR policies.

Analyses for Full restructurings are presented in Figure 5.2 for those properties that closed at market rent, exception rent, and as Watch List. Regardless of the restructuring outcome, the median completion time has been reduced dramatically. For Fulls that closed at market rent, the median completion time is 399 days across all cohorts. The duration has been reduced from 550+ days for the earlier cohorts to generally within 400 days for cohorts since the later part of 2000. This gain in efficiency coincides perfectly with the introduction of the owner's incentive package to the M2M process during the fall of 2000. Although completion time drops even further for cohorts since the third quarter of 2002, this is most likely due to the sample truncation problem mentioned earlier in this chapter—i.e., many of the projects that require a long processing time are still active, and we thus are not able to observe their completion time.

Taken at face value, this recent reduction in processing time may be attributable to changes brought about by OMHAR's current director, appointed in May of 2002, who has improved OMHAR's relationship with other parts of HUD. He has also implemented a number of personnel and organizational changes within OMHAR. These changes include, for example, the creation of a Production Manager position, increased oversight of the production process, and weekly (Monday) training conference calls. It is tempting to infer that these changes have made OMHAR's operation more efficient and effective, but we again caution the reader that our analysis for these most recent cohorts of Fulls is based on a small and truncated sample of completed transactions.

The completion times for Fulls closed at exception rent follow a similar trend. As expected, Figure 5.2 shows that they tend to involve a longer time to complete relative to regular Fulls, because exception rent transactions generally have more difficult issues to resolve. For example, exception rent properties tend to have lower REAC inspection scores, lower REAC financial performance scores, higher vacancy rates, and be in worse neighborhoods. While the median completion time across all cohorts is 456 days, those that entered the pipeline since the first quarter of 2002 have a median completion time within 400 days. In comparison, Fulls that are closed as Watch List require the shortest completion time among these three types of restructuring outcomes. The median completion time for such transactions is 356 days across all entering cohorts. This is because a Full transaction completed as a Watch List does not involve a closing process, which would in general add another 60 days of processing time and put them on the same timeline as the other Fulls.

Figure 5.2
Median Completion Time (Number of Days)—Full Restructuring



Processing Time by Major Milestone

For Full restructurings, the completion of the restructure plan by the PAE and its submission to OHMAR for approval is a major milestone. It signifies that the PAE has completed all the due diligence and underwriting processes. The corresponding milestone for a Lite restructuring is the submission of OMHAR Form 10.2—PAE's Justification for Lite Recommendation. For the purpose of this analysis, we label this key milestone "plan submission" for both restructuring types.

Figure 5.3 plots the duration between assignment acceptance date and plan submission date for the Lites by entering cohort, separately for regular Lites and Watch List Lites. For regular Lites, the median duration is 142 days across all cohorts. The corresponding duration for all Watch List Lites is 114 days. Clearly, this processing phase accounts for the vast majority of the total completion time. The trend across cohorts is very similar to the trend for total completion time we discussed in the previous section. The duration has shortened remarkably over the course of OMHAR's history, especially for regular Lites.

The median processing time required to bring a Lite from the plan submission stage to completion is depicted in Figure 5.4. The median duration is 19 days for regular Lites and 26 days for Watch List Lites (all cohorts combined). This processing phase accounts for only a small portion (less than a quarter on average) of the total completion time. For both transaction types, this duration fluctuates widely across cohorts. For regular Lites, it climbs steadily over time, while there are no discernible patterns for the Watch List Lites. This may reflect the fact that, over time, more attention of the OMHAR/PAE staff is being shifted to the Full transactions.

Figure 5.3
Median Number of Days Elapsed Between PAE Acceptance of Assignment and Plan Submission—Lite Restructuring

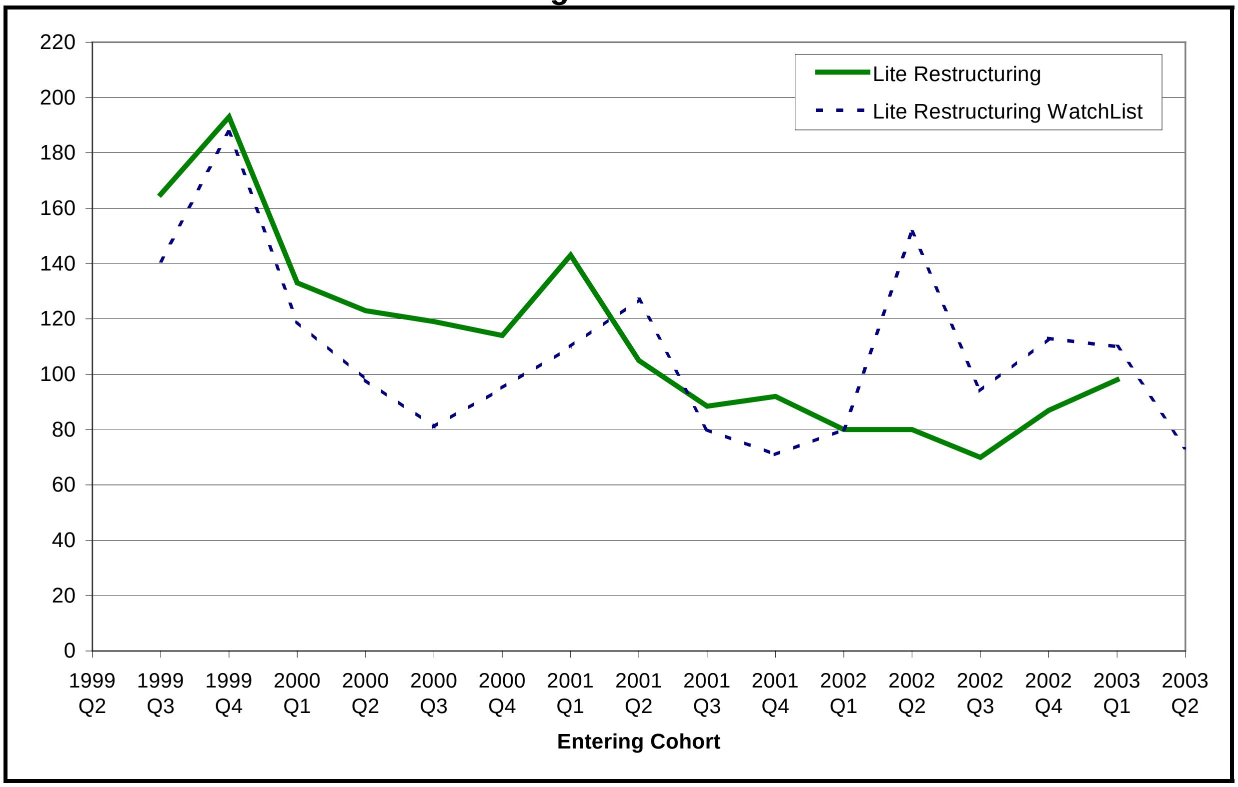
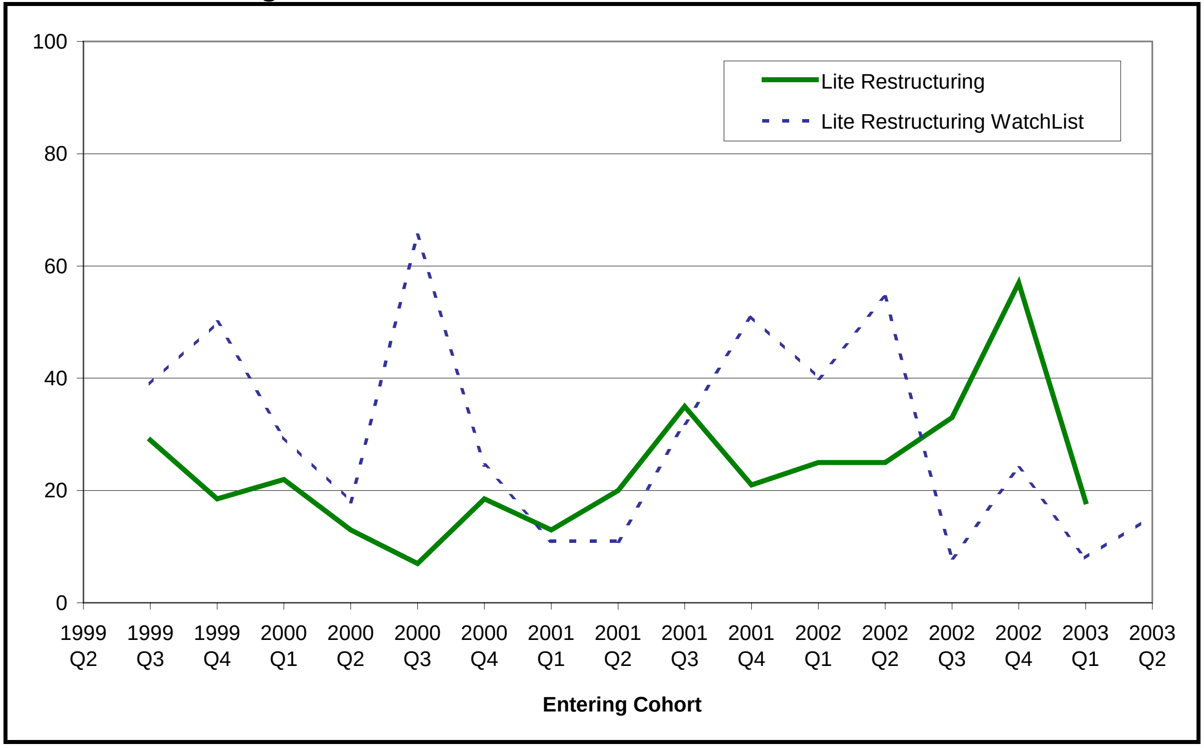


Figure 5.4
Median Number of Days Elapsed Between Plan Submission and Completion—Lite Restructuring



Similar analysis has been performed for Full restructurings. Figure 5.5 shows the median days elapsed between assignment acceptance and plan submission for the three types of Full restructurings. The median duration across all cohorts is 219 days, 261 days, and 264 days for Fulls closed at market rent, Fulls closed at exception rent, and Watch List Fulls, respectively. Once again, we observe a marked decline in the processing time across cohorts for all three outcome types, with reductions amounting to almost 50 percent. In general, Fulls closed at exception rent require a longer time to complete this phase of the processing.

The median number of days required to complete a Full restructuring starting from the plan submission stage is presented in Figure 5.6. The duration oscillates widely, and there are no discernible patterns over time for all three of the restructuring outcomes.

This analysis shows that, for both Lite and Full restructurings, most of the efficiency gain over the course of OMHAR's history is attributable to the shortening of processing time between the PAE's acceptance of assignment and plan submission.

Figure 5.5
Median Number of Days Elapsed Between PAE Acceptance of Assignment and Restructuring Plan Submission—Full Restructuring

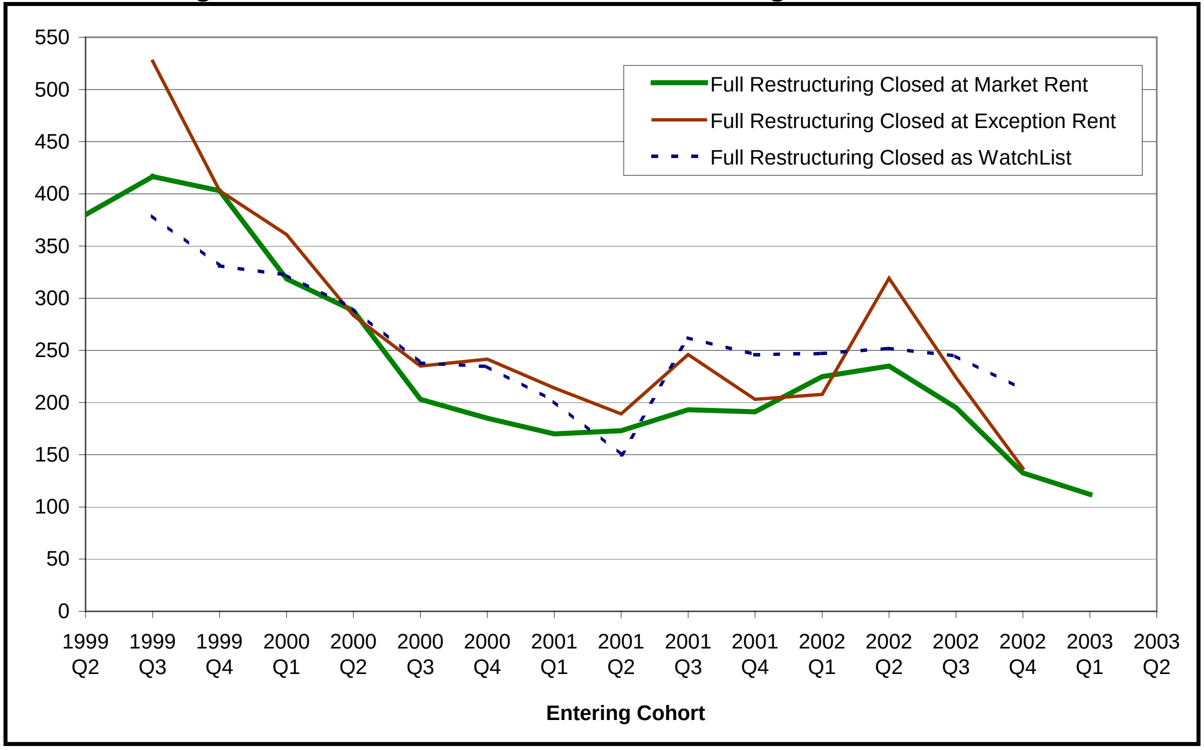
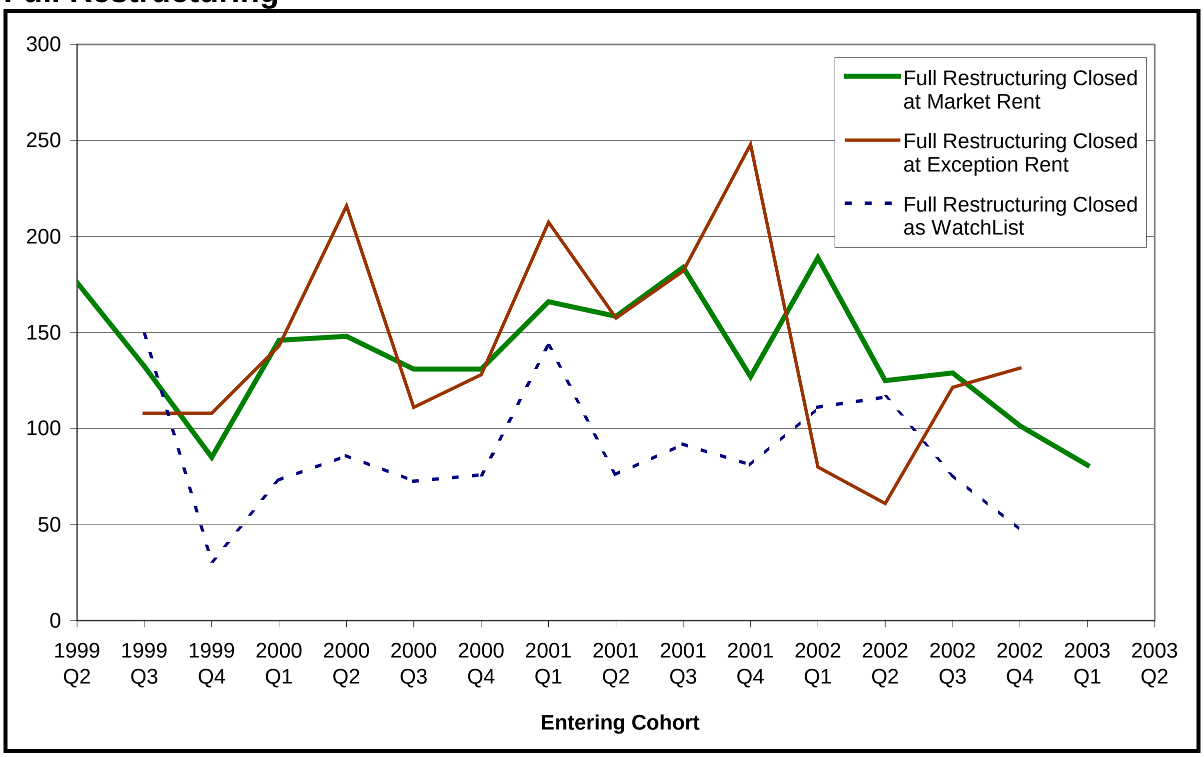


Figure 5.6
Median Number of Days Elapsed Between Plan Submission and Completion: Full Restructuring

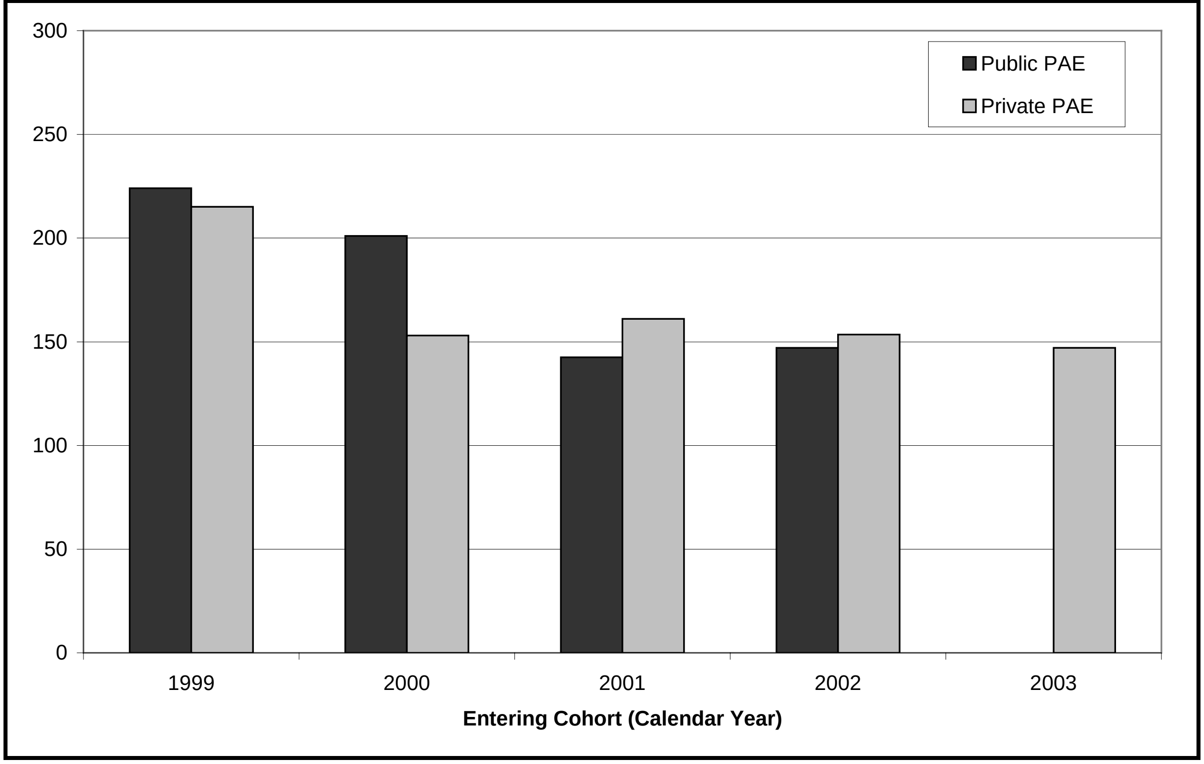


Processing Time by PAE Type

The remaining portion of this chapter examines the issue of relative efficiency between public and private PAEs. It is important to stress that, especially for the recent cohorts of transactions, many of the public PAEs subcontracted much of the processing work to private PAEs. We focus our analysis on the total completion time (that is, days elapsed between assignment acceptance and completion), stratified by restructuring outcome type and entering cohort (calendar year).

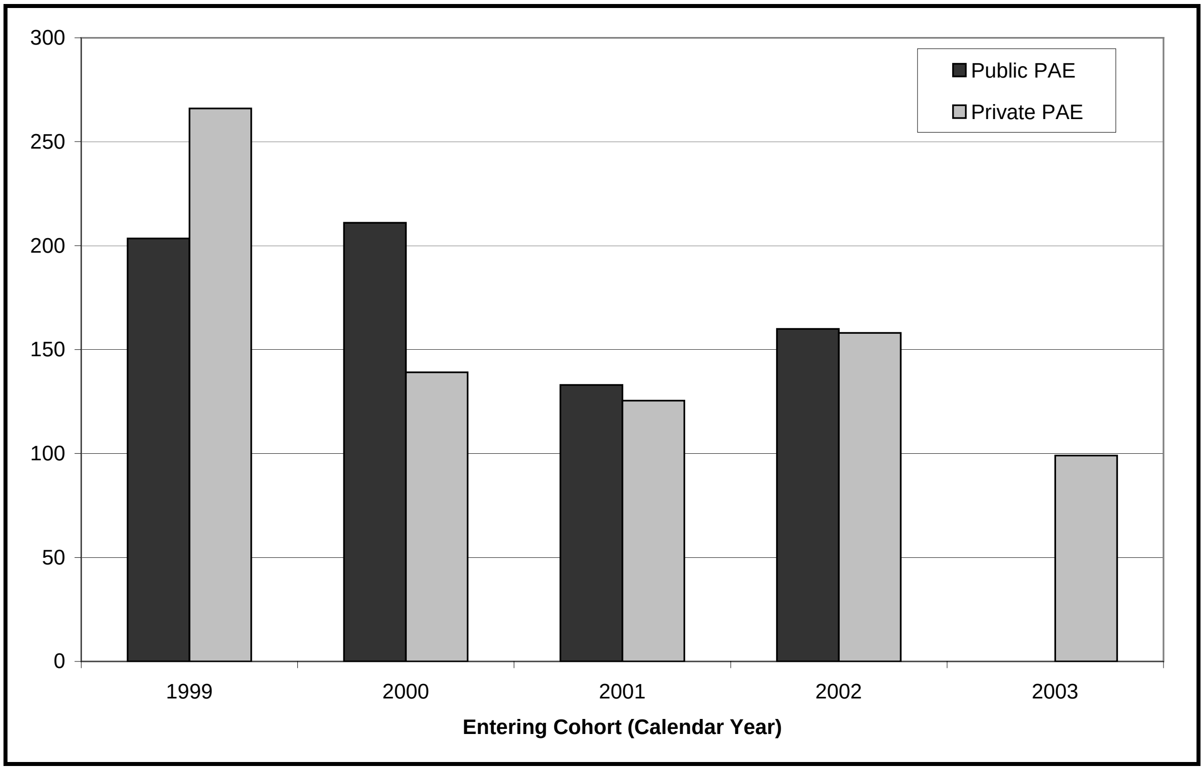
Figure 5.7 compares the median completion time for regular Lite transactions processed by public and private PAEs. The median completion time for all cohorts combined is 161 days for the private PAEs and 203 days for the public PAEs, implying that the private PAEs tend to be more efficient overall. The figure also shows that, over time, both types of PAEs have become more efficient. For projects that entered the pipeline during 2001 and 2002, public PAEs require slightly fewer days to complete the transactions.

Figure 5.7
Median Completion Time (Number of Days) by PAE Type—Lite Restructuring



Analysis for Lites closed at watchlist is presented in Figure 5.8. For all cohorts combined, private PAEs have a shorter completion time for such restructuring (134 days vs. 196 days). For the recent cohorts, however, the median processing time is almost identical across the two PAE types.

Figure 5.8
Median Completion Time (Number of Days) by PAE Type—Lite Restructuring Watch List



Similar comparisons for the Full restructurings are shown in the subsequent three figures. Analysis for the Fulls closed at market rent is presented in Figure 5.9. The median completion time for all cohorts combined is 387 days for the private PAEs and 458 days for the public PAEs. While the private PAEs appear to be more efficient overall, completion time for the more recent cohorts is extremely close between the two types of PAE. This most likely reflects the fact that, for the recent cohorts of transactions, many of the public PAEs subcontracted much of the work to private PAEs. Both types of PAEs appear to have become more efficient in terms of completion time.

Figure 5.10 shows the median completion time for Fulls closed at exception rent. For all cohorts combined, public PAEs (435 days) appear to hold a slight edge relative to the private PAEs (459 days) in terms of median completion time. The figure indicates that for the 1999, 2000, and 2001 cohorts of transactions, the public PAEs required fewer days to complete such restructurings. The reason for this processing time differential is unknown. It is worth pointing out that the number of exception rent transactions processed by the public PAEs each year was substantially smaller relative to the volume assigned to the private PAEs. It is likely that the public PAEs were able to dedicate more staff time to those transactions.

Analysis for the Fulls closed as Watch List is presented in Figure 5.11. The median completion time for all cohorts combined is 346 days for the private PAEs and 402 days for the public PAEs.

Figure 5.9
Median Completion Time (Number of Days) by PAE Type—Full Restructuring Closed at Market Rent

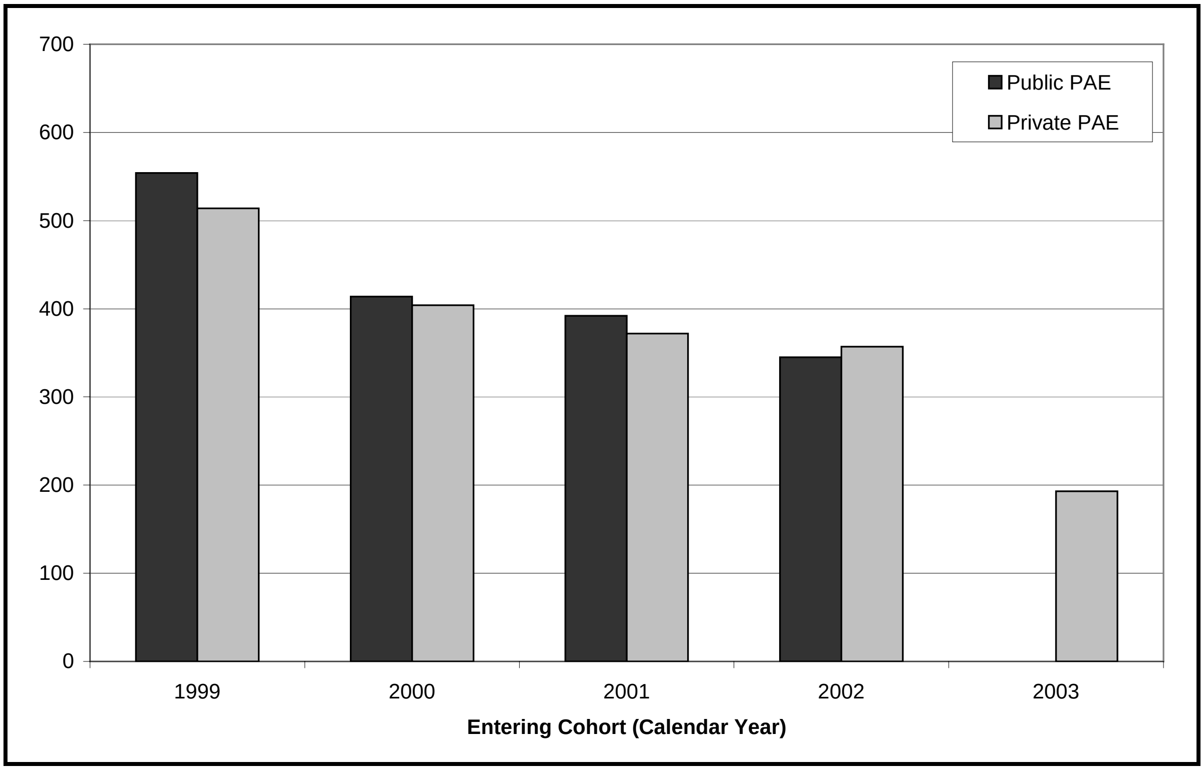


Figure 5.10
Median Completion Time (Number of Days) by PAE Type—Full Restructuring Closed at Exception Rent

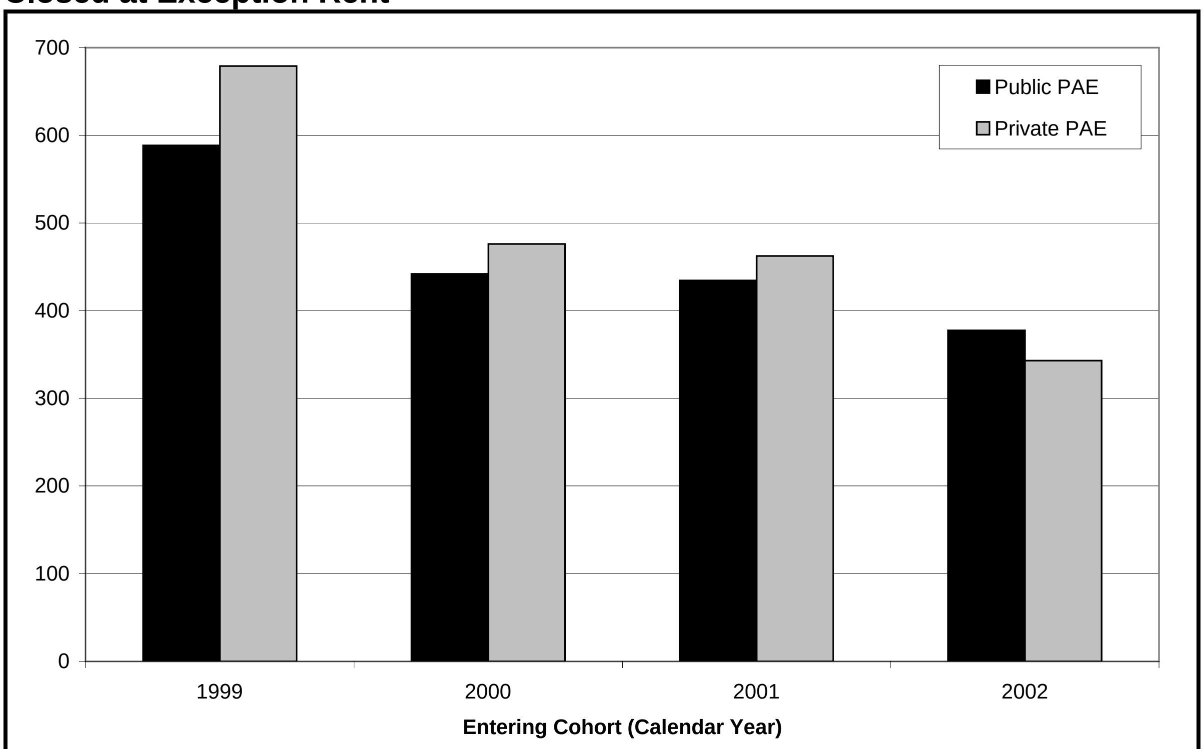
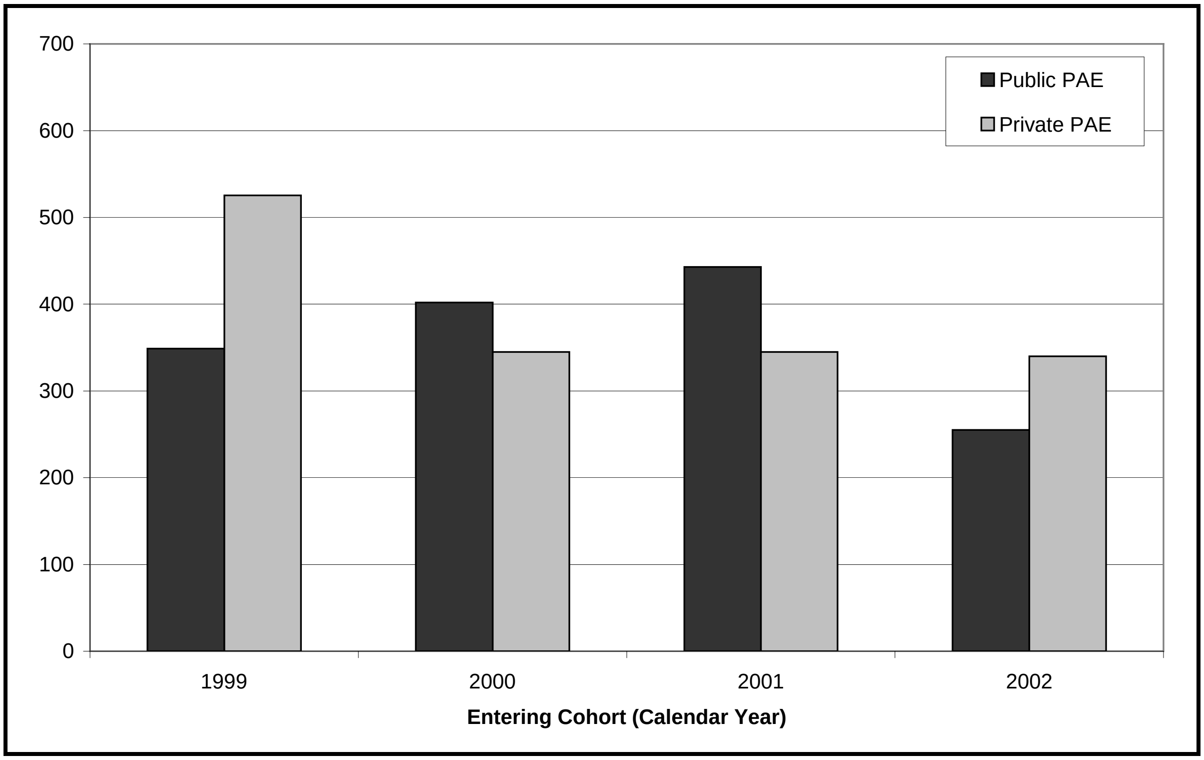


Figure 5.11
Median Completion Time (Number of Days) by PAE Type—Full Restructuring Watch List



Conclusion

As expected, we found that Full restructurings generally take more time to process than Lite restructurings. Because of the extra processing step involved, Fulls closed at exception rents tend to require the longest processing time. Processing time for all restructurings has been shortened over the course of OMHAR's history. Regardless of the restructuring types, the majority of the processing time is spent between the PAE's acceptance of the asset assignment and the submission of the restructuring plan. This portion of the processing time has declined markedly across the cohorts of transactions we examined. There appear to be no discernable trends for the duration between plan submission and final closing.

Both public and private PAEs have become more efficient in terms of processing time over the course of OMHAR's history. For almost all of the restructuring types, private PAEs require a slightly shorter time period for completion.

6. Analysis of Program Outcomes

Introduction

This chapter examines the housing outcomes of the Mark-to-Market program in terms of the goal of preservation of the affordable housing stock. One measure of program outcome is the location of properties that received treatment—that is, whether the program is preserving affordable rental stock located in high-cost, low vacancy, tight housing markets where vouchers may be difficult to use. Location results are presented in Chapter Three (Participation in the Mark-to-Market Program) of this report.

The Statement of Work raises some other outcome-related questions:

- Does the Mark-to-Market process assure that the properties remain financially and physically viable as affordable rental projects?

- How do Lite restructurings and Full restructurings differ in terms of financial and physical viability?

- Do Lites and Fulls differ in terms of post-restructuring performance?

To address these research questions, this chapter proceeds as follows:

- We first examine the underwriting standards developed by OMHAR and used by PAEs to process the Lite and Full transactions. Comparisons are made between the M2M underwriting guidelines and those used to originate multifamily mortgages in the conventional market and for loans of other FHA programs. The objective is to assess whether the M2M guidelines are adequate and appropriate when compared to the industry standards.

- Physical viability of the M2M properties will be measured largely by the REAC physical inspection scores, the initial deposit to replacement reserves, and the rehab escrow amounts that are required as part of the restructuring agreement.

- Additional analysis focuses on the financial performance of a cohort of the M2M properties that have undergone restructuring, comparing their pre- and post-restructuring operating outcomes. Because of the limited amount of financial data available in the post-restructuring period, we can provide only a snapshot estimate of these properties' performance.

- The last section provides a summary of the findings of this chapter.

Analysis of the M2M Underwriting Standards

An important feature of the M2M program is underwriting. In order to help ensure that properties remain viable over the long term, program underwriting needs to be rigorous and detailed. In the following section we highlight key features of the M2M underwriting process.

The PAE plays the lead role in underwriting both Full and Lite transactions. The OMHAR-developed underwriting model is used to assemble and analyze data needed to process each Full transaction. Once the PAE has completed underwriting and the results have been incorporated into a recommendation for a Lite or a restructuring plan for a Full, the recommendation or plan is submitted to OMHAR for a quality control underwriting review. Both the PAEs and OMHAR have engaged numerous professionals who are highly experienced in real estate underwriting and finance.

Below we describe the key components of the M2M underwriting for a Full restructuring, followed by a brief description of how underwriting proceeds for a Lite transaction.

Gross Revenue and Income

An important component of underwriting is determining Net Operating Income (NOI), which is the net revenue that could be generated from the property. This estimation includes calculating the gross potential rent from all rental units in the property plus income derived from other sources such as from commercial space, parking, laundry facilities, etc. The gross potential rent is calculated in two ways based on: a) comparable market rents and b) affordable rents that are required by statute to be used in the Low Income Housing Tax Credit program. Where the need is justified, the PAE may use Section 8 exception rents that exceed the market rents, in order to ensure the physical and financial viability of a project. For purposes of calculating NOI the PAE must use the lower of market rents or affordable rents, ensuring that the more conservative estimate is used so that the property can remain viable with affordable rents even in the event the Section 8 subsidy becomes unavailable. Regular FHA and conventional multifamily underwriting use market rent in calculating income.

The PAE uses a limited scope appraisal and its own site visit as the primary source for estimating comparable rents. For areas where comparable rents are few (such as remote rural areas), the appraiser's and PAE's professional judgment are especially needed.[17] This process is no different than if a non-M2M property were being underwritten in the same area.

Once gross income has been calculated, a downward adjustment is made for vacancy and bad debt/collection losses that may occur in both the residential space and the commercial space (if any). A similar adjustment is also typical for underwriting FHA and conventional loans. For an M2M property, the adjustment is determined by examining the historical vacancy and debt experience of the project and the relevant market information to derive separate vacancy

[17] For areas where no comparable rents can be found, the M2M legislation has suggested that the PAE should use 90% of the Fair-Market-Rent (FMR) as the benchmark.

rate and bad debt/collection factors. In addition, OMHAR requires certain minimum assumptions for each factor, assuring a more conservative assumption than if historical experience suggests lower rates. For residential vacancies, the PAE must assume at least 5 percent, while for bad debt/collection the minimum assumption is 2 percent. Underwriting of conventional market or other FHA loans uses assumptions that are similar to these.

Operating Expenses

A second underwriting component required for determining NOI is a project's operating expenses. These expenses include such items as utilities, management fees, insurance, repair and maintenance (separate from the reserve for replacement, discussed below), as well as the capital recovery payment, which is an allowance given to an owner as an incentive to participate in a Full M2M restructuring (see below). The data sources used to determine operating expenses include the limited scope appraisal, the previous three years of actual operating data, industry standards, and owners' data, as well as information from utility companies, insurance agents, taxing bodies, contractors, and input from HUD field office staff. The guidance provided by OMHAR to the PAEs on each of these items is generally consistent with that for conventional loans and regular FHA loans.

Reserve for Replacement

A third component of underwriting under the M2M program is the timing and estimated cost of replacing significant items in restructured properties. (This does not include estimates for immediate repair/rehabilitation, discussed below under Rehabilitation Escrow.) OMHAR requires a year-by-year breakdown of these items for the proposed mortgage term plus two years, a practice generally not required for regular FHA loans or for conventional market loans. The OMHAR requirement is a more detailed, longer-term assessment than is typically performed by the conventional market.

The study team heard from various stakeholders and other participants that this aspect of the M2M program was one of the major successes of the program. In many cases, an adequate reserve for replacement account for these properties is being fully funded for the first time. The detailed Physical Condition Assessment (PCA) performed by professional assessors, as well as comments from residents and reviews and adjustments by PAEs, help to give a good picture of the current physical condition of the property and provide the basis for scheduled replacement of key components. The underwriting model then helps to frame the cash flow impact of these costs over time and establish the proper funding for these expenses. Moreover, the PAE underwriter is required to incorporate an annual increase in the amount of deposits to the reserve account by an Operating Cost Adjustment Factor (OCAF), to assure full funding of this account and incorporate any impact on costs from inflation.

Net Operating Income (NOI) and First Mortgage

For most rental properties the standard definition of Net Operating Income is rental revenue minus standard operating expenses, allowing for contingency factors such as vacancies, and capital maintenance requirements. In M2M another expense is subtracted from revenue, which is the capital recovery payment to the owner. The rental revenue minus these expenses results in the adjusted NOI for a property. Once adjusted NOI is established, the PAE will determine how much, if any, mortgage can be serviced and still leave adequate cushion (see below). Ideally, the first mortgage would cover the cost of the required rehabilitation (minus the owner's 20 percent contribution) plus the transaction costs (minus the owner's 20 percent contribution), plus the amount of outstanding mortgage. However, this rarely occurs. Therefore, OMHAR normally pays down the outstanding mortgage—to zero, if necessary. If the NOI cannot support the mortgage necessary to cover repair/rehab and transaction costs, Section 8 exception rents are provided, if justified by a need for affordable housing.

The starting point for determining the amount of the first mortgage that can be supported is the NOI calculated for the property. In a conventional and regular FHA multifamily property, the NOI is divided by a factor, the *Debt Service Coverage Ratio* (*DSCR*), to derive the amount of debt service that can be supported by the property. The higher the ratio, the more conservative the assumption about how much debt can be supported by property revenue. A prudent underwriter will generally not structure a deal so tightly that a minor, unexpected increase in expenses or reduction in rental income would cause the project to fail financially. To provide that margin of safety, lenders will require an appropriate DSCR in underwriting.

At the inception of the M2M program, based on underwriting practice in the conventional market, OMHAR suggested a DSCR of 1.2 to 1.4 as providing an appropriate level of safety margin for M2M transactions. In other words, all transactions had NOI that was 20 to 40 percent greater than the debt service on their new first mortgages. However, after developing experience with the program, it was felt that this margin might not be adequate. Many of the loans are very small relative to the size of the project, a unique characteristic of the M2M program. Consequently, the dollar amount needed to service that small debt is also very low. An overage of 20 to 40 percent of this small amount is, in turn, a small amount. OMHAR underwriters recognized this fact and deemed this amount to be inadequate to provide a cushion for unexpected rises in expenses or vacancies in a project of any size.

For this reason, in early 2002, OMHAR required an approach where all transactions, regardless of the DSCR, must have an NOI that provides a cushion of 7 percent to 10 percent of their total expenses, over and above the amount needed to service the new first mortgage debt. In some cases, this may result in a DSCR of 3.0 or 4.0.

Return to Owner

Prior to 2000, OMHAR closed very few M2M Full restructurings. After a series of stakeholder meetings in the summer of 2000, two additional financial incentives were added to the surplus cash payment in order to induce owners to complete a Full restructure through successful closing. These payments were created to secure owner participation in M2M by providing a fair return on new money invested in the property. Payments are made in such a way as to assure efficient operation of the property after restructuring.

The current underwriting of M2M properties now includes three possible incentives, collectively known as the Owners Incentive Package (OIP):

- Capital recovery payment.
- Incentive performance fee.
- Share of surplus cash.[18]

With the creation of this package, owners were given a financial reason for completing a successful restructuring, while at the same time providing an incentive to owners to maintain the properties in good physical and financial condition.

The *capital recovery payment* (CRP) is a payment that provides the owner with a rate of return on new money invested in the property for repair/rehabilitation and transaction costs. The rate of return would be equivalent to rate for alternative investments found in the market, which has recently been about 7 percent on an annualized basis. The CRP is included as an expense for underwriting and is incorporated into the calculation of adjusted NOI. Assuming that certain terms and conditions are met and that funds are available, the CRP will be paid to the owner. If no funds are available, payment accrues until a later date when surplus cash is available.

The *incentive performance fee* (IPF) provides an incentive to the owner to operate the property efficiently and minimize operating expenses. Unlike the CRP, the IPF is not included as an expense and does not reduce the NOI used in underwriting. As with the CRP, certain terms and conditions must be met before the IPF is paid. However, if no funds are available after payment of expenses, debt service on the first mortgage, and any capital recovery payment, the IPF will not be paid, nor will it accrue for payment at a future date.

If s*urplus cash* is available after payment of all operating expenses, debt service on the first mortgage, and the CRP and IPF payments, the owner will receive up to 25 percent of the remaining amount. The remainder of the surplus cash is paid toward the M2M second and third mortgages (if any). An example of this underwriting calculation appears in Table 6.1.

[18] The “share of surplus cash” incentive existed before the introduction of the Owners Incentive Package.

Table 6.1: Calculating Adjusted NOI and Surplus Cash Flow

Gross Potential Rent @ Market	**$1,020,000**
- vacancy loss and bad debt (@ 7%)	**- 71,400**
- operating expenses	**- 720,000**
- capital recovery pmt to owner	**- 10,000**
- replacement reserves	**- 75,000**
Adjusted NOI	**$ 143,600**
- 1st mortgage debt service	**- 106,000**
- incentive performance fee to owner	**- 28,500**
Surplus Cash Flow	**$ 9,100**
- 75% to second mortgage	**- 6,825**
- 25% to owner	**- 2,275**

Rehabilitation Escrow

The immediate rehabilitation requirements are identified in the PCA and adjusted by the PAE as needed.[19] Tenant-identified needs play a major role in determining the items that should be included in the rehabilitation escrow. The M2M legislation limits the scope of the repairs to those "for the purpose of restoring the project to a non-luxury standard adequate for the rental market intended at the original approval of the project-based assistance." These may include the replacement of roofs and windows, installation of fire-resistant doors and security lighting. However, the program is not designed to handle repairs/rehabilitation beyond a reasonable limit – about $10,000 per unit, according to one of OMHAR financial advisors.

Partial (or full) Payment of Claim

The calculation of the partial payment claim is unique to the M2M process and without a parallel in the conventional market. The amount of the claim is based on the size of the existing and new first mortgages, the deposit to the reserve for replacement account, transaction costs, amount invested by the owner, incentive payments to the owners, and the rehabilitation escrow.

In no case may the claim be more than the unpaid principal balance (UPB) of the insured first mortgage prior to restructuring. In virtually all restructurings, the partial claim is more than just the difference between the UPB on the existing first mortgage and the restructured first mortgage supportable by the new restructured NOI. In most cases, the partial claim payment will also include amounts to cover the initial deposit to the reserve for replacement account, and a portion of the immediate rehabilitation costs and transaction costs approved by the PAE for the restructuring.

[19] Rehabilitation in this context does not include substantial rehabilitation as defined by FHA.

Second and Third Mortgages

As with the partial payment of claim, simultaneously underwriting the second and third mortgages (where applicable) is another unique element of the M2M program. These loans attempt to recapture at least a portion of the amount of the claim paid as part of the restructuring. Payment on these loans is required only from cash available after the first mortgage payment and the Incentive Performance Fees are paid. If surplus cash is available, a minimum of 75 percent of this amount is required for payment on the second and third mortgages, with the remaining 25 percent paid to the owner as part of his or her return.

OMHAR has provided guidance to the underwriters on sizing second mortgages to determine an amount that can "reasonably expected to be repaid." It is still too early to tell how these loans will perform, as only the first year of data is available at the time of this report and may not be typical of future performance.

Underwriting Lite Transactions

The previous discussion has focused on OMHAR's guidance for underwriting a Full restructuring. In some cases, however, properties may qualify for contract renewal as a Lite transaction. A Lite transaction involves marking down rents only and does not involve a restructure of the existing mortgage. Rarely, a Lite may include refinancing the existing mortgage to achieve a reduced interest rate, but no partial claim is paid as part of the transaction.

OMHAR has established two forms of Lite transactions – Tier I Lite and Tier II Lite. In a Lite transaction, the PAE determines the rent and the immediate and ongoing repair needs in the same manner as in a Full transaction. However, the PAE will only consider whether the income at market rent level could cover the operating expenses reported in the latest Audited Financial Statement and the determined repair needs. If the DSCR is 1.2 or greater, the property is processed as a Tier I Lite transaction. If the DSCR appears to be slightly lower than 1.2, the PAE would (1) conduct further analysis on the expenses and (2) consider whether a DSCR of 1.1 may be appropriate. Such transactions are called Tier II Lites. If it is determined that the property still does not appear to be viable, the PAE will recommend that the property be processed as a Full restructure.

Underwriting Lite transactions is easier and more streamlined than underwriting Full restructurings and involves less detailed analysis. For example, the underwriting model is not required for a Lite transaction. Other significant differences include:

- Lites receive a less detailed market rent study, rather than the detailed appraisal required for a Full restructuring.
- No adjustments to NOI are made for Capital Recovery Payments because the owner makes no financial contribution.
- There is no partial claim payment.
- There is no second or third mortgage.
- The mortgage may be refinanced under a Tier II Lite, but the UPB stays the same.
- There is no "cushion" built into the expenses.

- The minimum vacancy and collection loss factor is 5 percent, as opposed to 7 percent for Fulls.
- There is no rehab escrow.

Given the relatively strict tests for processing a property as a Lite and the owner incentive package available after the fall of 2000, very few Lite transactions continue to be processed. Even if a property renews as a Lite, it remains eligible for a Full restructuring in the future. This would trigger the more detailed and rigorous underwriting analysis.

In conclusion, the rigorous underwriting of M2M transactions is at least as thorough as standard FHA or conventional multifamily underwriting and therefore one should expect the underwriting to contribute to the long-term financial viability of the program.

Analysis of the Required Rehab Escrows and Initial Deposit to Replacement Reserves

One important feature of the M2M program that is likely to contribute to long-term viability of the properties is the program's emphasis on physical needs. As part of the underwriting for Full restructuring transactions, the property's reserve for replacement is calculated so as to ensure funding for ongoing repairs for the next 20 years. The initial deposit to the replacement reserve is fully financed as part of the new mortgage. Immediate capital needs (first year) are also included in the transaction, and 80 percent of immediate needs are funded through the program. Property owners pay for the remaining 20 percent of the immediate rehab costs. The provision of funds for rehab needs should have a large impact on the future viability of restructured properties.

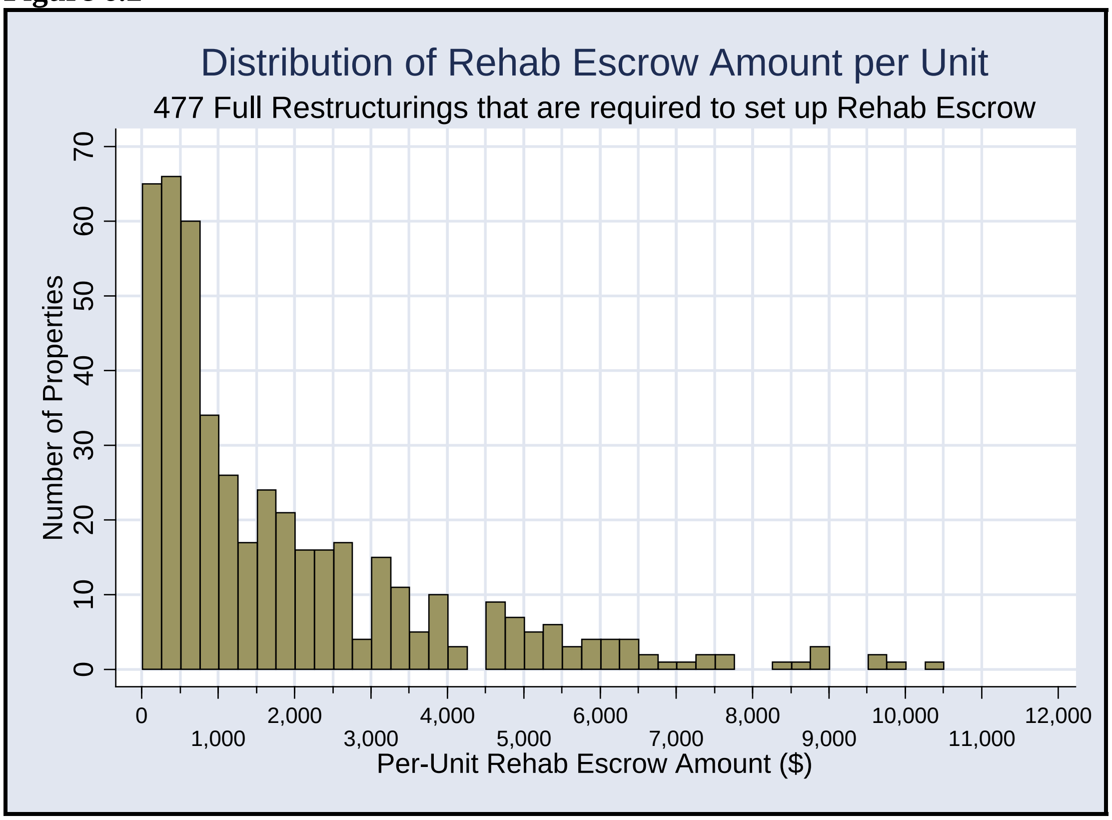
Table 6.2 shows the amounts required for the rehabilitation escrows for Full restructuring transactions. (These data are presented graphically in Figure 6.2.) As the table shows, for 477 Full transactions that required rehab escrows the average amount was $2,244 per unit (with a median $1,103). Consistent with their worse physical condition, escrows for properties that closed with exception rents were higher than for properties that closed at market rent—an average of $2,729 per unit compared with $2,044 per unit (the median escrow amount for exception rent deals was $2,045 per unit compared with $950 per unit for market rent transactions). The large differential between the average and median per-unit escrows for market rent transactions implies that the distribution is skewed – the majority of transactions required a relatively low level of escrows.

The total across all properties set aside for rehab escrows was over $114 million.

Table 6.2: Rehab Escrow Amounts Per Unit

	Closed at Market Rent	Closed with Exception Rents	All Fulls
Min	$9	$44	$9
25th Percentile	$404	$604	$466
Mean	$2,044	$2,729	$2,244
Median	$950	$2,054	$1,103
75th Percentile	$2,174	$3,991	$2,685
Max	$38,734	$12,207	$38,735
Total across all units	$86,264,426	$28,444,408	$114,708,834
Number of Properties	338	139	477

Figure 6.2



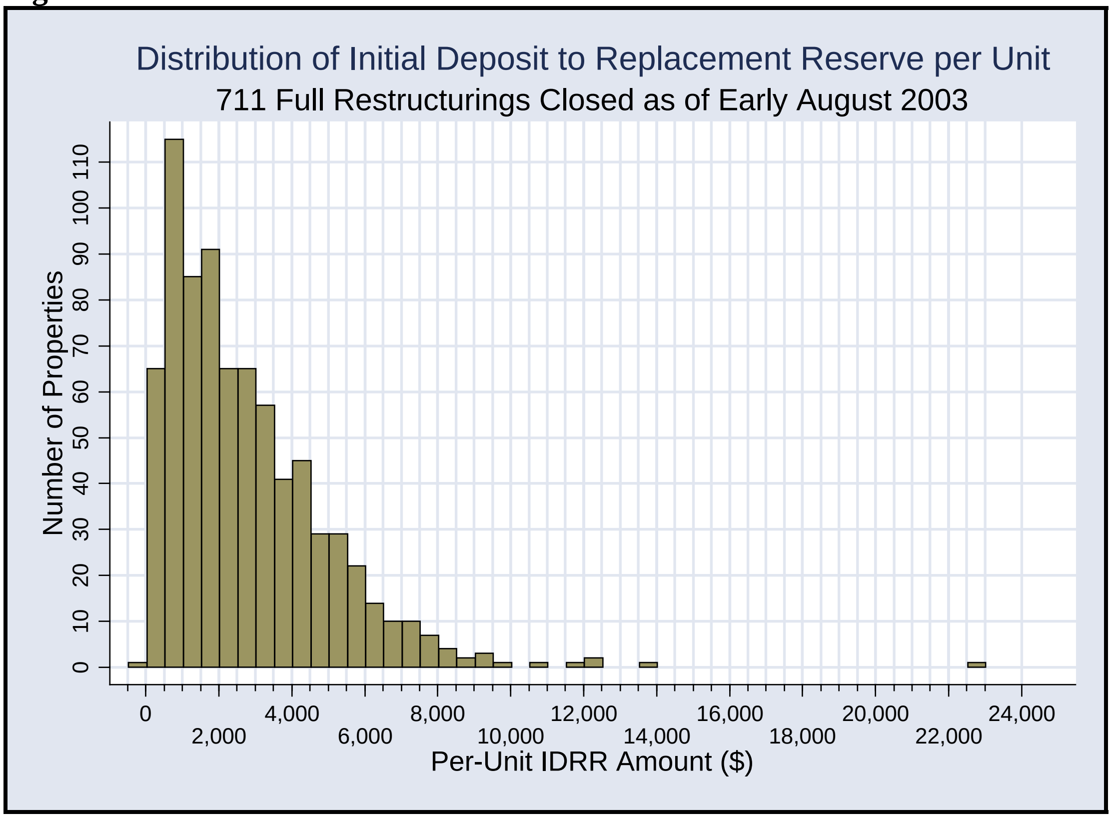
In addition to the rehab escrows that address immediate capital needs, the underwriting for Full transactions also addresses the expected capital needs – through deposits to the replacement reserve – for the next 20 years in order to ensure property viability. In cases where substantial repairs or replacements are projected to happen in the first few years after closing, funds are allocated as part of the M2M transaction for an initial deposit to the replacement reserve. As can be seen in Table 6.3 (and graphically in Figure 6.3), the average initial deposit to the replacement reserve is $2,752 per unit, with a median of $2,206. As was the case with escrow accounts, the initial deposits are higher for exception rent transactions, averaging $3,367 per unit with a median of $3,000. The average is $2,512 for market rent transactions, with a median of $1,974.

Across all units the initial deposits to the replacement reserves total over $164 million.[20]

Table 6.3: Initial Deposit to the Replacement Reserve per Unit

	Closed at Market Rent	Closed with Exception Rents	All Fulls
Min	$73	$25	$25
25th Percentile	$1,014	$1,464	$1,125
Mean	$2,512	$3,367	$2,752
Median	$1,974	$3,000	$2,206
75th Percentile	$3,478	$5,033	$3,900
Max	$22,769	$10,667	$22,769
Total Across All Units	$110,833,573	$53,901,165	$164,734,738
Number of Properties	552	215	767

Figure 6.3



In cases where critical repairs (life threatening repair needs) pertaining to health and fire hazards are identified in the Physical Condition Assessment (PCA) document during the restructuring process, property owners are required to fix those problems before closing. After closing, owners are expected to draw funds from the rehab escrow and complete the other M2M-required repairs over the subsequent 12-month period. Taken together, these funds for the rehab escrow and the initial deposits to the replacement reserves represent a tangible benefit for tenants residing in these HUD-assisted properties. As a result of M2M, the tenants are able to live in units that are safer, of higher physical quality, and better maintained.

[20] Our estimate does not include prior balance in the replacement reserve.

Comparisons of Pre- and Post-Restructuring Property Performance

The remaining portion of this chapter compares the performance of a set of M2M properties in the pre- and post-restructuring periods using financial data from the Annual Financial Statements (AFS) assembled by HUD's REAC (Real Estate Assessment Center). Physical inspection scores from REAC are used as a proxy to examine whether there are changes in the property's physical condition after the restructuring.

To ensure that there are sufficient AFS data in the pre- and post-restructuring periods for comparison, we focus our analysis exclusively on the M2M transactions completed during calendar years 2000 and 2001. This results in a total of 903 completed transactions: 362 closed Lites, 285 Fulls closed at market rents, 77 Fulls closed at exception rents, and 179 Watch List properties. For the year 2000 cohort of properties, data for the pre-restructuring period are based on the average of the 1998 and 1999 data, while an average of the 2001 and 2002 data is used for the post-restructuring period.[21] For the year 2001 cohort of properties, a simple 3-year average of the 1998-2000 data is used for the pre-restructuring period, while data for the post-restructuring period are based on the 2002 data.[22] For ease of comparison, all dollar amounts are converted to a per-unit-month basis and adjusted to the year 2002 values using the Consumer Price Index published by the Bureau of Labor Statistics.

Since we have only one to two years of financial data for the post-restructuring period, the comparison results may not predict these properties' long-term performance. (For those closed during 2001, there is only one year of post-restructuring financial data.) This is especially the case for the Full restructuring properties, because the M2M closing requirements make their cash flow and surplus cash levels anomalous for the closing year. In particular, surplus cash is likely to be negative because the M2M rehab costs have been incurred, but the reimbursement from the M2M rehab escrow may not have occurred yet. Similarly, operating expenses right after closing may not be typical. Our analysis, nonetheless, provides a snapshot estimate of these properties' performance before and after the restructuring.

Table 6.4 presents a comparison of the operating characteristics of these M2M properties in the pre- and post-restructuring periods, stratified by restructuring outcome type. A concern in this analysis is that observed changes in these variables may be driven by factors that are external to the M2M program (such as local housing markets and neighborhood factors).

The financial variables are:

- Rental vacancy rate.
- Administrative expenses.
- Utilities expenses.
- Operating and maintenance expenses.

[21] For cohorts with multiple years of performance data, we reported the average across years because it mitigates the year-to-year variations due to idiosyncratic factors.
[22] The 2003 AFS data were not available when the evaluation team was preparing this report.

- Taxes and insurance expenses.
- Total operating expenses (administrative + utilities + operating and maintenance + taxes and insurance).

To reduce the impact of extreme values in the financial data, we report the median value of each variable for each of the restructuring outcome groups. The second panel of the table highlights, for each variable, the median percentage increase and decrease in the value and the proportion of properties in which the specific operating variable has increased or decreased.

The table shows that, across all four restructuring outcome groups, median total operating expenses have declined in the post-restructuring period. Fulls closed at exception rent tend to have higher total operating expenses relative to the other groups in both the pre- and post-restructuring periods. For example, in the post-restructuring period, the median operating cost is $413 for the exception rent properties, compared to $333 for the Fulls closed at market rent, $332 for the Lites, and $320 for the Watch List properties. Further examination of the sub-categories of the expenses suggests that this higher cost is largely due to higher operating and maintenance expenses. Another important observation is that the median expense levels associated with taxes and insurance have increased across the board in the post-restructuring period. Among those properties with increased operating and maintenance expenses, the median increase ranges from 16 percent to 21 percent across the four groups of properties. These increases are most likely associated with the overall increases in insurance cost in the nation because of the events of September 11, 2001.

Among the four groups, Full restructurings appear to have the largest proportion of properties in which total operating expenses had increased in the post-restructuring period—49 percent for the Fulls closed at market rent and 44 percent for the exception rent Fulls. The range of increase is 8 percent for Fulls closed at market rent and 6 percent for exception rent Fulls.

Vacancy rate is another important indicator of a property's operation, because it represents a loss of potential rental income. As shown in the table, there appears to be a slight increase in the median vacancy rate for Lites and exception rent properties, while the vacancy rate for the Watch List group as a whole has decreased after the restructuring. The reason for these changes is unknown. It is worth stressing that the vacancy rates of these developments are, to a large extent, driven by the demand and supply of the housing markets and by neighborhood factors that are external to the property's management and physical condition.

Table 6.4
Comparison of Pre- and Post-Restructuring Operation Characteristics of Completed Lite Restructurings and Full Restructurings (903 Restructurings Closed during Calendar Years 2000 and 2001)

MEDIAN PER-UNIT-MONTH	LITE RESTRUCTURING	FULL RESTRUCTURING: Closed at Market Rent	FULL RESTRUCTURING: Closed at Exception Rent	Lite and Full Watchlist
Pre-restructuring Vacancy Rate	1.5%	2.3%	4.4%	3.5%
Post-restructuring Vacancy Rate	2.0%	2.3%	5.0%	3.0%
Pre-restructuring Administrative Expenses	$109	$105	$115	$107
Post-restructuring Administrative Expenses	$102	$101	$112	$96
Pre-restructuring Utilities Expenses	$58	$45	$78	$59
Post-restructuring Utilities Expenses	$61	$46	$76	$59
Pre-restructuring Operating & Maintenance Expenses	$123	$114	$162	$124
Post-restructuring Operating & Maintenance Expenses	$105	$111	$144	$106
Pre-restructuring Taxes & Insurance Expenses	$59	$59	$69	$57
Post-restructuring Taxes & Insurance Expenses	$60	$63	$70	$59
Pre-restructuring Total Operating Expenses	$362	$335	$437	$359
Post-restructuring Total Operating Expenses	$332	$333	$413	$320
Proportion of Properties in Which Vacancy Rate Increased	45%	51%	53%	43%
Median Percentage of Increases	100%	100%	80%	125%
Proportion of Properties in Which Vacancy Rate Decreased	37%	41%	42%	48%
Median Percentage of Decreases	-54%	-50%	-42%	-50%
Proportion of Properties in Which Administrative Expenses Increased	35%	35%	46%	35%
Median Percentage of Increases	7%	6%	8%	8%
Proportion of Properties in Which Administrative Expenses Decreased	65%	65%	54%	65%
Median Percentage of Decreases	-10%	-10%	-11%	-14%
Proportion of Properties in Which Utilities Expenses Increased	60%	55%	47%	50%
Median Percentage of Increases	12%	12%	11%	10%
Proportion of Properties in Which Utilities Expenses Decreased	40%	45%	53%	50%
Median Percentage of Decreases	-7%	-8%	-10%	-10%
Proportion of Properties in Which Operating & Maintenance Expenses Increased	32%	45%	36%	32%
Median Percentage of Increases	16%	19%	17%	21%
Proportion of Properties in Which Operating & Maintenance Expenses Decreased	68%	55%	64%	68%
Median Percentage of Decreases	-19%	-18%	-16%	-20%
Proportion of Properties in Which Taxes & Insurance Increased	60%	70%	71%	61%
Median Percentage of Increases	12%	13%	18%	14%
Proportion of Properties in Which Taxes & Insurance Decreased	40%	30%	29%	39%
Median Percentage of Decreases	-11%	-14%	-16%	-9%
Proportion of Properties in Which Total Operating Expenses Increased	36%	49%	44%	34%
Median Percentage of Increases	7%	8%	6%	10%
Proportion of Properties in Which Total Operating Expenses Decreased	64%	51%	56%	66%
Median Percentage of Decreases	-10%	-9%	-9%	-11%
Number of Properties	362	285	77	179

Comparisons based on additional performance indicators are shown in Table 6.5.

The performance indicators include:

- REAC overall physical inspection score (1-100).
- REAC overall financial performance score (1-100).
- Expense-to-income ratio.
- Debt Service coverage ratio.
- Quick ratio.
- Surplus cash level.

We use the REAC physical inspection score as a proxy for the property's general physical condition. The table indicates that the score has increased for the majority of the properties since restructuring. Among the four restructuring outcome types, while Fulls closed at market rent have the highest pre-restructuring median score (83), this group also has the largest proportion (47 percent) of properties with decreased score. Nonetheless, the median level of decrease is not alarming (12 percent).

All other measures shown on the table are designed to capture the financial soundness of these properties' operation.

The REAC financial performance score is a composite measure based on a series of other financial indicators. In general, properties with a score above 60 are considered to be financially healthy. As can be seen from the table, the median score is above 60 across the board in the post-restructuring period. Lites have the highest median score in both the pre-restructuring (80) and post-restructuring (75) periods relative to the other groups. In contrast, the Watch List properties appear to have the lowest median score among the four groups in both the pre-restructuring (70) and post-restructuring (61) periods. A worrisome observation is that about half of both Fulls closed at exception rents and Watch List properties had a performance score below 60 in the post-restructuring period. In addition, all four groups of properties have experienced a decrease in the median performance score since restructuring.

The expense-to-income ratio variable is intended to gauge whether the operating incomes are sufficient to cover expenses (excluding debt services). Ratios less than 1 suggest that expenses are less than incomes. The data indicate that, while the post-restructuring ratio has increased for all the restructuring outcome types except for the Lites, all groups have a median ratio that is below 1 in both periods. This suggests that in general these properties have sufficient incomes to cover operating expenses in both periods.

Table 6.5: Comparison of Pre- and Post-Restructuring Performance of Completed Lite Restructurings and Full Restructurings (903 Restructurings Closed during Calendar Years 2000 and 2001)

Median	LITE RESTRUCTURING	FULL RESTRUCTURING		Lite and Full Watchlist
		Closed at Market Rent	Closed at Exception Rent	
Pre-restructuring REAC Physical Inspection Score	82	83	77	77
Post-restructuring REAC Physical Inspection Score	85	82	79	81
Pre-restructuring REAC Financial Performance Score	80	71	72	70
Post-restructuring REAC Financial Performance Score	75	68	61	61
Pre-restructuring Expense-to-income Ratio	0.64	0.62	0.78	0.69
Post-restructuring Expense-to-income Ratio	0.70	0.84	0.94	0.74
Pre-restructuring Debt-service-coverage Ratio	1.82	1.20	1.24	1.31
Post-restructuring Debt-service-coverage Ratio	1.27	1.17	0.78	0.98
Pre-restructuring Quick Ratio	1.11	0.68	0.72	0.59
Post-restructuring Quick Ratio	1.20	0.70	0.47	0.39
Pre-restructuring Surplus Cash	$742	$248	$28	$170
Post-restructuring Surplus Cash	$287	$99	-$97	-$117
Proportion of Properties with Increased REAC Physical Inspection Scores	57%	46%	57%	57%
Median Percentage of Score Increases	16%	14%	22%	27%
Proportion of Properties with Decreased REAC Physical Inspection Scores	41%	47%	43%	42%
Median Percentage of Score Decreases	-11%	-12%	-10%	-10%
Proportion of Properties with Increased REAC Financial Performance Scores	30%	37%	31%	27%
Median Percentage of Score Increases	8%	15%	24%	10%
Proportion of Properties with Decreased REAC Financial Performance Scores	68%	63%	67%	69%
Median Percentage of Score Decreases	-11%	-17%	-28%	-18%
Proportion of Properties with Increased Expense-to-Income Ratio	77%	96%	86%	77%
Median Percentage of Increases	16%	36%	27%	15%
Proportion of Properties with Decreased Expense-to-Income Ratio	22%	4%	13%	23%
Median Percentage of Decreases	-7%	-7%	-11%	-8%
Proportion of Properties with Increased Debt-service-coverage Ratio	18%	47%	43%	23%
Median Percentage of Increases	22%	44%	93%	18%
Proportion of Properties with Decreased Debt-service-coverage Ratio	82%	53%	56%	77%
Median Percentage of Decreases	-31%	-49%	-113%	-34%
Proportion of Properties with Increased Quick Ratio	55%	43%	33%	38%
Median Percentage of Increases	85%	95%	164%	106%
Proportion of Properties with Decreased Quick Ratio	44%	57%	67%	60%
Median Percentage of Decreases	-51%	-53%	-59%	-60%
Proportion of Properties with Increased Surplus Cash	20%	39%	30%	23%
Median Percentage of Increases	19%	14%	-96%	16%
Proportion of Properties with Decreased Surplus Cash	80%	61%	70%	77%
Median Percentage of Decreases	-62%	-74%	-76%	-70%
Number of Properties	362	285	77	179

As mentioned earlier, DSCR is a measure indicating whether the properties are generating sufficient revenues to cover the mortgage debt service. A DSCR that is less than 1 means that the property does not have adequate revenues to cover its mortgage payments. Our tabulation in Table 6.5 reveals that the median DSCR has decreased across all restructuring outcome types in the post-restructuring period. For Watch List properties and Fulls closed at exception rent, the median DSCR has fallen to a level that is less than 1.

Quick ratio is a variable used to measure financial liquidity. It is defined as the total of cash and equivalents plus accounts and notes receivable, divided by the current liabilities. A ratio of 1 or above indicates ample liquidity. Our analysis shows that, except for the Lite restructurings, all other restructuring outcomes have a quick ratio that is below 1 in both periods. In addition, the Watch List properties and exception rent Fulls have experienced a decline in the median quick ratio.

Our last property performance measure is surplus cash from the audited Annual Financial Statements submitted to HUD. Surplus cash is the amount by which cash on hand exceeds accounts payable as of the date of the financial statements. Positive surplus cash indicates that the property has cash over and above the amount needed to clear its payables (and, thus, that the property had positive cash flow during the year). Negative surplus cash indicates that the property does not have sufficient cash to cover its payables (and, thus, either had negative cash flow during the year, or had insufficient positive cash flow to retire its year-beginning excess payables).[23] As shown in Table 6.5, median surplus cash has declined across the board after restructuring for the cohort of restructurings we examined. While the Lites and Fulls closed at market rent still maintain a positive level of median surplus cash in the post-restructuring period, surplus cash for exception rent Fulls and Watch List properties has dropped to a negative level. This suggests that many exception rent Fulls and Watch List properties have experienced cash flow problems since the restructuring.

To summarize, it appears that the Lite group of properties has the best financial performance in both the pre- and post-restructuring periods among the cohorts of restructuring outcome types we examined. In comparison, a sizable portion of the Fulls closed at exception rent and Watch List properties have values for many of the financial performance indicators in the post-restructuring period that are worrisome. Given the limited amount of post-closing financial data available (one to two years), it is difficult to assess the longer term financial performance of these properties. An encouraging sign is that, according to data collected by the Office of Housing, the number of defaults that have occurred to this portfolio of properties is very small.

Conclusion

M2M is a HUD program that addresses fully the issue of funding ongoing rehab and capital replacement needs. This is unlike conventional market multifamily financing, which expects

[23] In general, a property that has positive surplus cash will distribute it, either to the owner or to the Residual Receipts account. For such a property, positive surplus cash at the next year end reflects the property's positive cash flow during the year.

a resale and recapitalization every few years. It also is unlike other FHA programs, which typically have provided per-unit-per-year contributions to replacement reserves appropriate to early years of a new property, but not large enough for the 40-year mortgage term. Funds for rehab escrow and initial deposit to replacement reserves totaled over $114 million and $164 million for the cohorts of Full transactions closed through early August 2003. Owners are also required to make annual deposits to the replacement reserves account. These funds represent a tangible benefit for tenants living in these HUD-assisted properties. As a result of M2M, these tenants are able to live in higher physical quality, better maintained units.

Relative to financing in the conventional market and other FHA programs, the M2M program has employed a set of underwriting standards that are specifically tailored for these properties. The standards, in theory, will foster long-term financial and physical viability for these properties. This is especially the case for the cohorts of projects that were underwritten with the "expense cushion" policy introduced in early 2002. However, at the time of this evaluation, HUD has not collected adequate financial data in the post-restructuring period to allow us to examine these properties' actual long-term performance.

Our examination of cohorts of transactions that were underwritten before the "expense cushion" standard reveals that many of these projects have lower values on some of the financial performance indictors than in the pre-restructuring period. For example, there is evidence that some had negative surplus cash and did not have sufficient income to cover operating expenses and debt service. The reason for this underperformance is not immediately clear. Since we have only one to two years' financial data for the post-restructuring period, the results may not be representative of long-term performance. These properties deserve further investigation based on longer-term financial data. It will also be important to test whether transactions that were processed with the "expense cushion" underwriting standards since early 2002 have better financial performance in the post-restructuring period relative to the earlier cohorts, once their financial statement data become available.

7. The Prospective Study

Introduction

The Prospective Study component of the M2M evaluation was designed to provide a "snapshot" of M2M operations at the time of the evaluation's data collection. Fifteen case studies of properties in the M2M "pipeline" during the study period (March through November 2003) were conducted. The data collection methodology was a series of open-ended discussions with the major stakeholders in each of the 15 restructuring processes. These stakeholders included:

- The lead underwriter for the PAE with responsibility for negotiating the restructuring agreement.

- The owner and/or an owner's representative who were directly involved in the restructuring process.

- Individuals responsible for onsite management of the property.

- A sample of tenants at the property.

- Other individuals, such as the OMHAR relationship manager or HUD field staff, who could provide perspective on the restructuring process.

Data collection for each case study typically began with telephone interviews with the PAE underwriter and the owner/owner's representative. In approximately half the cases, the restructuring process had proceeded sufficiently to enable PAEs to supply the researchers with background documentation (e.g., draft restructuring models) prior to a researcher's site visit to a property.

A senior member of the research team conducted a site visit to each of the 15 properties. On each visit the researcher conducted interviews with onsite property managers and a sample of tenants. Whenever possible, the site visits were also used to conduct face-to-face interviews with PAE staff and owners and owner representatives. In some cases the researchers were also able to interview community representatives, such as Housing Authority staff, who had an interest in the restructuring.

The objectives of the site visits were to:

- Obtain the onsite property manager's perspective on the operational history of the property and the likely impact of the restructuring.

- Obtain a confidential tenant perspective on the quality of the property management, as well as an assessment of the level of tenant participation in the restructuring.

- Make an assessment of the general physical condition of the property.

- Obtain both management and tenant perspectives on the possibility of the tenants being able to use vouchers instead of receiving a project-based subsidy.

- Document the characteristics of the neighborhood immediately adjacent to the property, for example, a neighborhood undergoing gentrification.

Subsequent to each site visit, the researchers remained in contact with owners and PAE underwriters to document progress (or lack thereof) in the restructuring. As additional documentation became available, such as approved Plans, it was requested from the PAE. Ongoing telephone interviews with PAE staff and owners were conducted on particular points of interest. Data collection continued for each property in the sample, until either a restructuring was completed or the data collection period had ended (November 1, 2003).

The full case studies for each of the 15 properties appear in the second section of this report. In this chapter we present a descriptive overview of the 15 properties followed by a cross-site analysis of the case study data. This presentation begins with a discussion of the methodology employed to select the Prospective Study sample.

Sampling Methodology

The research team employed a purposive sampling approach to select the 15 properties for the Prospective Study. Criteria employed in the selection of the properties included:

- *Stage in the Restructuring Process*. Since the objective of the Prospective Study was to develop a "snapshot" of the M2M process, the team wanted to observe all stages of the restructuring process. To achieve this goal, some properties were selected just as they were beginning the process, while others were selected because they were fairly far along in the process.

- *Restructure Type*. The team wanted the opportunity to observe the M2M process for both Lite and Full Restructurings.

- *PAE Type*. The team wanted to observe the underwriting process as managed by both public and private PAEs.

- *Tenancy Type*. The selection process aimed to include a higher proportion of Section 8 "family" properties in the sample as opposed to Section 8 "elderly" properties.

- *Properties with Exception Rents*. The selection criteria were weighted toward these properties in order to document conditions that justified rents in excess of established market rents.

- *High and Low Poverty Census Tracts*. The team wanted to observe how the M2M process played out in a variety of socioeconomic environments.

- *A Mix of "Large" and "Small" Owners*. The team wanted to observe if there were any differences in the M2M process between owners of large Section 8 portfolios and owners with a few or only a single Section 8 property.

An additional selection factor limited the number of properties in the sample that were handled by the same PAE to two. This was done in an effort to minimize the burden on PAE staff. This limitation also enabled the project team to observe the underwriting process at most of the large PAEs supporting OMHAR.

The OMHAR tracking database was the source for the sample selection. Based on the proportion of Lites and Fulls in process at that time, it was decided to select a sample composed of 12 Fulls and 4 Lites. During the course of initial contacts with PAEs it was discovered that a number of the Lites in the sample were actually being processed as Fulls. During the data collection period it proved impossible to identify "Lite" restructurings that met the other selection criteria. In the end, the Prospective Study sample consisted of 13 Full restructurings and one Lite restructuring. This actually reflected the proportion of Lites (12 percent) in process at the time.

A number of the properties in the initial sample were eliminated, either because they closed before interviews could be conducted or because they were no longer considered active cases. The final composition of the Prospective Study sample is shown in Table 7.1.

Table 7.1
Final Composition of the Prospective Study Sample

Property	M2M Type	Tenant Type	No. of Units	Exception Rent
Russell Erskine, Huntsville, AL	Full	Elderly	66	No Cost Plan Yet Developed
Winthrop, Tacoma, WA	Full	Family	194	No
Myrtle Manor, Phoenix, AZ	Full	Family	44	No
Kingsley Park, Essex, MD	Full	Family	312	No
Murphy Blair, St. Louis, MO	Full	Family	68	Yes
Lynne Acres, Shelbyville, KY	Full	Family	40	No
Six Chimneys, Cleveland, OH	Full	Disabled	46	No
Valley Heights, Quincy, CA	Full	Family	48	Yes
Genesee Towers, Utica, NY	Full	Elderly	66	Yes
Eastward Court, Casper, WY	Full	Family	32	Yes
Sneedville Gardens, Sneedville, TN	Full	Family	50	No
Villa 14, Ault, CO*	Full	Elderly	36	No
Village Green, Red Bay, AL*	Full	Family	48	Yes
Fair Park, Sardenia, OH	Full	Family	41	N/A
College Park, Lancaster, CA	Lite	Family	78	N/A

*Properties that were originally selected as Lites but later became Fulls.

Characteristics of the Sample

Salient characteristics of the Prospective Study sample include the following:

- The properties were relatively small compared to the total universe of FHA-insured Section 8 multifamily properties. The average size of the properties was 62 units. This compares to the average 103 units in the FHA-insured portfolio. However, the small unit size was representative of properties in the M2M pipeline at the time of data collection.

- Most of the properties were constructed under the Section 8 NC/SR programs in the early 1980s. Ten of the properties had been constructed between 1981 and 1983. These properties were very similar in construction type: detached garden-style apartments of one, two, or three stories. The properties normally had large amounts of open space between buildings. The sample also included several older buildings, including apartment complexes or hotels built in the first half of the twentieth century and rehabilitated at the time they became part of the Section 8 program. These structures were located in Tacoma, Washington; Cleveland, Ohio; Utica, New York; Essex, Maryland; St. Louis, Missouri; and Huntsville, Alabama.

- On the whole, the properties in the sample were in good physical condition. With a few notable exceptions, such as the Murphy Blair property in St. Louis, the properties appeared to have been well managed with an acceptable level of maintenance. Even in cases where there was a need for significant rehabilitation in the first 12 months of a restructuring, this was not due to an unacceptable level of deferred maintenance. It often represented normal replacement cycles, such as appliances, or significant upgrades that would improve the value of the property, such as installation of central air conditioning.

- Most of the properties in the sample were located in relatively well-maintained residential and/or commercial districts. This characteristic may be associated with a preponderance of medium and small communities in the sample. Three of the urban properties in the sample—in Tacoma, Cleveland, and Essex (just outside of Baltimore)—were located in “improving” neighborhoods. Again, Murphy Blair was an exception, located in a “distressed” neighborhood.

- The majority of the properties had maintained close to 100 percent occupancy, at least over the near term. This may reflect the lack of comparable rental units in small and medium size communities, although it is also an indication of a high demand for affordable housing in these communities, particularly considering the long waiting lists at a high proportion of the properties. Only two of the properties—Murphy Blair in St. Louis, Missouri and Village Green in Red Bay, Alabama—had significant vacancy rates.

The M2M Process for the Prospective Study Sample

The tables 7.2 and 7.3, immediately below, summarize the major steps in the M2M restructuring process during the study's eight-month timeframe. The aspects of the restructuring process documented in Table 7.2 are:

- M2M status at start of the data collection period.
- M2M status at close of the data collection period.
- Decrease in HAP rents either proposed or implemented.
- Estimated net savings to HUD per-unit over 20 years of restructuring agreement (where available). Net savings takes into account reduced Section 8 costs, claims against the FHA insurance fund, and OMHAR's estimate of the potential repayment of second or third mortgages, in present value terms.

Table 7.2
M2M Status, Rent Reduction, and Savings

Property	Initial Status	Closing Status	Rent Reduction	NPV of Savings Per Unit Over 20 Years
Russell Erskine Huntsville, AL	Assigned to PAE	Draft Plan	NA	NA
Winthrop Tacoma, WA	Owner Submits Data Collection Rept.	Revised Plan	8%	($4,640)
Myrtle Manor Phoenix, AZ	Referred from Field Office	Owner Commitment Executed	34%	$50,000
Kingsley Park Essex, MD	Appraiser Assigned by PAE	Draft Plan	6.8%	NA
Murphy Blair St. Louis, MO	Owner Approves COI	Draft Plan	15%	($8,163)
Lynne Acres Shelbyville, KY	Owner Approves COI	Plan Approved	24%	$11,625
Six Chimneys Cleveland, OH	PAE Completes Due Diligence	Approved Plan	38%	$12,360
Valley Heights Quincy, CA	Plan in OMHAR Review	Closed	13%	($15,194)
Genesee Towers Utica, NY	Plan in OMHAR Review	Plan Approved	23%	$10,613
Eastward Court Casper, WY	PAE Completes Due Diligence	Closed	45.3%	$10,322
Sneedville Gardens Sneedville, TN	Plan in OMHAR Review	Closed	15.4%	($871)
Villa 14 Ault, CO	Plan in OMHAR Review	Closed	17.5%	$11,982
Village Green Red Bay, AL	PAE Completes Due Diligence	Draft Plan Submitted	NA	NA
Fair Park Sardenia, OH	PAE Developing	Same	NA	NA
College Park Lancaster, CA	Lite Agreement under OMHAR Review	Final Review	28%	$9,229

NA = Not Available.

Table 7.3 presents the following restructuring items for each property in the sample:

- Per-unit rehab expenditures in 12-month initial rehab plan.
- Reasons for lack of progress to restructuring agreement (where applicable).
- Exception rents as percentage of market rents (where applicable).

Table 7.3: Per-Unit Expenditures, Progress and Exception Rents

Property	Per-Unit Rehabilitation Expenditures	Reason for Lack of Progress	Exception Rents
Russell Erskine	NA	Change in ownership	NA
Winthrop	$4,369.00	No problems	109%
Myrtle Manor	$318.20	No problems	NA
Kingsley Park	NA	Community opposition	NA
Murphy Blair	$3,589.00	Unit condemned	105.5%
Lynne Acres	$810.25	No problems	NA
Six Chimneys	$2,460.00	No problems	NA
Valley Heights	$3,702.00	No problems	125%
Genesee Towers	$6,364.00	Two owner appeals	146%
Eastward Court	$9,953.50	No problems	110%
Sneedville Gardens	$1,041.00	No problems	109%
Villa 14	$944.50	No problems	NA
Village Green	$4,660.00	Ownership change	NA
Fair Park	NA	Owner refusal	NA
College Park	NA	No problems	NA

NA = Not Available.

Salient Characteristics of the M2M Process for the Prospective Study Sample

The findings from the Prospective Study sample permit some general conclusions about the M2M program as it was operating in 2003.

- **The program exhibits a significant degree of administrative efficiency.** Given the requirements of the M2M underwriting process, the properties in the sample moved toward restructuring agreements with relative efficiency. Six properties moved from an in-process stage to closing or virtual closing within the 6- to 7-month data collection timeframe. In those cases where the process had stalled, the key factors were external to the administrative procedures developed by OMHAR. Such factors included major deficiencies in property maintenance (Murphy Blair), disagreements at the local political level about the future of the project (Kingsley Park), and proposed or actual changes in property ownership (Fair Park and Red Bay). This efficiency reflects the experience level of the PAEs. By 2003 the PAEs understood the parameters that would meet OMHAR's underwriting requirements. In most cases M2M had become a process that would identify a site-specific approach that would meet those parameters, rather than a negotiation.

- **The process places a heavy emphasis on preservation of affordable housing**. As the data indicate, OMHAR has been willing to approve restructurings that are likely to result in increases in HUD expenditures, including Winthrop, Village Heights, Sneedville Gardens, and Murphy Blair. It has also attempted to preserve properties that have had significant vacancy rates, such as Red Bay, where the pre-M2M vacancy rate was more than 20 percent. Current operational procedures appear to favor a *de facto* presumption of the need for project-based assisted housing unless there is considerable evidence to the contrary. This is clearly in accordance with the intent of the MAHRA legislation. The main factor that appears to recommend not finalizing an agreement is the effect of significant vacancy rates on the project's long-term financial viability.

- **The restructuring process is essentially an OMHAR/PAE/Owner negotiation**. There is limited involvement of external stakeholders in the restructuring process. In only a couple of instances (Kingsley Park and Winthrop) were there input into the process by local elected officials or local agencies. There was also no real input into the process by tenant organizations. There was only one instance of active involvement of the ITAG/OTAG organizations that were a major feature of the authorizing legislation. Negotiations proceeded at the technical level between the PAE underwriter and the owner's representative. Wider issues of local housing policy were seldom discussed with local officials in detail. This was despite the fact that PAEs met all requirements for notification of local authorities. Except where there was an existing governmental interest (such as a redevelopment effort) local officials did not take an interest in the restructuring.

- **The M2M process does not change the ownership type of the properties.** Only one of the owners in the sample was a nonprofit organization. This was a foundation that operates a housing development with onsite services for individuals with developmental disabilities in Cleveland, Ohio. For the most part, the ownership cadre for the Section 8 properties after M2M is the same set of owners/developers who were directly involved in the construction or development of properties at the outset of the current Section 8 multifamily program.

- **In a high proportion of the cases the restructuring has little immediate impact on the tenants.** As Table 7.3 indicates, the per-unit amount of rehabilitation completed during the first 12 months of a restructuring agreement varies widely. In some cases (e.g., Winthrop, Eastward Court, and Village Heights), the repair amounts are quite substantial. In those cases the tenants will receive immediate benefits. In a majority of cases, however, the per-unit expenditures are quite modest and the restructuring will provide little or no short-term enhancement to the housing quality offered to tenants (often because the housing is already of good quality).

- **The current formula for the restructuring provides a high degree of confidence in the properties' long-term financial viability.** For the majority of properties, the major players in the negotiating process—the PAE underwriters and the owners' representatives—saw no major threats to the long-term financial stability of the properties. The underwriting guidelines, as of 2003, had factored in the recently rapid increases in such major expense items as insurance and utilities. In addition, the inclusion of “payables” as an item in the final restructuring agreement reduces the short-term financial liability of properties. Negotiations between owners and underwriters focused mainly on such items as the short-term “rehab” expenses to be covered by the owner. The details of the refinancing and reserve requirements had become essentially “*pro forma*” aspects of the negotiations.

Complicating Factors

The characteristics of the restructuring process presented immediately above focus on typical features of the negotiations as of 2003. For the most part, both owners and underwriters had a clear understanding of the restructuring process. The underwriters, in particular, knew what guidelines OMHAR had established for completing financial restructurings.

The M2M process, however, has not become standardized. A review of the 15 cases clearly shows that many of the restructuring negotiations had unique, site-specific complications that could either stall or otherwise complicate the process. Both underwriters and OMHAR staff continued to deal with novel situations for which there was no clear policy guidance. Some of those complicating factors are discussed below on a site-specific basis.

Kingsley Park

Kingsley Park is an unusual M2M property. The County housing authority administers the Section 8 contract because the property is subsidized under the Section 8 Moderate Rehabilitation program. The Baltimore County Housing Department provides transitional housing in vacant units at the Kingsley Park property for households on the Housing Choice Voucher waiting list. At the time the property entered M2M, many of the units at Kingsley Park were occupied by these prospective voucher users. Several informants suggested that a high proportion of the transitional tenants placed at Kingsley Park from the voucher waiting list had a history of behavioral problems.

There was also a high level of drug activity on the property, which is located in Essex, an older suburb of Baltimore, in the jurisdiction of Baltimore County. The neighborhood immediately adjacent to the property has been “gentrifying” in recent years. County policy has been to attempt to reduce the number of subsidized multifamily units in the County. There had been a failed attempt to place Kingsley Park on a list of properties that the County could seize through eminent domain.

The owner of Kingsley Park has been willing, for a considerable amount of time, to negotiate a restructuring agreement with OMHAR, although County officials have strongly opposed a new long-term contractual agreement for a development as large as Kingsley Park (312 units). The owner has explored ways to finance a redevelopment that would downsize the property, but OMHAR staff indicated they believe there is a need for more affordable rental units than the 60 units envisioned by one of the downsizing plans. These opposing policy objectives resulted essentially in a stand-off, with the County allowing only an interim extension of the property's operating contract. The M2M process meanwhile continued, with development of a draft restructuring plan. It was still unclear at the end of the data collection period whether Kingsley Park will remain a property with 312 small units or be significantly reconfigured through the restructuring process.

The Kingsley Park case was a major exception among the 15 properties in the study sample. This was a case where the proposed financial restructuring attempted to proceed in the middle of a public debate about the future use of the property. The M2M process, while efficient in most instances, is not designed to deal with active intervention by a wide variety of local stakeholders. In cases such as this, the technical expertise of the OMHAR process needs to be supplemented by policy expertise and inter-governmental coordination.

Murphy Blair

The Murphy Blair complex is located in a neighborhood called Old North St. Louis. The property has been poorly maintained, with consistently low REAC physical and financial scores. There has also been considerable turnover in onsite management throughout the years, with the most recent management firm assuming responsibilities in July 2003. The onsite review of the property indicated a need for major rehabilitation, including work on the foundations and roof. During the restructuring process, one of the property's buildings was cited for serious code violations and was condemned.

Murphy Blair has provided a dilemma for the PAE underwriters and OMHAR. The draft restructuring plan estimated more than a $500,000 loss ($8,000 per unit) over 20 years. In addition, data on the St. Louis housing market show high vacancy rates, although few three-bedroom units are available in the local area. This was a major attraction for the tenants residing at Murphy Blair.

At the close of the data collection period, this restructuring was on hold while the issue of the condemned building was addressed.

The Murphy Blair case suggests the need for a mechanism that enables a quick determination to exclude a property from the M2M program. Whether some justification for the affordable housing at Murphy Blair could be developed is unclear. In this instance it would have been beneficial to have a RAAP analysis early on in the negotiations. Instead of such a review, the process has proceeded as a normal restructuring, with the attendant costs. It is not clear if this investment of time will result in any benefit to the tenants or low-income individuals in the community.

Village Green

Village Green is a 48-unit scattered-site property in the small rural community of Red Bay, Alabama. In the last several years the property consistently had vacancy rates above 20 percent. In addition, the onsite review indicated considerable evidence of less-than-satisfactory maintenance. There was an obvious need for major repairs to the windows, interior walls, siding, and appliances. Some of the units that had been vacant for an extended period appeared to be in significant disrepair.

Given these conditions, Village Green was an obvious candidate for possible exclusion from the M2M process. In addition to the need for a major rehab investment, the property had a reputation for criminal activity requiring police attention. The assigned underwriters for this property were aware of its possible marginality at the start of the M2M process.

The situation was complicated further by a change in ownership during the early phase of the M2M process. Ownership and management were transferred from one owner of a large Section 8 portfolio to another (along with 40+ other Section 8 properties). The underwriters developing the restructuring plan then had to assess the performance of the previous owner against the stated plans of the new owner to upgrade the physical plant. The new owners also proposed a marketing strategy that would bring occupancy close to 100 percent. The underwriters thus had to match historic performance data against an untested management plan for the property.

At the end of the data collection period, the PAE had submitted a draft restructuring plan to OMHAR. Because of its rural location, there may be a need for continued existence of this rental housing, although OMHAR indicated that it still had serious concerns with the high vacancy rate. It was unclear if this property would proceed to an implemented restructuring agreement.

This property might have benefited from an interim arrangement that provided for an assessment of the new management team. One possibility would have been to place the property on the Watch List, which may have enabled OMHAR to gauge the success of the new management in upgrading the property. The history of the property had appeared to be a "chicken and egg" situation where substandard maintenance led to a high vacancy rate, which in turn led to more substandard maintenance. At the end of the data collection period it was not at all certain if the new owners could break this cycle. Additional performance data would have provided an opportunity for more informed decision making.

Six Chimneys

Six Chimneys is a congregate Section 8 property in Cleveland, Ohio that provides a full complement of support services to a tenant population that has severe learning disabilities. The facility has a range of services seldom provided in Section 8 properties. These include a 24-hour manned security desk, nursing services, a kitchen, and a variety of internal communication and monitoring systems. Funding for the facility's service components is provided by State and local agencies.

The complicating factor in this restructuring was the need for 12-month rehabilitation funds to be applied to the special needs of the tenant population. For example, could enhancements to the security and nursing stations be included in the restructuring package? (The Plan finally drafted for this property did not include these items.)

By the end of the data collection period this property had successfully negotiated an approved restructuring plan. In this Plan the rehabilitation expenditures are limited to what are normal HUD-funded items such as improvements to the heating system.

While the nonprofit owner was generally satisfied with the agreement, there was some frustration that the "service component" of the facility was not adequately addressed in the restructuring negotiations. Local officials would have been notified of the restructuring as a matter of standard procedure, but no State or local agency took an active part in the negotiations.

Winthrop Apartments

Winthrop Apartments is a 194-unit, 12-story structure in the downtown business district of Tacoma, Washington. Of the 194 units, 174 receive Section 8 subsidies. The building was originally constructed in 1924 as a hotel and remodeled into a Section 8 property in 1972. It was in need of extensive repair when it entered the M2M restructuring process as a result of poor maintenance. The PAE's initial plan for rehabilitation identified nearly $900,000 in short-term repair needs. Three major items included in this plan were:

- Major plumbing repairs ($365,000).
- Elevator upgrades ($279,000).
- Replacement of 450 corridor doors with fire-rated doors and hardware ($100,000).

OMHAR made the decision to proceed with this restructuring even though the initial rehabilitation costs would be substantial, and the net effect of the restructuring would be a net loss of $4,640 per unit over 20 years. OMHAR made this decision despite a high rental-vacancy rate for the immediate area. In addition, some local officials desired a different and higher-end use for the property. The Winthrop property is in a downtown section of Tacoma where there has been a major redevelopment effort in recent years.

Because of local interest in redeveloping downtown Tacoma, the property has been the subject of discussions between the PAE, OMHAR, HUD staff, the Housing Director for the city of Tacoma, and other local housing groups. These discussions focus on the "pros" of preserving affordable housing in downtown Tacoma versus the "cons" of Tacoma's revitalization effort.

General Conclusions about Complications in Restructuring

There appear to be at least three factors that can complicate a restructuring effort. These include:

- Questions about whether a property is a needed and/or effectively managed Section 8 property (Kingsley Park, Murphy Blair, Village Green).
- The desire of local stakeholders to promote alternative uses for the property or to have meaningful input into the restructuring process (Kingsley Park).
- An operating environment at a property that does not fit the picture of a standard Section 8 property (Six Chimneys, Winthrop, Kingsley Park).

In such cases it is unclear that the current M2M process provided sufficient information to reach informed decisions. In marginal cases, OMHAR and PAE staff would benefit from greater input from the Multifamily Housing staff. This would provide a broader perspective on housing needs (and projected needs) in a community, as well as increasing the likelihood that creative cooperative efforts could be undertaken. In short, the M2M process would become less of a technical financial endeavor and more of a housing policy initiative.

In the case of local stakeholders, there probably needs to be a mechanism to ensure that possible partners get involved in the process at an early stage. Involvement of possible partners could also be explored for those properties that provide services other than housing.

Even with this review of complicating factors, it should be noted that a high proportion of OMHAR restructurings went through the process in 2003 with few, if any, complications. This was true for the properties in Ault, Colorado; Sneedville, Tennessee; Shelbyville, Kentucky; Lancaster, California; Casper, Wyoming; Phoenix, Arizona; and Cleveland, Ohio. In all of these cases, the processing moved expeditiously and was treated as a relatively routine matter by the owners or the owner representative.

The PAEs' Perspective on the M2M Process

At the time of the project's data collection, approximately 90 percent of the M2M underwriting was being conducted by the large, private PAEs. These organizations typically had several real estate or financial service components, with the M2M underwriting handled as a distinct unit of the larger entity. The majority of underwriters were full-time employees of the PAE and could draw on the resources of the entire organization. However, some of the PAEs assigned cases to independent underwriters who operated essentially as independent consultants and were paid fixed fees to develop a restructuring plan and negotiate a final agreement with the owner.

From the perspective of the PAE and the independent underwriters, there is a major incentive to proceed with a restructuring. The PAEs receive fees on a property-by-property basis, with incentive payments if they complete certain stages of a restructuring within a specified timeframe. The independent consultants receive their payments in a similar fashion.

Input from the underwriters handling the sample properties indicated that the entire restructuring process had become routinized. By 2003 there was a standard process for an M2M restructuring anticipated by the underwriters. This was due not only to their level of experience, but also to the availability of the final version of the financial model that must be used to develop each plan. The financial model now reflects OMHAR decisions on many underwriting issues that had delayed earlier M2M plans. In addition, beginning in 2002 OMHAR had established Memoranda of Understanding (MOUs) with the large PAEs. Those MOUs granted a PAE essentially a “first choice” option to handle all restructurings for specified owners of large portfolios of Section 8 properties. In such cases a PAE was able to establish an ongoing working relationship with a given ownership entity.

Observation of PAE administration of restructurings for the 15 properties in the sample led to the following observations about the PAEs’ current role in M2M restructurings:

- The majority of restructurings are directly handled by underwriters with both considerable professional experience and experience handling M2M negotiations. For the majority of properties the lead underwriter was able to provide owners with a clear description of the program’s requirements and likely outcomes. This experience also enabled PAE staff to identify third-party vendors (for example, for Physical Condition Assessments) whose work products would pass review by OMHAR. In those cases for which less experienced underwriters were given lead responsibility, they could draw on the experience and expertise of senior staff in their organizations.

- PAE underwriters often assumed a directive role in the development of a restructuring agreement. The underwriter’s experience with M2M often enabled the underwriter to have a fairly accurate “vision” of what was achievable under OMHAR’s established guidelines. In a high proportion of cases, once the data collection activities were completed, owners were content to wait and see “how the numbers played out.” The likelihood that an underwriter would take a lead role increased for owners who had already successfully completed a number of M2M restructurings.

- PAE staff devoted considerable resources to meeting the tenant involvement requirements of the M2M process. There were no indications that these steps were completed in a *pro forma* fashion. Input from tenants indicated that the presentations at the tenant meetings were clear, and the facilitators were willing to address any tenant concerns. (In the case of Six Chimneys, the PAE took considerable trouble to develop a meeting format that provided valid input from the developmentally disabled tenant population.) However, some of these meetings were scheduled on short notice, thus reducing tenant participation.

- PAE staff were often able to anticipate OMHAR requirements and adjust the restructuring process accordingly. In one case the underwriter essentially put the restructuring process on hold for several months until the ownership entity had completed its annual financial statement. The underwriter knew that OMHAR would require the most recent financial data in a final review. This “hold” probably saved significant time and effort in the review stage of the restructuring process.

- By 2003 PAE staff were able to make quick judgments on the feasibility of any Lite applications. Use of the financial model enabled them to make such judgments within days of receipt of an owner’s financial data. The owners of several properties in the sample had applied for Lite restructurings, but then accepted the PAE determination that they could proceed in M2M only through a Full restructuring.

The Owners’ Experience in the M2M Process

Of the 15 properties in the sample, 14 were owned by private-sector ownership entities and a foundation sponsor owned one property. Two-thirds of the properties were owned by the same entities that developed the property at the time it entered the Section 8 portfolio.

Some characteristics of the owners’ participation in the M2M process included:

- **The owners had limited flexibility as to entering the M2M process.** Only two or three of the properties (including the Lite restructuring in Lancaster, California) were good candidates for a move to the unassisted market sector. For the most part, these properties would retain their value for the owners only while they remained as part of the Section 8 portfolio.

- **Most negotiations were carried out by owner representatives and not by owners of record**. Thus, the owner input into the negotiating process had become routinized. One reason for this was that by 2003 the owner community had considerable experience dealing with OMHAR, the PAEs, and M2M. Most owners expected few surprises in a given restructuring. The holders of large Section 8 portfolios had established units in their organizations that dealt only with M2M issues.

- **For the properties in the sample, most owners maintained a fairly passive role in the negotiations (with a few notable exceptions).** This reflected both their familiarity with the M2M program and a general confidence in the ability of the underwriters.

- **The most common contentious issue remaining for owners was the type and extent of the immediate rehabilitation items.** While these items represented an opportunity to add to the value of the property, the owner had to “front” a significant portion of the cost (for most items, 20 percent). As of 2003 owners appeared to take the view that the refinancing numbers “would work themselves out.” For properties with substantial short-term rehabilitation requirements, this was not the case.

The Tenants' Experience in the M2M Process

The M2M authorizing legislation attempted to ensure that Section 8 tenants were able to take an active role in a restructuring. In addition, a major objective of the entire restructuring effort is to enhance the quality of services afforded to Section 8 tenants (even beyond the preservation of affordable housing in a community).

Observations of the restructuring process at the 15 properties in the sample led to the following general conclusions:

- **The involvement of tenant support and/or advocacy groups, such as the ITAG/OTAG grantees, appears to be almost non-existent.** Among the case studies there was only a single example of such a group being involved in the negotiating process. Just as importantly, tenants expressed no knowledge that such groups were available for support or consultation.

- **The required tenant meetings appeared to be only moderately successful in informing tenants about the restructuring process.** These meetings were often poorly attended. Even in cases where these meetings were well attended the majority of tenants at the property did not attend a meeting, and their knowledge of the M2M process was minimal.

- **A high proportion of tenants interviewed for the study expressed skepticism about the ability to use vouchers as an alternative housing subsidy in their community.** These responses might simply reflect a resistance to change when people had an established residency. However, a high proportion of tenants also indicated little or no understanding of how the voucher system works.

- **The extent to which tenants have had substantive input into the prioritization of rehab requirements for a property is unclear.** The short-term rehab package is the most immediate benefit a restructuring provides tenants. For most properties in the sample, tenant impact on this prioritization was minimal.

- **It is unclear whether the requisite tenant meetings provided tenants with an opportunity to express unguarded opinions about the quality of onsite management**. This is an issue of prime importance to tenants. At a number of the sites, however, the onsite management was actively involved, for at least a major portion of the meetings.

- **The written notifications and descriptions of restructuring agreements provided to tenants, for the most part, were written in boiler-plate language not appropriate for tenant populations.** More appropriate would have been materials that answered the core questions of most interest to tenants (for example, will my rent be raised?).

- **In five of the fifteen projects, tenants received short-term (12-month) rehab benefits worth more than $3,000 per unit.** Short-term, major improvements of this type are the most tangible benefit perceived by tenants at the conclusion of a restructuring.

Other Lessons Learned

In general, the M2M process is one that by 2003 was standardized and well understood by PAE underwriters and the owner community. This standardization did not preclude site-specific conditions that would require substantive negotiations, special reviews, or unique technical solutions. At least three of the restructurings (Murphy Blair, Kingsley Park, and Red Bay) involved issues that could result in a failure to complete the process.

While some are unique to a single case in the sample, the following lessons may prove useful when considering OMHAR's entire current and future portfolio:

- **Short-term economic developments may heavily influence how an owner approaches the restructuring process.** At one site in the sample, the property was in an area that had experienced significant expansion of the private-sector rental market in the mid-1990s. The economic downturn that began in 2000-2001 had a significant negative impact on that market. Without that downturn, it is possible that the property's owner might have tried to shift the property to the private sector at the expiration of the HAP contract. Instead, the owner applied for a Lite restructuring. The PAE made a quick determination that the financial condition of the property would not support a Lite. The owner then decided to proceed with a Full restructuring. This restructuring has now closed, and the property has been preserved for the Section 8 portfolio.

- **Section 8 properties may serve tenant populations drawn from outside the immediate community.** At one of the properties, nearly three-quarters of the units were occupied by students attending the local community college. Nearly all of these students were from outside the immediate community. Interview data indicated that many of the students would not have been able to attend the college without the availability of subsidized housing. Thus, this property will now continue (the restructuring has closed) to meet the housing needs of a low-income population, albeit one not drawn from the local community. In this case there was some doubt that the property could maintain an adequate occupancy level without a constant stream of student tenants.

- **Even when well handled, the level of tenant participation remained small.** One PAE had developed an exemplary tenant-notification form for tenant meetings. The language was clear, precise, and free of jargon. The PAE moved aggressively to distribute these notices around the property. Still, only 10 tenants showed up for a meeting. More effective approaches will need to be developed if HUD continues to place a heavy emphasis on tenant involvement.

- **The M2M program is ill-suited to address cases where key community stakeholders, including elected officials, oppose the preservation of an affordable multifamily property.** At one property, local stakeholders have vigorously opposed the preservation of a large multifamily property. There are possibilities for a compromise solution—a reduction in the number of subsidized units. It is not clear, however, what entity should be conducting such a negotiation. OMHAR's mandate appears to be too narrow for it to assume such a role, but it is not clear what other parties should also be engaged.

- **The OMHAR structure is not well designed to bring "partners" into a restructuring even when that appears to be the optimal strategy to provide the greatest benefit to tenants.** In two cases, both involving large properties, a major redevelopment appeared to be the best strategy to meet the needs of both tenants and the local community. Identifying the partners that could be brought in to assist in such a redevelopment is not an anticipated role for either the PAEs or OMHAR. This is particularly true in the case of PAEs, whose performance is measured by their ability to move transactions through the system.

- **At properties where external providers provide services to Section 8 tenants, there needs to be greater involvement of the providers in the M2M process.** One property in the sample provides a 24-hour secure housing environment for a developmentally disabled population. The service component of this property is funded by a variety of State and local agencies. These agencies were not, however, involved in development of the M2M restructuring plan. Involvement of such providers would probably provide opportunities to leverage resources and enhance quality of life for tenant populations.

- **In assessing the justification for preservation, particularly in the case of exception rents or a substantive net loss to the government, the process needs to include a more expansive analysis of housing alternatives.** The M2M process places a high value on preserving affordable housing. This orientation is appropriate. A high proportion of the properties in the sample were in small rural communities or small urban areas. Analysis of rental markets in such cases is normally restricted to the "built-up" areas in the vicinity. For the tenant populations in such areas there may be alternative assisted properties or other rental properties. In some cases the alternatives to Section 8 properties may be sub-standard housing units in isolated rural areas. Factors such as this should be considered when determining the level of tenant benefits such properties provide.

- **There needs to be a more effective mechanism for establishing the suitability of seriously deteriorated properties for restructuring.** Some properties in the sample showed indications of sub-standard maintenance. Once the M2M application had been made, the PAE had the responsibility of determining if a viable restructuring package could be developed. The financial incentive in such cases, at the PAE level, is to see whether there is any way a restructuring plan can be made to work. In such cases, it might be preferable to ask the PAE to demonstrate, with a heavy preponderance of evidence, the need to move ahead on a restructuring. The gains from preservation, however, are not always sufficient to justify large Federal costs.

- **Security should be made a more explicit concern when identifying critical needs for a property.** This is an issue frequently of paramount importance to tenants. Lack of security can have a direct impact on financial performance as it often drives up the vacancy rate. In some cases, tenants may be reluctant to bring up the issue because it may reflect on the quality of onsite management. It may be advisable to solicit some third-party input on this tenant concern.

- **In some places, exception rents are a necessary tool in preserving needed, affordable housing**. In one sample community, nearly one-third of the households could qualify to live in the Section 8 property and there is little private-market rental housing. This community has had a nearly static economy for several decades with very little construction. Although exception rents may be appropriate for such a community, there needs to be a consistent standard for justifying the requests. The documentation for the exception rent properties in the sample ranged from highly detailed to that of simply boiler-plate language. The justification documentation should demonstrate a clear understanding of the specific characteristics of a local housing market.

Appendix A

Tables for Chapter 3

Comparison of Property Characteristics by Program Participation Status

This appendix presents tables that compare the characteristics of properties by participation status in the program. The tables provide the same information as the tables in Chapter 3, but add information on distributions of key variables.

In addition, Table A3.11 presents results of regression models that isolate the effects of each characteristic on the status of the property. For each model the table presents the properties included and the dependent variable, followed by rows showing the effect of each variable. The dependent variable in each of these equations is a “yes/no” variable (the property either is or is not of the particular type—such as a Lite or a Full). When the dependent variable is categorical (yes/no) the regression model is estimated using the logistic estimation procedure, in which the probability of having a particular outcome (e.g., closing as a Full) is expressed as a function of a set of location and property characteristics expected to be associated with that outcome.

When the explanatory variable is also categorical, one of the categories must be excluded as the reference category in order for the regression to converge to a unique solution. The largest category is generally chosen as the omitted category for each characteristic and then becomes essentially a reference category. The regression results can be interpreted as the effect on the probability of having a particular characteristic relative to having the reference characteristic. The reference category is indicated by “REF” in the table. For each variable “NS” indicates that the variable was not statistically significant in the regression. A “+” indicates the variable had a statistically significant positive effect on the probability of having a particular outcome, and “-” indicates a statistically significant negative effect.

Table A3.1
Characteristics of Program Participants and Non-Participants

	Opt-Out**		Entered Program		Non-Participants Except Opt Out	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	**1,096**		**2416**		**5,558**	
Number of Units	**122,837**		**205993**		**601,145**	
Location						
Census region						
Northeast	125	11%	515	21%	1,089	20%
Midwest	302	28%	583	24%	1,634	29%
South	337	31%	971	40%	1,772	32%
West	332	30%	347	14%	1,063	19%
Metro Location						
Central City	559	51%	1157	48%	2,903	52%
Balance of Metro (Suburb)	401	37%	528	22%	1,551	28%
Non-metro	136	12%	732	30%	1,104	20%
Tract Characteristics						
Proportion of Vacant Hsg Units						
Average		8%		10%		8%
0% to 5%	390	36%	495	21%	1,673	30%
5% to 10%	416	38%	1013	42%	2,346	42%
10% to 20%	234	21%	737	31%	1,305	23%
20% +	56	5%	171	7%	234	4%
Homeownership Rate						
Average		47%		49%		46%
0% to 40%	389	36%	773	32%	2,080	37%
40% to 60%	345	32%	612	25%	1,528	27%
60% to 70%	200	18%	537	22%	990	18%
70% +	162	15%	493	20%	960	17%
Poverty Rate						
Average		18%		26%		22%
0% to 10%	386	35%	315	13%	1,336	24%
10% to 20%	370	34%	700	29%	1,685	30%
20% to 30%	156	14%	555	23%	1,072	19%
30% to 40%	95	9%	378	16%	727	13%
40% +	90	8%	467	19%	738	13%
Rent-to-Income Ratio						
Average		21%		22%		22%
0% to 40%	557	51%	1221	51%	2,720	49%
40% to 60%	439	40%	813	34%	2,037	37%
60% to 70%	76	7%	303	13%	631	11%
70% +	23	2%	80	3%	169	3%

Table A.3.1 *(Continued)*
Characteristics of Program Participants and Non-Participants

	Opt-Out**		Entered Program		Non-Participants Except Opt Out	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	**1,096**		**2416**		**5,558**	
Number of Units	**122,837**		**205993**		**601,145**	
Percent Minority						
Average		32%		41%		38%
0% to 10%	322	29%	759	31%	1,731	31%
10% to 25%	287	26%	393	16%	985	18%
25% to 50%	217	20%	361	15%	980	18%
50% to 75%	116	11%	275	11%	622	11%
75% +	154	14%	626	26%	1,239	22%
Property Characteristics						
Development Size						
Average Number of Units	112		85		108	
Less than 50 units	259	24%	687	28%	1,179	21%
50-99 units	297	27%	976	40%	1,875	34%
100-199 units	379	35%	614	25%	1,862	34%
200 or more units	161	15%	138	6%	642	12%
Unit Size						
Average number of bedrooms per unit	1.82		1.77		1.70	
Density						
Proportion of 3+bedroom units		19%		20%		19%
Occupancy Type						
Family	956	87%	1646	68%	3,867	70%
Elderly/disabled	140	13%	770	32%	1,691	30%
Building Type						
High-rise/elevator	138	13%	622	26%	1,486	27%
Other	958	87%	1794	74%	4,072	73%
Age						
Average	26		23		26	
0-20	91	8%	492	20%	795	14%
20-25	355	32%	1265	52%	1,727	31%
25-30	321	29%	326	14%	1,586	29%
30+	329	30%	332	14%	1,451	26%
HUD Program Type						
Older Assisted	767	70%	702	29%	3,249	58%
Newer Assisted	329	30%	1714	71%	2,309	42%
Mortgage Sponsor Type						
Profit Motivated	518	47%	1314	54%	1,996	36%
Limited Dividend	446	41%	876	36%	2,125	38%
Non-Profit	72	7%	217	9%	1,299	23%
Other	61	6%	9	0%	138	2%

Table A3.1 *(Continued)*
Characteristics of Program Participants and Non-Participants

	Opt-Out**		Entered Program		Non-Participants Except Opt Out	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	**1,096**		**2416**		**5,558**	
Number of Units	**122,837**		**205993**		**601,145**	
Mortgage Financed Type						
State HFA Bond Financed	17	2%	199	8%	487	9%
Other	1079	98%	2217	92%	5,071	91%
REAC Financial Performance Score						
Average	63		66		68	
0-40	206	19%	247	10%	421	8%
40-60	253	23%	574	24%	1,200	22%
60-80	371	34%	1076	45%	2,523	45%
80+	265	24%	519	21%	1,414	25%
REAC Physical Inspection Score						
Average	78		80		81	
0-40	22	2%	27	1%	54	1%
40-60	115	11%	208	9%	374	7%
60-80	424	39%	825	34%	1,907	34%
80+	535	49%	1356	56%	3,223	58%
Per Unit Unpaid Principal Balance (UPB)						
Average	$15,954		$23,054		$18,687	
$0-$10,000	390	36%	431	18%	1,546	28%
$10,000-$25,000	501	46%	946	39%	2,585	47%
$25,000-$35,000	140	13%	664	27%	802	14%
$35,000+	65	6%	374	15%	625	11%
Change in REAC Capital Deficiency Score						
Decrease or No Change	694	63%	1578	65%	3,624	65%
Increase	402	37%	838	35%	1,934	35%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio						
Average		89%		129%		101%
< 80%	415	38%	53	2%	1,576	28%
80% to 100%	304	28%	264	11%	1,369	25%
100% to 125%	317	29%	854	35%	1,478	27%
125% to 150%	48	4%	738	31%	749	13%
150%+	12	1%	507	21%	386	7%

Table A3.2
Tenant Characteristics
Program Participants and Non-Participants

	Entered Program		Non-Participants Except Opt Out	
	Number	Percent	Number	Percent
Number of Properties	**2,118**		**5,355**	
Number of Units	**178,635**		**575,545**	
Length of Residence (years)				
Average	4.76		5.22	
< 2.5	339	14%	419	8%
2.5 to 5	1077	45%	2,349	42%
5 to 8	813	34%	2,248	40%
8 +	187	8%	542	10%
Household Size				
Average	2.03		1.94	
< 1.15	557	23%	1,489	27%
1.15 to 2	406	17%	1,166	21%
2 to 2.5	758	31%	1,523	27%
2.5+	675	28%	1,335	24%
Percent Elderly Household				
Average		27%		36%
0% to 5%	624	26%	848	15%
5% to 20%	890	37%	1,914	34%
20% to 50%	352	15%	1,098	20%
50% +	537	22%	1,680	30%
Percent Disabled Household				
Average		15%		13%
0% to 5%	466	19%	1,439	26%
5% to 10%	530	22%	1,307	24%
10% to 20%	834	35%	1,754	32%
20% +	570	24%	1,010	18%
Average		28%		24%
0% to 5%	621	26%	1,769	32%
5% to 25%	344	14%	980	18%
25% to 50%	1059	44%	2,215	40%
50% +	355	15%	544	10%
Average		55%		52%
0% to 10%	621	26%	1,379	25%
10% to 50%	474	20%	1,356	24%
50% to 80%	273	11%	749	13%
80% +	1046	43%	2,056	37%

Table A3.3
Characteristics of Closed Properties – Closed Lites and Fulls

	All Closed		Closed Lite		Closed Full	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	**1187**		**391**		**796**	
Number of Units	**104,852**		**37,256**		**67,596**	
Location						
Census region						
Northeast	239	20%	71	18%	168	21%
Midwest	252	21%	78	20%	174	22%
South	540	45%	146	37%	393	49%
West	155	13%	95	24%	60	8%
Metro Location						
Central City	486	41%	197	50%	289	36%
Balance of Metro (Suburb)	280	24%	108	28%	172	22%
Non-metro	421	35%	86	22%	335	42%
Neighborhood (Census Tract) Characteristics						
Proportion of Vacant Hsg Units						
Average		10%		9%		10%
0% to 5%	240	20%	105	27%	135	17%
5% to 10%	536	45%	157	40%	378	48%
10% to 20%	329	28%	112	29%	216	27%
20% +	82	7%	16	4%	66	8%
Homeownership Rate						
Average		52%		48%		54%
0% to 40%	315	26%	120	31%	194	24%
40% to 60%	323	27%	135	35%	187	24%
60% to 70%	286	24%	83	21%	203	26%
70% +	263	22%	52	13%	211	27%
Poverty Rate						
Average		26%		24%		28%
0% to 10%	142	12%	68	17%	73	9%
10% to 20%	353	30%	124	32%	228	29%
20% to 30%	265	22%	79	20%	186	23%
30% to 40%	185	16%	60	15%	125	16%
40% +	242	20%	59	15%	183	23%
Rent-to-Income Ratio						
Average		21%		22%		21%
0% to 40%	645	54%	186	48%	459	58%
40% to 60%	369	31%	155	40%	213	27%
60% to 70%	139	12%	37	9%	102	13%
70% +	34	3%	12	3%	22	3%

Table A3.3 *(Continued)*
Characteristics of Closed Properties – Closed Lites and Fulls

	All Closed		Closed Lite		Closed Full	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	**1187**		**391**		**796**	
Number of Units	**104,852**		**37,256**		**67,596**	
Proportion of Racial/Ethnic Minorities						
Average		38%		40%		37%
0% to 10%	413	35%	125	32%	288	36%
10% to 25%	195	16%	68	17%	127	16%
25% to 50%	162	14%	53	14%	109	14%
50% to 75%	133	11%	49	13%	84	10%
75% +	285	24%	96	25%	189	24%
Property Characteristics of Closed Properties						
Development Size						
Average Number of Units	88		96		85	
Less than 50 units	299	25%	83	21%	215	27%
50-99 units	487	41%	147	38%	339	43%
100-199 units	332	28%	132	34%	199	25%
200 or more units	70	6%	28	7%	42	5%
Unit Size						
Average number of bedrooms per unit	1.78		1.68		1.84	
Density						
Proportion of 3+bedroom units	250	21%	71	18%	178	22%
Occupancy Type						
Family	788	66%	254	65%	535	67%
Elderly/disabled	399	34%	137	35%	261	33%
Building Type						
High-rise/elevator	301	25%	116	30%	185	23%
Other	886	75%	275	70%	611	77%
Age						
Average	24		26		23	
0-20	95	8%	21	5%	75	9%
20-25	726	61%	167	43%	559	70%
25-30	170	14%	102	26%	69	9%
30+	195	16%	102	26%	93	12%
HUD Program Type						
Older Assisted	389	33%	197	50%	192	24%
Newer Assisted	798	67%	194	50%	604	76%
Mortgage Sponsor Type						
Profit Motivated	659	56%	178	46%	481	60%
Limited Dividend	394	33%	160	41%	234	29%
Non-Profit	127	11%	53	14%	74	9%
Other	6	1%	0	0%	6	1%

Table A3.3 *(Continued)*
Characteristics of Closed Properties – Closed Lites and Fulls

	All Closed		Closed Lite		Closed Full	
	Number	**Percent**	**Number**	**Percent**	**Number**	**Percent**
Number of Properties	**1187**		**391**		**796**	
Number of Units	**104,852**		**37,256**		**67,596**	
Mortgage Financed Type						
State HFA Bond Financed	80	7%	10	3%	70	9%
Other	1107	93%	381	97%	726	91%
Most Recent REAC Financial Performance Score						
Average	68		74		65	
0-40	82	7%	15	4%	67	8%
40-60	265	22%	52	13%	213	27%
60-80	561	47%	169	43%	391	49%
80+	280	24%	156	40%	124	16%
Most Recent REAC Physical Inspection Score						
Average	81		84		80	
0-40	3	0%	0	0%	3	0%
40-60	84	7%	20	5%	64	8%
60-80	395	33%	113	29%	283	36%
80+	705	59%	259	66%	446	56%
Per Unit Unpaid Principal Balance (UPB)						
Average	$20,244		$15,515		$22,567	
$0-$10,000	244	21%	139	36%	105	13%
$10,000-$25,000	570	48%	198	51%	373	47%
$25,000-$35,000	286	24%	37	9%	249	31%
$35,000+	87	7%	17	4%	70	9%
Change in REAC Capital Deficiency Score						
Decrease or No Change	768	65%	242	62%	526	66%
Increase	419	35%	149	38%	270	34%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio						
Average		128%		119%		133%
< 80%	20	2%	11	3%	9	1%
80% to 100%	134	11%	71	18%	63	8%
100% to 125%	426	36%	176	45%	250	31%
125% to 150%	381	32%	95	24%	287	36%
150%+	226	19%	38	10%	188	24%

Table A3.4
Tenant Characteristics of Closed Properties – Closed Lites and Fulls

	All Closed		Closed Lite		Closed Full	
	Number	Percent	Number	Percent	Number	Percent
Properties	**1135**		**384**	**34%**	**751**	**66%**
Units	**99,597**		**36,691**		**62,906**	
Length of Residence (years)						
Average	4.52		4.70		4.43	
< 2.5	132	12%	37	10%	124	17%
2.5 to 5	363	32%	176	46%	355	47%
5 to 8	242	21%	155	40%	234	31%
8 +	46	4%	16	4%	38	5%
Household Size						
Average	2.01		1.90		2.07	
< 1.15	165	15%	122	32%	157	21%
1.15 to 2	121	11%	57	15%	113	15%
2 to 2.5	278	25%	105	27%	270	36%
2.5+	213	19%	99	26%	205	27%
Percent Elderly Household						
Average		29%		36%		25%
0% to 5%	202	18%	81	21%	194	26%
5% to 20%	297	26%	132	34%	289	39%
20% to 50%	126	11%	38	10%	118	16%
50% +	155	14%	131	34%	147	20%
Percent Disabled Household						
Average		15%		14%		16%
0% to 5%	122	11%	94	24%	114	15%
5% to 10%	177	16%	87	23%	169	22%
10% to 20%	272	24%	132	34%	264	35%
20% +	208	18%	69	18%	200	27%
Percent Female-headed Single Parent Household with Children						
Average		28%		25%		29%
0% to 5%	178	16%	140	36%	170	23%
5% to 25%	113	10%	45	12%	105	14%
25% to 50%	373	33%	142	37%	365	49%
50% +	109	10%	50	13%	101	13%
Percent Racial/ethnic Minority-headed Household						
Average		51%		54%		50%
0% to 10%	241	21%	104	27%	233	31%
10% to 50%	158	14%	75	20%	150	20%
50% to 80%	83	7%	41	11%	75	10%
80% +	300	26%	163	42%	292	39%

Table A3.5
Location Characteristics of Closed Fulls – Market Rent versus Exception Rent

	All Fulls		Full at Market		Fulls at Exception Rent	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	796		572		224	
Number of Units	67596		50311		17285	
Location						
Census region						
Northeast	168	21%	116	20%	52	23%
Midwest	174	22%	120	21%	54	24%
South	393	49%	294	51%	99	44%
West	60	8%	42	7%	18	8%
Metro Location						
Central City	289	36%	206	36%	83	37%
Balance of Metro (Suburb)	172	22%	134	23%	38	17%
Non-metro	335	42%	232	41%	103	46%
Neighborhood (Census Tract) Characteristics						
Proportion of Vacant Hsg Units						
Average		10%		9%		12%
0% to 5%	135	17%	117	20%	18	8%
5% to 10%	378	48%	281	49%	97	43%
10% to 20%	216	27%	135	24%	82	36%
20% +	66	8%	39	7%	27	12%
Homeownership Rate						
Average		54%		54%		54%
0% to 40%	194	24%	134	23%	61	27%
40% to 60%	187	24%	133	23%	54	24%
60% to 70%	203	26%	155	27%	48	22%
70% +	211	27%	151	26%	61	27%
Poverty Rate						
Average		27%		26%		31%
0% to 10%	73	9%	64	11%	9	4%
10% to 20%	228	29%	168	29%	61	27%
20% to 30%	186	23%	135	24%	51	23%
30% to 40%	125	16%	91	16%	33	15%
40% +	183	23%	114	20%	70	31%
Rent-to-Income Ratio						
Average		21%		21%		21%
0% to 40%	459	58%	341	60%	118	53%
40% to 60%	213	27%	151	26%	63	28%
60% to 70%	102	13%	63	11%	38	17%
*70% +	22	3%	17	3%	5	2%

Table A3.5 *(Continued)*
Location Characteristics of Closed Fulls – Market Rent versus Exception Rent

	All Fulls		Full at Market		Fulls at Exception Rent	
	Number	**Percent**	**Number**	**Percent**	**Number**	**Percent**
Number of Properties	796		572		224	
Number of Units	67596		50311		17285	
Proportion of Racial/Ethnic Minorities						
Average		37%		37%		38%
0% to 10%	288	36%	219	38%	69	31%
10% to 25%	127	16%	82	14%	44	20%
25% to 50%	109	14%	75	13%	33	15%
50% to 75%	84	10%	56	10%	27	12%
75% +	189	24%	139	24%	50	23%
Property Characteristics of Closed Fills						
Development Size						
Average Number of Units	85		88		78	
Less than 50 units	215	27%	130	23%	85	38%
50-99 units	339	43%	256	45%	83	37%
100-199 units	199	25%	155	27%	44	20%
200 or more units	42	5%	31	5%	11	5%
Unit Size						
Average number of bedrooms per unit	1.8		1.8		1.8	
Density						
Proportion of 3+bedroom units	178	22%	128	22%	50	22%
Occupancy Type						
Family	535	67%	373	65%	162	72%
Elderly/disabled	261	33%	199	35%	62	28%
Building Type						
High-rise/elevator	185	23%	144	25%	40	18%
Other	611	77%	428	75%	184	82%
Age						
Average	23		23		24	
0-20	75	9%	53	9%	22	10%
20-25	559	70%	430	75%	129	58%
25-30	69	9%	41	7%	28	13%
30+	93	12%	49	9%	44	20%
HUD Program Type						
Older Assisted	192	24%	107	19%	86	38%
Newer Assisted	604	76%	465	81%	138	62%

Table A3.5 *(Continued)*
Location Characteristics of Closed Fulls – Market Rent versus Exception Rent

	All Fulls		Full at Market		Fulls at Exception Rent	
	Number	Percent	Number	Percent	Number	Percent
Number of Properties	796		572		224	
Number of Units	67596		50311		17285	
Mortgage Sponsor Type						
Profit Motivated	481	60%	367	64%	115	51%
Limited Dividend	234	29%	156	27%	78	35%
Non-Profit	74	9%	44	8%	30	13%
Other	6	1%	5	1%	1	0%
Mortgage Financed Type						
State HFA Bond Financed	70	9%	51	9%	19	8%
Other	726	91%	521	91%	205	92%
Most Recent REAC Financial Performance Score						
Average	65		66		61	
0-40	67	8%	35	6%	32	14%
40-60	213	27%	146	25%	68	30%
60-80	391	49%	298	52%	93	42%
80+	124	16%	94	16%	30	14%
Most Recent REAC Physical Inspection Score						
Average	80		81		77	
0-40	3	0%	0	0%	3	1%
40-60	64	8%	39	7%	24	11%
60-80	283	36%	187	33%	96	43%
80+	446	56%	346	60%	100	45%
Per Unit Unpaid Principal Balance (UPB)						
Average	$22,567		$23,596		$19,938	
$0-$10,000	105	13%	54	9%	51	23%
$10,000-$25,000	373	47%	276	48%	97	43%
$25,000-$35,000	249	31%	185	32%	64	29%
$35,000+	70	9%	57	10%	12	6%
Change in REAC Capital Deficiency Score						
Decrease or No Change	526	66%	379	66%	147	66%
Increase	270	34%	193	34%	77	34%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio						
Average		133%		132%		136%
< 80%	9	1%	7	1%	2	1%
80% to 100%	63	8%	47	8%	15	7%
100% to 125%	250	31%	186	33%	63	28%
125% to 150%	287	36%	216	38%	71	32%
150%+	188	24%	115	20%	73	32%

Table A3.6
Tenant Characteristics of Closed Fulls – Market Rent versus Exception Rents

	All Full		Full at Market Rent		Full at Exception Rent	
	Number	Percent	Number	Percent	Number	Percent
Properties	**751**		**538**	**72%**	**213**	**28%**
Units	**62,906**		**46,399**	**74%**	**16,507**	**26%**
Length of Residence (years)						
Average	4.43		4.6		4.0	
< 2.5	124	17%	83	15%	41	19%
2.5 to 5	355	47%	245	46%	110	52%
5 to 8	234	31%	174	32%	60	28%
8 +	38	5%	36	7%	2	1%
Household Size						
Average	2.07		2.1		2.1	
< 1.15	157	21%	118	22%	39	18%
1.15 to 2	113	15%	73	14%	40	19%
2 to 2.5	270	36%	191	36%	79	37%
2.5+	205	27%	152	28%	53	25%
Percent Elderly Household						
Average		25%		27%		20%
0% to 5%	194	26%	131	24%	63	30%
5% to 20%	289	39%	200	37%	89	42%
20% to 50%	118	16%	89	17%	29	14%
50% +	147	20%	115	21%	32	15%
Percent Disabled Household						
Average		16%		15%		18%
0% to 5%	114	15%	78	15%	36	17%
5% to 10%	169	22%	133	25%	36	17%
10% to 20%	264	35%	196	36%	68	32%
20% +	200	27%	128	24%	72	34%
Percent Female-headed Single Parent Household with Children						
Average		29%		29%		29%
0% to 5%	170	23%	128	24%	42	20%
5% to 25%	105	14%	72	13%	33	15%
25% to 50%	365	49%	253	47%	112	53%
50% +	101	13%	78	15%	23	11%
Percent Racial/ethnic Minority-headed Household						
Average		50%		50%		51%
0% to 10%	233	31%	165	31%	68	32%
10% to 50%	150	20%	113	21%	37	17%
50% to 80%	75	10%	47	9%	28	13%
80% +	292	39%	212	39%	80	38%

Table A3.7
Characteristics of Watch List Versus Other Closed (Fulls and Lites) Properties

	Watch List		All Other Closed	
	Number	Percent	Number	Percent
Number of Properties	**297**		**1187**	
Number of Units	**23234**		**104852**	
Location				
Census region				
Northeast	60	20%	239	20%
Midwest	105	35%	252	21%
South	90	30%	540	45%
West	42	14%	155	13%
Metro Location				
Central City	160	54%	486	41%
Balance of Metro (Suburb)	51	17%	280	24%
Non-metro	87	29%	421	35%
Tract Characteristics				
Proportion of Vacant Hsg Units				
Average		11%		10%
0% to 5%	55	19%	240	20%
5% to 10%	107	36%	536	45%
10% to 20%	109	37%	329	28%
20% +	26	9%	82	7%
Homeownership Rate				
Average		48%		52%
0% to 40%	101	34%	315	26%
40% to 60%	74	25%	323	27%
60% to 70%	67	23%	286	24%
70% +	55	18%	263	22%
Poverty Rate				
Average		26%		26%
0% to 10%	46	15%	142	12%
10% to 20%	73	25%	353	30%
20% to 30%	77	26%	265	22%
30% to 40%	51	17%	185	16%
40% +	50	17%	242	20%
Rent-to-Income Ratio				
Average		22%		21%
0% to 40%	154	52%	645	54%
40% to 60%	98	33%	369	31%
60% to 70%	37	12%	139	12%
70% +	9	3%	34	3%

Table A3.7 *(Continued)*
Characteristics of Watch List Versus Other Closed (Fulls and Lites) Properties

	Watch List		All Other Closed	
	Number	Percent	Number	Percent
Number of Properties	**297**		**1187**	
Number of Units	**23234**		**104852**	
Percent Minority				
Average		41%		38%
0% to 10%	88	30%	288	36%
10% to 25%	48	16%	127	16%
25% to 50%	51	17%	109	14%
50% to 75%	33	11%	84	10%
75% +	77	26%	189	24%
Property Characteristics				
Development Size				
Average Number of Units	78		88	
Less than 50 units	100	34%	299	25%
50-99 units	119	40%	487	41%
100-199 units	64	22%	332	28%
200 or more units	14	5%	70	6%
Unit Size				
Average number of bedrooms per unit	1.85		1.78	
Density				
Proportion of 3+bedroom units		22%		21%
Occupancy Type				
Family	229	77%	788	66%
Elderly/disabled	68	23%	399	34%
Building Type				
High-rise/elevator	66	22%	301	25%
Other	231	78%	886	75%
Age				
Average	25		24	
0-20	27	9%	95	8%
20-25	152	51%	726	61%
25-30	62	21%	170	14%
30+	56	19%	195	16%
HUD Program Type				
Older Assisted	129	43%	389	33%
Newer Assisted	168	57%	798	67%

Table A3.7 *(Continued)*
Characteristics of Watch List Versus Other Closed (Fulls and Lites) Properties

	Watch List		All Other Closed	
	Number	**Percent**	**Number**	**Percent**
Number of Properties	**297**		**1187**	
Number of Units	**23234**		**104852**	
Mortgage Sponsor Type				
Profit Motivated	150	50%	659	56%
Limited Dividend	127	43%	394	33%
Non-Profit	19	6%	127	11%
Other	1	0%	6	1%
Mortgage Financed Type				
State HFA Bond Financed	18	6%	80	7%
Other	279	94%	1107	93%
REAC Financial Performance Score				
Average	63		68	
0-40	40	14%	82	7%
40-60	72	24%	265	22%
60-80	125	42%	561	47%
80+	60	20%	280	24%
REAC Physical Inspection Score				
Average	76		81	
0-40	9	3%	3	0%
40-60	48	16%	84	7%
60-80	98	33%	395	33%
80+	142	48%	705	59%
Per Unit Unpaid Principal Balance (UPB)				
Average	$19,341		$20,244	
$0-$10,000	84	28%	244	21%
$10,000-$25,000	123	42%	570	48%
$25,000-$35,000	60	20%	286	24%
$35,000+	30	10%	87	7%
Change in REAC Capital Deficiency Score				
Decrease or No Change	196	66%	768	65%
Increase	101	34%	419	35%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio				
Average		122%		128%
< 80%	6	2%	20	2%
80% to 100%	39	13%	134	11%
100% to 125%	139	47%	426	36%
125% to 150%	79	27%	381	32%
150%+	34	11%	226	19%

Table A3.8
Tenant Characteristics – Watch List Versus Other Closed

	Watch List		All Other Closed	
	Number	**Percent**	**Number**	**Percent**
Number of Properties	**570**		**1135**	
Number of Units	**50733**		**99,597**	
Tenant Data				
Length of Residence (years)				
Average	4.38		4.5	
< 2.5	54	18%	169.0	14%
2.5 to 5	142	48%	555.4	47%
5 to 8	89	30%	405.9	34%
8 +	13	4%	56.7	5%
Household Size				
Average	2.15		2.0	
< 1.15	51	17%	290.6	24%
1.15 to 2	53	18%	178.1	15%
2 to 2.5	87	29%	393.3	33%
2.5+	105	35%	317.7	27%
Percent Elderly Household				
Average		21%		29%
0% to 5%	92	31%	287.8	24%
5% to 20%	122	41%	440.8	37%
20% to 50%	37	12%	164.0	14%
50% +	45	15%	289.2	24%
Percent Disabled Household				
Average		14%		15%
0% to 5%	72	24%	216.8	18%
5% to 10%	58	20%	267.6	23%
10% to 20%	103	35%	414.5	35%
20% +	60	20%	281.9	24%
Percent Female-headed Single Parent Household with Children				
Average		32%		28%
0% to 5%	54	18%	322.6	27%
5% to 25%	52	17%	157.4	13%
25% to 50%	130	44%	531.0	45%
50% +	55	18%	158.3	13%
Percent Racial/ethnic Minority-headed Household				
Average		59%		51%
0% to 10%	59	20%	353.3	30%
10% to 50%	60	20%	235.4	20%
50% to 80%	40	13%	120.7	10%
80% +	138	46%	475.5	40%

Table A3.9
Property Characteristics – Fulls Versus All Others

	Fulls		All Others Except Opt Out and Pipe Line	
	Number	Percent	Number	Percent
Number of Properties	**796**		**6,570**	
Number of Units	**67596**		**690,469**	
Location				
Census region				
Northeast	168	21%	1,278	19%
Midwest	174	22%	1,911	29%
South	393	49%	2,122	32%
West	60	8%	1,259	19%
Metro Location				
Central City	289	36%	3,439	52%
Balance of Metro (Suburb)	172	22%	1,796	27%
Non-metro	335	42%	1,335	20%
Tract Characteristics				
Proportion of Vacant Hsg Units				
Average		10%		9%
0% to 5%	135	17%	1,906	29%
5% to 10%	378	48%	2,747	42%
10% to 20%	216	27%	1,622	25%
20% +	66	8%	296	5%
Homeownership Rate				
Average		54%		47%
0% to 40%	194	24%	2,429	37%
40% to 60%	187	24%	1,822	28%
60% to 70%	203	26%	1,193	18%
70% +	211	27%	1,126	17%
Poverty Rate				
Average		28%		22%
0% to 10%	73	9%	1,507	23%
10% to 20%	228	29%	1,978	30%
20% to 30%	186	23%	1,301	20%
30% to 40%	125	16%	883	13%
40% +	183	23%	900	14%
Rent-to-Income Ratio				
Average		21%		22%
0% to 40%	459	58%	3,214	49%
40% to 60%	213	27%	2,412	37%
60% to 70%	102	13%	740	11%
70% +	22	3%	204	3%

Table A3.9 *(Continued)*
Property Characteristics – Fulls Versus All Others

	Fulls		All Others Except Opt Out and Pipe Line	
	Number	Percent	Number	Percent
Number of Properties	**796**		**6,570**	
Number of Units	**67596**		**690,469**	
Percent Minority				
Average		37%		39%
0% to 10%	288	36%	2,032	31%
10% to 25%	127	16%	1,157	18%
25% to 50%	109	14%	1,131	17%
50% to 75%	84	10%	750	11%
75% +	189	24%	1,500	23%
Property Characteristics				
Development Size				
Average Number of Units	85		105	
Less than 50 units	215	27%	1,456	22%
50-99 units	339	43%	2,257	34%
100-199 units	199	25%	2,151	33%
200 or more units	42	5%	706	11%
Unit Size				
Average number of bedrooms per unit	1.84		1.71	
Density				
Proportion of 3+bedroom units		22%		19%
Occupancy Type				
Family	535	67%	4,554	69%
Elderly/disabled	261	33%	2,016	31%
Building Type				
High-rise/elevator	185	23%	1,757	27%
Other	611	77%	4,813	73%
Age				
Average	23		26	
0-20	75	9%	901	14%
20-25	559	70%	2,208	34%
25-30	69	9%	1,807	27%
30+	93	12%	1,655	25%
HUD Program Type				
Older Assisted	192	24%	3,683	56%
Newer Assisted	604	76%	2,887	44%

Table A3.9 *(Continued)*
Property Characteristics – Fulls Versus All Others

	Fulls		All Others Except Opt Out and Pipe Line	
	Number	Percent	Number	Percent
Number of Properties	**796**		**6,570**	
Number of Units	**67596**		**690,469**	
Mortgage Sponsor Type				
Profit Motivated	481	60%	2,510	38%
Limited Dividend	234	29%	2,519	38%
Non-Profit	74	9%	1,403	21%
Other	6	1%	139	2%
Mortgage Financed Type				
State HFA Bond Financed	70	9%	536	8%
Other	726	91%	6,034	92%
REAC Financial Performance Score				
Average	65		68	
0-40	67	8%	514	8%
40-60	213	27%	1,392	21%
60-80	391	49%	2,954	45%
80+	124	16%	1,710	26%
REAC Physical Inspection Score				
Average	80		81	1%
0-40	3	0%	67	1%
40-60	64	8%	467	7%
60-80	283	36%	2,231	34%
80+	446	56%	3,805	58%
Per Unit Unpaid Principal Balance (UPB)				
Average	$22,567		$18,695	
$0-$10,000	105	13%	1,830	28%
$10,000-$25,000	373	47%	3,046	46%
$25,000-$35,000	249	31%	978	15%
$35,000+	70	9%	716	11%
Change in REAC Capital Deficiency Score				
Decrease or No Change	526	66%	4,269	65%
Increase	270	34%	2,302	35%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio				
Average		133%		104%
< 80%	9	1%	1,611	25%
80% to 100%	63	8%	1,533	23%
100% to 125%	250	31%	1,924	29%
125% to 150%	287	36%	1,005	15%
150%+	188	24%	497	8%

Table A3.10
Tenant Characteristics Closed Fulls Versus All Others

	Fulls		All Others Except Opt Out and Pipe Line	
	Number	Percent	Number	Percent
Number of Properties				
Number of Units				
Tenant Data				
Length of Residence (years)				
Average	4.43		5.14	
< 2.5	131	17%	547	8%
2.5 to 5	376	47%	2,815	43%
5 to 8	248	31%	2,610	40%
8 +	40	5%	599	9%
Household Size				
Average	2.07		1.95	
< 1.15	166	21%	1,741	26%
1.15 to 2	120	15%	1,346	20%
2 to 2.5	286	36%	1,811	28%
2.5+	217	27%	1,623	25%
Percent Elderly Household				
Average		25%		35%
0% to 5%	205	26%	1,095	17%
5% to 20%	306	38%	2,283	35%
20% to 50%	125	16%	1,220	19%
50% +	156	20%	1,946	30%
Percent Disabled Household				
Average		16%		13%
0% to 5%	121	15%	1,670	25%
5% to 10%	179	22%	1,527	23%
10% to 20%	280	35%	2,103	32%
20% +	212	27%	1,215	18%
Percent Female-headed Single Parent Household with Children				
Average		29%		24%
0% to 5%	180	23%	2,060	31%
5% to 25%	112	14%	1,130	17%
25% to 50%	386	49%	2,625	40%
50% +	107	13%	688	10%
Percent Racial/ethnic Minority-headed Household				
Average		50%		53%
0% to 10%	247	31%	1,621	25%
10% to 50%	159	20%	1,551	24%
50% to 80%	79	10%	871	13%
80% +	310	39%	2,508	38%

Table A3.11
Regression Analysis

	Probability of Participation	Probability of Closing as Full	Probability of Exception Rent	Probability of Closing as Watch List	Fulls vs. All Others (Except Opt Outs and Pipeline)
Properties Included	MtM Participants and Non-Participants, excluding Opt-Outs	Closed Fulls and Closed Lites	Closed Fulls	Closed Fulls, Closed Lites and Watch List Properties	Closed Fulls, Closed Lites, All AOTC properties and non-participants, excluding Opt-Outs
Dependent Variable	=1 if participant =0 otherwise	=1 if Full =0 if Lite	=1 if Exception Rent =0 if Market Rent	=1 if Watchlist =0 if Close Lite or Full	=1 if Closed Full =0 Otherwise
Number of Properties	7,974	1,187	796	1,484	7,360
Location					
Census region					
Northeast	+	NS	+	NS	+
Midwest	-	+	+	+	-
South	Ref	Ref	Ref	Ref	Ref
West	+	+	+	NS	NS
Metro Location					
Central City	NS	+	NS	+	NS
Balance of Metro (Suburb)	Ref	Ref	Ref	Ref	Ref
Non-metro	-	NS	NS	NS	NS
Tract Characteristics					
Proportion of Vacant Hsg Units	NS	NS	NS	NS	
Homeownership Rate	+	-	NS	-	+
Poverty Rate	+	-	+	-	+
Property Characteristics					
Development Size	-	-	NS	-	NS
Density (Proportion of 3+bedroom units)	+	+	NS	NS	+
Occupancy Type					
Family	Ref	Ref	Ref	Ref	Ref
Elderly/disabled	-	NS	NS	NS	-
Building Type					
High-rise/elevator	NS	-	Ref	NS	NS
Other	Ref	Ref	NS	Ref	Ref
Age	NS	-	NS	NS	-

Table A3.11 *(Continued)*
Regression Analysis

	Probability of Participation	Probability of Closing as Full	Probability of Exception Rent	Probability of Closing as Watch List	Fulls vs. All Others (Except Opt Outs and Pipeline)
Properties Included	**MtM Participants and Non-Participants, excluding Opt-Outs**	**Closed Fulls and Closed Lites**	**Closed Fulls**	**Closed Fulls, Closed Lites and Watch List Properties**	**Closed Fulls, Closed Lites, All AOTC properties and non-participants, excluding Opt-Outs**
Dependent Variable	**=1 if participant =0 otherwise**	**=1 if Full =0 if Lite**	**=1 if Exception Rent =0 if Market Rent**	**=1 if Watchlist =0 if Close Lite or Full**	**=1 if Closed Full =0 Otherwise**
Number of Properties	**7,974**	**1,187**	**796**	**1,484**	**7,360**
HUD Program Type					
Older Assisted	-	-	+	+	-
Newer Assisted	Ref	Ref	Ref	Ref	Ref
Mortgage Sponsor Type					
Profit Motivated	Ref	Ref	Ref	Ref	Ref
Limited Dividend	+	NS	NS	NS	NS
Non-Profit	-	NS	NS	NS	NS
Other					
Mortgage Financed Type					
State HFA Bond Financed	-	NS	NS	NS	-
Other	Ref	Ref	Ref	Ref	Ref
REAC Financial Performance Score	-	-	-	-	-
REAC Physical Inspection Score	-	-	-	-	NS
Per Unit Unpaid Principal Balance (UPB)	-	+	-	NS	-
Change in REAC Capital Deficiency Score	+	+	NS	NS	+
Pre-restructure Sec. 8 Contract Rent to FMR Ratio	+	+	+	NS	+

Appendix B

Tables for Chapter 4

Comparison of Property Characteristics Based on Total Savings

This appendix presents tables that compare property characteristics based on total savings. The tables provide the same information as the tables in Chapter 4, but add information on distributions of key variables.

Table A4.3 also presents results of regression analysis that isolates the effects of each characteristic on savings, separately for closed Lites and Fulls. For each model the table presents the properties included and the dependent variable, followed by rows showing the effect of each variable. The dependent variable, total savings, is a continuous variable, and therefore the Ordinary Least Squares (OLS) Regression method is used. OLS regression fits a *linear* regression line by minimizing the least squared residuals.

Some of the explanatory variables are categorical. When that is the case, one of the categories must be excluded as the reference category in order for the regression to converge to a unique solution. The largest category is generally chosen as the omitted category for each characteristic and then becomes essentially a reference category. The regression results can be interpreted as the effect on saving relative to having the reference characteristic. The reference category is indicated by "REF" in the table. For each variable "NS" indicates that the variable was not statistically significant in the regression. A "+" indicates the variable had a statistically significant positive effect on the probability of having a particular outcome, and "-" indicates a statistically significant negative effect. "NA" indicates that the variable is not included in the regression. (The variable closed at market or exception rents is not included in the Lite regression).

Table A4.1
Factors Affecting Savings for Lite Transactions

	All Lites	Lite Average Savings = $12,143 Savings Above Average	 Savings Below Average
Number of Properties	**385**	**147**	**238**
Number of Units	**35,870**	**13,439**	**22,431**
Average Savings	**$12,143**	**$22,928**	**$5,482**
Location			
Census region			
Northeast	$16,292	27%	13%
Midwest	$8,036	14%	24%
South	$11,391	32%	42%
West	$13,575	27%	22%
Metro Location			
Central City	$13,358	56%	46%
Balance of Metro (Suburb)	$12,313	29%	27%
Non-metro	$9,219	16%	26%
Neighborhood (Census Tract) Characteristics			
Proportion of Vacant Housing Units			
Average		8%	8%
0% to 5%	$12,570	35%	27%
5% to 10%	$10,309	34%	46%
10% to 20%	$13,733	28%	24%
20% +	$16,412	3%	3%
Homeownership Rate			
Average		45%	51%
0% to 40%	$13,420	37%	26%
40% to 60%	$11,883	35%	35%
60% to 70%	$12,107	18%	24%
70% +	$10,048	10%	15%
Rent-to-Income Ratio			
Average		23%	21%
0% to 20%	$11,568	44%	50%
20% to 30%	$12,814	42%	39%
30% to 40%	$12,764	11%	8%
40% +	$11,020	3%	3%
Proportion of Racial/Ethnic Minorities			
Average		45%	37%
0% to 10%	$5,051	29%	34%
10% to 25%	$2,921	15%	19%
25% to 50%	$2,174	14%	13%
50% to 75%	$6,718	12%	13%
75% +	$10,257	31%	20%

Table A4.1 ***(Continued)***
Factors Affecting Savings for Lite Transactions

		Lite Average Savings = $12,143	
	All Lites	Savings Above Average	Savings Below Average
Number of Properties	**385**	**147**	**238**
Number of Units	**35,870**	**13,439**	**22,431**
Average Savings	**$12,143**	**$22,928**	**$5,482**
Poverty Rate			
Average		25%	23%
0% to 10%	$11,436	15%	19%
10% to 20%	$12,416	33%	32%
20% to 30%	$11,012	18%	22%
30% to 40%	$12,750	17%	14%
40% +	$13,409	18%	13%
Property Characteristics			
Development Size			
Average Number of Units		91	94
Less than 50 units	$13,241	23%	20%
50-99 units	$12,375	39%	37%
100-199 units	$11,298	32%	35%
200 or more units	$10,650	7%	7%
Unit Size			
Average number of bedrooms per unit		1.62	1.72
Density			
Proportion of 3+bedroom units		16%	20%
Occupancy Type			
Family	$12,365	62%	66%
Elderly/disabled	$11,690	38%	34%
Building Type			
High-rise/elevator	$11,557	38%	24%
Other	$13,508	62%	76%
Age			
Average		25.9	26.5
0-20	$13,093	6%	4%
20-25	$12,037	43%	42%
25-30	$11,996	27%	26%
30+	$11,762	23%	27%
HUD Program Type			
Older assisted	$11,873	46%	54%
Newer assisted	$12,265	54%	46%
Mortgage Sponsor Type			
Profit Motivated	$11,282	47%	45%
Limited Dividend	$11,535	37%	43%
Non-Profit	$14,877	17%	12%
Other	N.A.	0%	0%

Table A4.1 *(Continued)*
Factors Affecting Savings for Lite Transactions

	All Lites	Lite Average Savings = $12,143	
		Savings Above Average	Savings Below Average
Number of Properties	**385**	**147**	**238**
Number of Units	**35,870**	**13,439**	**22,431**
Average Savings	**$12,143**	**$22,928**	**$5,482**
Mortgage Financed Type			
State HFA Bond Financed	$10,058	2%	3%
Other	$12,199	98%	97%
Per Unit Unpaid Principal Balance (UPB)			
Average		$17,556	$14,158
$0-$10,000	$11,490	31%	38%
$10,000-$25,000	$11,675	48%	53%
$25,000-$35,000	$13,229	12%	7%
$35,000+	$19,688	9%	2%
Most Recent REAC Financial Performance Score			
Average		72	73
0-40	$12,335	7%	6%
40-60	$11,703	16%	16%
60-80	$10,822	36%	42%
80+	$12,988	41%	36%
Most Recent REAC Physical Inspection Score			
Average		86	86
0-40	$5,147	0%	1%
40-60	$14,022	4%	3%
60-80	$11,103	18%	22%
80+	$12,243	78%	75%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio			
Average		129%	113%
< 100%	$7,607	9%	29%
100% to 125%	$11,296	42%	47%
125% to 150%	$15,074	30%	21%
150%+	$19,054	19%	3%
Change in REAC Capital Deficiency Score			
Decrease or No Change	$12,362	65%	60%
Increase	$11,294	35%	40%
PAE Type			
Public	$11,287	39%	45%
Private	$12,785	61%	55%
Restructuring Type			
Closed at Market Rent	$12,143	100%	100%
Closed at Exception Rent	N.A.	0%	0%

Table A4.2
Factors Affecting Savings for Full Transactions

	All Full	Full Positive Savings Average Savings = $11,098		
		Savings Above Average	Savings Below Average	Negative Savings (Loss)
Number of Properties	**790**	**192**	**361**	**237**
Number of Units	**67,065**	**18,219**	**30,840**	**18,006**
Average Savings	**$5,674**	**$22,480**	**$5,044**	**-$6,981**
Location				
Census region				
Northeast	$15,315	47%	17%	7%
Midwest	$1,896	9%	24%	28%
South	$2,750	32%	53%	59%
West	$8,950	12%	6%	6%
Metro Location				
Central City	$7,781	44%	34%	32%
Balance of Metro (Suburb)	$8,023	30%	21%	16%
Non-metro	$2,673	26%	45%	52%
Neighborhood (Census Tract) Characteristics				
Proportion of Vacant Housing Units				
Average		8%	8%	9%
0% to 5%	$10,250	29%	24%	19%
5% to 10%	$4,346	45%	49%	49%
10% to 20%	$4,836	23%	25%	27%
20% +	$7,364	3%	3%	4%
Homeownership Rate				
Average		44%	55%	59%
0% to 40%	$11,235	40%	22%	16%
40% to 60%	$5,100	24%	23%	22%
60% to 70%	$3,345	20%	24%	33%
70% +	$3,442	16%	31%	29%
Rent-to-Income Ratio				
Average		24%	21%	20%
0% to 20%	$3,639	40%	61%	66%
20% to 30%	$7,250	35%	24%	24%
30% to 40%	$9,366	19%	13%	9%
40% +	$16,522	7%	2%	1%
Proportion of Racial/Ethnic Minorities				
Average		48%	34%	33%
0% to 10%	$10,774	32%	40%	34%
10% to 25%	$10,061	11%	16%	20%
25% to 50%	$12,698	9%	12%	20%
50% to 75%	$10,533	12%	12%	8%
75% +	$16,071	36%	20%	19%

Table A4.2 ***(Continued)***
Factors Affecting Savings for Full Transactions

	All Full	Full Positive Savings Average Savings = $11,098		
		Savings Above Average	**Savings Below Average**	**Negative Savings (Loss)**
Number of Properties	**790**	**192**	**361**	**237**
Number of Units	**67,065**	**18,219**	**30,840**	**18,006**
Average Savings	**$5,674**	**$22,480**	**$5,044**	**-$6,981**
Poverty Rate				
Average		30%	27%	26%
0% to 10%	$4,450	7%	10%	9%
10% to 20%	$3,650	23%	29%	34%
20% to 30%	$6,323	23%	25%	22%
30% to 40%	$5,609	18%	14%	16%
40% +	$8,268	30%	21%	19%
Property Characteristics				
Development Size				
Average Number of Units		95	85	76
Less than 50 units	$3,604	26%	24%	33%
50-99 units	$5,012	34%	45%	46%
100-199 units	$8,101	30%	27%	17%
200 or more units	$11,826	9%	4%	4%
Unit Size				
Average number of bedrooms per unit		1.76	1.80	1.96
Density				
Proportion of 3+bedroom units		20%	21%	25%
Occupancy Type				
Family	$5,492	67%	62%	74%
Elderly/disabled	$6,142	33%	38%	26%
Building Type				
High-rise/elevator	$3,565	40%	23%	10%
Other	$12,876	60%	77%	90%
Age				
Average		23.9	23.4	22.6
0-20	$4,811	9%	9%	10%
20-25	$4,910	64%	70%	76%
25-30	$9,651	13%	8%	6%
30+	$7,597	13%	13%	8%
HUD Program Type				
Older assisted	$8,222	32%	23%	18%
Newer assisted	$4,997	68%	77%	82%

Table A4.2 *(Continued)*
Factors Affecting Savings for Full Transactions

		Full Positive Savings **Average Savings = $11,098**		
	All Full	**Savings Above Average**	**Savings Below Average**	**Negative Savings (Loss)**
Number of Properties	**790**	**192**	**361**	**237**
Number of Units	**67,065**	**18,219**	**30,840**	**18,006**
Average Savings	**$5,674**	**$22,480**	**$5,044**	**-$6,981**
Mortgage Sponsor Type				
Profit Motivated	$3,286	46%	62%	71%
Limited Dividend	$10,256	45%	26%	23%
Non-Profit	$7,225	9%	12%	6%
Other	$5,432	0%	1%	0%
Mortgage Financed Type				
State HFA Bond Financed	$7,706	11%	9%	8%
Other	$5,477	89%	91%	92%
Per Unit Unpaid Principal Balance (UPB)				
Average		$24,198	$22,022	$22,290
$0-$10,000	$9,024	17%	13%	10%
$10,000-$25,000	$3,133	31%	50%	55%
$25,000-$35,000	$6,631	35%	30%	31%
$35,000+	$12,165	17%	7%	5%
Most Recent REAC Financial Performance Score				
Average		71	64	55
0-40	$1,924	10%	12%	24%
40-60	$2,254	17%	24%	34%
60-80	$6,604	43%	47%	32%
80+	$12,106	29%	17%	10%
Most Recent REAC Physical Inspection Score				
Average		83	83	80
0-40	$5,840	1%	0%	1%
40-60	$4,666	8%	9%	9%
60-80	$5,261	25%	22%	29%
80+	$6,040	67%	69%	61%
Pre-restructure Sec. 8 Contract Rent to FMR Ratio				
Average		146%	132%	125%
< 100%	$342	4%	8%	14%
100% to 125%	$2,957	20%	34%	38%
125% to 150%	$6,032	37%	37%	34%
150%+	$11,063	40%	21%	14%
Change in REAC Capital Deficiency Score				
Decrease or No Change	$6,094	66%	66%	66%
Increase	$4,935	34%	34%	34%

Table A4.2 *(Continued)*
Factors Affecting Savings for Full Transactions

		Full Positive Savings Average Savings = $11,098		
	All Full	**Savings Above Average**	**Savings Below Average**	**Negative Savings (Loss)**
Number of Properties	**790**	**192**	**361**	**237**
Number of Units	**67,065**	**18,219**	**30,840**	**18,006**
Average Savings	**$5,674**	**$22,480**	**$5,044**	**-$6,981**
PAE Type				
Public	$3,976	11%	20%	22%
Private	$6,059	89%	80%	78%
Restructuring Type				
Closed at Market Rent	$7,649	80%	81%	52%
Closed at Exception Rent	$652	20%	19%	48%

Table A4.3
Regression Results

	Full Regression Results	Lite Regression Results
Number of Properties	**790**	**385**
Properties Included	**Closed Fulls**	**Closed Lites**
Dependent Variable	**Total Savings**	**Total Savings**
Location		
Census region		
Northeast	NS	
Midwest	-	-
South	Ref	Ref
West	+	+
Metro Location		
Central City	NS	+
Balance of Metro (Suburb)	Ref	Ref
Non-metro	-	-
Proportion of Vacant Housing Units	-	NS
Homeownership Rate	-	NS
Poverty Rate	-	NS
Property Characteristics		
Development Size		
Average Number of Units	NS	NS
Density	+	NS
Proportion of 3+bedroom units		
Occupancy Type		
Family	Ref	Ref
Elderly/disabled	-	-
Building Type		
High-rise/elevator	+	NS
Other	Ref	Ref
Age	NS	NS
HUD Program Type		
Older assisted	+	NS
Newer assisted	Ref	Ref
Mortgage Sponsor Type		
Profit Motivated	Ref	Ref
Limited Dividend	+	NS
Non-Profit	NS	+
Other		
Mortgage Financed Type		
State HFA Bond Financed	NS	-
Other	Ref	Ref

Table A4.3 *(Continued)*
Regression Results

	Full Regression Results	Lite Regression Results
Per Unit Unpaid Principal Balance (UPB)-	-	NS
Most Recent REAC Financial Performance Score	+	NS
Most Recent REAC Physical Inspection Score	+	NS
Pre-restructure Sec. 8 Contract Rent to FMR Ratio	+	+
Change in REAC Capital Deficiency Score	NS	NS
PAE Type		
Public	+	NS
Private	Ref	Ref
Restructuring Type		NA
Closed at Market Rent	Ref	
Closed at Exception Rent	-	

Appendix C: Case Studies

Introduction

This is the second section of the evaluation of the U.S. Department of Housing and Urban Development's (HUD) Mark to Market (M2M) program. It has been prepared by Econometrica, Inc., and its subcontractor, Abt Associates, under contract to HUD. In 2002, HUD's Office of Policy Development and Research contracted with Econometrica, Inc., to assess and describe the program's implementation. This study is the first assessment of the program since its inception, and has three components:

- A process study that includes an analysis of how the program has been administered.
- A retrospective analysis that provides quantitative information on participation in the program, program costs and savings, efficiency of the M2M process, and program outcomes.
- Case studies developed to present a picture of the program as it was operating at the time the study was conducted.

The first section of the report presents all of the analytical studies and the data upon which they are based, including a cross site analysis that presents summary information on all the case study sites, and provides some conclusions based on review of all 15 case studies. This section contains the case studies.

The case studies cover a small sample of fifteen purposively selected properties, and include information gathered at site visits, and from analyses of data regarding each site. (Details on sample selection are presented in Chapter 7.)

Case Studies were developed for the following M2M properties:

- College Park Apartments
  Lancaster, California
- Eastward Courts
  Casper, Wyoming
- Fair Park Apartments
  Sardinia, Ohio
- Genesse Towers
  Utica, New York
- Kingsley Park
  Essex, Maryland
- Lynn Acres
  Shelbyville, Kentucky
- Murphy Blair Rehab III
  St. Louis, Missouri
- Myrtle Manor
  Phoenix, Arizona
- Russell Erskine Apartments
  Huntsville, Alabama
- Six Chimneys, Inc.
  Cleveland, Ohio
- Sneedville Gardens,
  Sneedville, Tennessee
- Winthrop Apartments
  Tacoma, Washington
- Valley Heights Apartments
  Quincy, California
- Villa Fourteen,
  Ault, Colorado
- Village Green Apartments
  Red Bay, Alabama

During the site visits, project staff interviewed property managers, owners (when available), and a sample of tenants. They spoke at length with the PAE underwriter responsible for the restructuring, and reviewed PAE materials including the Physical Assessment Report, the property Appraisal, the Restructuring Plan, and, if available, a narrative report regarding the property. In some cases Residential Assistance Assessment Plan (RAAP) reports were available and reviewed. Staff of the Public Housing Authority, or other contract administrators, were contacted for data about the property and the local housing market. Census data and REAC scores were reviewed for information about the property, area population, and the local housing market.

Each case study covers the following topics:

- A description of the property, its neighborhood, the housing market, and the financial history of the property.

- A description of the Participating Administrative Entity (PAE) handling the restructuring.

- A discussion of the major milestones in the restructuring process and tenant involvement in the M2M process.

- Details regarding the restructuring including: rent levels pre- and post-M2M, estimated savings, financing details, renovation items and their costs, outcomes for tenants, and viability of the project.

Case Study One: College Park Apartments
Lancaster, California—Lite Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

The College Park Apartments is an apartment complex located in Lancaster, California. The property was built in 1983 under the Section 8 New Construction program, and is comparable in style to many of the Section 8 properties built at that time. The property contains 60 units in 8 buildings and a separate rental office building. The apartment structures are a two-story town house design, with exterior staircases.

Lancaster, California is a community with a population of approximately 120,000 located in the “high desert” above the San Fernando Valley in Los Angeles County, 70 miles from downtown Los Angeles. Traditionally, Lancaster has been known as a retirement community. However, in the last 20 years, some light industry has moved into the area, and Lancaster serves as a “bedroom community” for nearby Edwards Air Force Base. Another major institution in the community is Lancaster Community College, which specializes in technical training courses, many of them related to the aircraft industry.

According to 2000 census data, the population of the Lancaster tract where the property is located is 78 percent non-Hispanic white, and 12 percent Hispanic. The poverty rate in the 2000 data is 9.6 percent.

Over the years, the College Park complex has traditionally had close to a 100 percent occupancy rate. Turnover normally is about one unit per month, and several of the tenants have lived at the complex since it opened in 1983. The tenant populations appear to be a mix of young families, single mothers, and a small percentage of elderly tenants. There was no indication that college students had attempted to obtain housing at the facility.

The common areas of the property are well maintained with large areas of manicured lawns and shrubbery. In addition, all the parking areas are also well maintained. The Physical Condition Assessment (PCA) noted that the property appeared to be in excellent condition given its age. One week prior to the project site visit, there was a fire that was easily contained in a single unit. The Fire Department saw this as evidence of good quality construction.

The Neighborhood

The neighborhood immediately surrounding the College Park property is mainly one of large single family residences. From all appearances, many of these properties have a high market value. Directly across the street from the property is a condominium complex. A six-lane road, which is one of the main thoroughfares of Lancaster, runs along one side of the College Park complex. The complex is located about one-half mile from the main campus of Lancaster Community College. As in many southern California residential neighborhoods, there are no retail outlets close to the complex. Interviews with tenants indicated that most residents do have cars, and the complex is located on a bus route.

The Housing Market

There are five multifamily subsidized housing complexes in the community (both Section 8 and Public Housing). The homeownership rate given for the tract in 2000 census data was 64.1 percent. The vacancy rates for both the total housing market and the rental market were a relatively low 5.4 percent.

Financial History of the Project

The College Park property is owned and managed by a development and property management group based in Los Angeles. The group has been the owner and manager of the property since its construction in 1983. The same group owns and operates two other Section 8 multifamily properties in Lancaster. In addition, this management group has been active in developing private sector single family and multifamily residences in the Lancaster area.

This property has consistently received “90” level scores for financial management. Likewise, the maintenance reserve has consistently been maintained at a high per-unit level.

The Participating Administrative Entity (PAE): ONTRA

The College Park restructuring was handled by ONTRA, Inc., a private PAE located in Austin, Texas. ONTRA has been supporting government organizations, primarily as an underwriter and manager for distressed properties, for over 20 years. The company has served clients such as the Federal Deposit Insurance Corp, the Federal Savings and Loan Insurance Corp. (FSLC), and the Resolution Trust Corp. (RTC). For the past few years they have handled restructurings for the M2M program.

The company is divided into three in-house teams: 1) a restructure specialist team; 2) a field specialist team; and 3) an administrative team. The restructure specialist team develops the plan, handles underwriting, runs underwriting calculations, handles second tenant meetings, and deals with owner representatives. The field specialists develop the market rents, handle comparable assessments, and conduct the first tenant meetings. The administrative team works with vendors, performs closings, manages the collection of documents for submission to HUD, and handles the post-closing process.

ONTRA has completed about 280 M2M restructurings, of which roughly 80 were Fulls. Their last Lite was completed in July 2001, and of the 40 M2M deals currently in progress, virtually all are Fulls. ONTRA operates nationwide, with many of their restructurings occurring in the Midwest and West.

The underwriter assigned to coordinate the College Park restructuring has been working for ONTRA for almost two years. At the time of this restructuring she was handling four other M2M negotiations. The underwriter appeared to be thoroughly familiar with M2M procedures and standard policies.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- The College Park property was referred to ONTRA on December 2, 2002, with the notice that the owner was requesting a LITE restructuring.

- The first major activity in the process was a rent comparability study developed by the owner. This study was submitted to the ownership group on January 31, 2003 and immediately forwarded to the ONTRA underwriter. After receipt of this documentation the ONTRA underwriter identified third party vendors for the independent rent comparability study and the Physical Condition Assessment.

- The independent rent appraisal was submitted to ONTRA on April 14, 2003. It estimated market rents below those estimated by the owner's study.

- The Physical Condition Assessment (PCA) was forwarded to ONTRA on April 15, 2003. The PCA found the property to be in good condition. Repairs and maintenance items appeared to have been addressed on a timely basis. The PCA found only a limited number of maintenance items that needed to be addressed within a 12-month timeframe. These were:

    - Painting of a concrete walkway.
    - Sealing cracks on paving.
    - Touch-up painting of wooden siding.
    - Replacement of several utility doors.
    - Replacement of 4 chipped sinks.
    - Repainting of wood landings and entrances on second stories.

  The estimated total cost for these items was $15,300, which the PAE felt could be paid out of the cash reserves of the property.

- On May 23, 2003, ONTRA made a formal recommendation that the College Park HAP contract be renewed at the market rent levels established by the independent rent comparability study. This recommendation was formally approved by OMHAR on June 6, 2003.

- In the case of Lites, of course, there is no formal closing date for a financial restructuring. Rather, after OMHAR's approval, the property is then referred back to the local HUD Office of Housing to finalize a new 5-year HAP agreement at the newly established rent levels. As of October 2003, the OMHAR system had not received notification that the finalized HAP agreement was in place.

Tenant Involvement in the M2M Restructuring

OMHAR's procedures do not call for tenant meetings in Lite restructurings. However, in this case, ONTRA did solicit tenant feedback (apparently this has become a standard ONTRA procedure in the case of Lites). On March 23, 2003, the ownership sent a Tenant Response Form to all residents at College Park. The form provided instructions to send the form directly to ONTRA. Four forms were returned to ONTRA, all of them indicating general satisfaction with the management of the property.

On April 22, 2003, an ONTRA staff person facilitated a tenant meeting. There were 25 residents at the meeting. Eleven feedback forms were obtained at the meeting, all of which indicated general satisfaction with property management. One issue that was brought up on several forms was the need for more security. Interviews with tenants on-site indicated that this concern was likely due to minor thefts (e.g., bicycles) often attributed to residents of a public housing complex about two blocks distant from College Park.

Details of the M2M Restructuring

Rent Levels

The PAE recommended that the rents at College Park be reduced to the market levels established by the independent rent comparability study. These levels are provided in Table 1 below.

Table 1. PAE-Recommended Rents

Type of Unit	Previous HAP Rents	New/Market Rents
Two-Bedroom	$798.00	$735.00
Three-Bedroom	$869.00	$850.00
Four-Bedroom	$944.00	$900.00

In the model used for Lites the PAE does not calculate a Fair Market Rent for a given locality.

Estimated Savings

The estimated savings to the government for this rent restructuring over 20 years were $563,000.00. This works out to a per-unit savings over the same timeframe of $9,229.50. However, in the case of a Lite, it should be noted that the owner has made a commitment to keep the property in Section 8 for only 5 years.

Financing

No financing was involved in this Lite restructuring.

Renovation Items and Costs

No renovation items or costs were associated with this Lite rent restructuring, except as noted earlier in the discussion of the Physical Condition Assessment.

Outcomes for Tenants

As indicated above, this has been a well-managed property, located in a fairly up-scale neighborhood. The level of tenant satisfaction with the property was high. It was a major benefit for the tenants that this property was able to remain in Section 8 with only a modest reduction in the subsidized rent levels. If the owner had been required to go to Full restructuring there is a possibility that the ownership may have considered taking the property into the private sector.

Viability of the Project after M2M Restructuring

Given the history of this property, there is a high degree of confidence that the property will continue to be maintained at a more than satisfactory level through the course of the new 5-year HAP agreement.

Lessons Learned from This Site

The lessons learned from analysis of the M2M restructuring at this site are:

- Section 8 rent subsidies at high rates do serve the interests of a low-income population. In Lancaster, rent comparability studies showed generally high rents in the area. At the same time, there is a considerable low-income population in the community. Without the availability of subsidized housing this population would likely have to resort to sub-standard housing or devote an exceedingly high proportion of their income to housing costs.

- There are cases where M2M type initiatives could lead owners to “opt out” of Section 8. Of the 15 properties studied for this report, it appeared that most owners would have difficulty moving a property to the private sector. However, in the case of College Park, a move to the private sector may have been a real option. In any future initiatives, HUD may want to consider some level of flexibility in cases of this type, i.e., a genuine need for affordable housing but also realistic private sector opportunities for the Section 8 owners.

Case Study Two: Eastward Court Apartments Casper, Wyoming—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

The Eastward Court Apartment complex is located in the city of Casper, Wyoming, the county seat of Natrona County, in the east central portion of Wyoming. According to the 2000 Census, Natrona County has a population of 66,533 with Casper comprising 75 percent of this number with 49,644 residents. The immediate adjacent portions of Natrona County are devoted to farming and large, open cattle ranges. The Casper census tract containing Eastward Court has an extremely low poverty rate of 7.8 percent. Nearly 97 percent of the 2000 population was classified as non-Hispanic white.

Casper has long served as the service hub for Wyoming's oil and natural gas industries (the famous Teapot Dome field is located about 60 miles north of Casper). The oil and gas industry is famously cyclical. After a downturn in the late 1990s there has been a recent upturn, particularly in natural gas production. Casper also has a relatively large service/retail sector with major employers including the Wyoming Medical Center, Boise Cascade Office Products and Casper College. The closest communities of any size are Douglas (pop.5, 200) 60 miles away, and Riverton (pop.9, 300) more than 120 miles away.

The Eastward Court Apartments complex was built in 1981 under the Section 8 New Construction program. The property consists of 32 family units in 9 buildings on a 2.2 acre lot. There is a separate building containing the laundry facilities and maintenance shed. The property also has a playground.

The buildings are townhouse-style, two-story wood framed structures with concrete foundations. The exterior is a combination of brick veneer and wood siding. Of the 32 units, 22 are two-bedroom/one-bath units and 10 are three-bedroom/one-bath units. Of the 22 two-bedroom/one-bath units, four are designated as handicapped accessible.

At the time of the project site visit the property appeared to be in fairly good condition. The lawns and trees were well-maintained. The wood siding and trim suffered from the effects of the severe winter weather in Casper, and presented a "worn" look. The asphalt sidewalks and the paved parking lot were in obvious need of repair.

The management agent for Eastward Court is independent from the ownership of the property. This firm has managed the property since 1995, when it took over duties from the previous company. They currently manage 2,669 units in 65 properties located in Alaska, Colorado, Montana, Wyoming, and Washington.

For the last several years the Eastward Court property has virtually had a 100 percent level of occupancy. For the last two years, the average time on the waiting list for prospective tenants has been between 4 and 6 months. The majority of tenants appear to be single adults, a fair number with children. However, there are also some elderly and disabled tenants at the property.

The Neighborhood

The Eastward Court property sits at the western end of a residential neighborhood of well-maintained single family residences that appear to be 60 to 70 years old. Immediately across the street from the property are several non-subsidized multifamily apartment buildings. On the street immediately to the west of the property are several buildings housing medical offices, and several local service agencies. Beyond the office buildings is open range land running for ten miles to the next ridge of the central Wyoming Mountains.

The Housing Market

Although there appears to be a dearth of multifamily properties in Casper (see the justification for exception rents below), census data indicates a high vacancy rate in the local rental market. The 2000 census data shows a vacancy rate of 21.4 percent in the rental market. The census data also indicates a relatively high percentage (59 percent) of home ownership in the Eastward Court census tract. This is often an indicator of a “tight” rental market, particularly for low income households.

Tenants were strongly of the opinion that vouchers would be difficult to use in Casper, especially to obtain units comparable in quality to those at Eastward Court. The on-site property managers and several other property owners who were present at the property during the site visit seconded this viewpoint.

Financial History of the Project

The Eastward Court Apartments complex is currently owned by the Limited Partnership that developed the property under the Section 8 New Construction program in 1981. All past ratings of Eastward Court indicated that financial management was sound and ample reserves were maintained.

The Participating Administrative Entity (PAE): Colorado Housing and Finance Authority (CHFA)

The Colorado Housing and Finance Authority (CHFA) is a public entity providing a wide range of housing assistance to Colorado residents. The core mission of CHFA is to provide affordable housing and business growth opportunities for the State. To meet this objective CHFA offers (only within Colorado) three main types of financing, namely:

- Home ownership mortgages to qualifying low- and moderate-income Colorado individuals and families.

- Rental housing loans for new construction and rehabilitation of existing facilities, and the administration of the Low Income Housing Tax Credit (LIHTC) program.

- Commercial loans to locally-owned businesses in Colorado and administration of the Brownfields loan program.

The CHFA programs are funded through issuance of taxable or tax exempt bonds and from other secured resources. CHFA is not a State agency, and its bonds and notes are not obligations of the State of Colorado and are not repaid with tax dollars. CHFA is self-supporting and pays all operating expenses from its program revenues.

CHFA has been particularly interested in promoting development in the rural parts of the state that have not shared in the recent "booms" of such urban centers as Denver and Fort Collins. In addition, because of the explosive growth in such urban areas, the preservation of affordable housing became a focus of the organization. This concern led CHFA to form an affordable housing unit in the late 1990s, and it is this unit that has operated as a PAE since the inception of the M2M program.

Because CHFA issues mortgages within the State of Colorado, it may not administer any M2M restructurings in the state due to a conflict of interest. To date, CHFA has coordinated over 50 restructurings in four other states. Approximately 20 percent of these restructurings have been Lites. At the time of the evaluation, CHFA was handling three restructurings. CHFA staff handles all aspects of the restructuring process in-house, including development of the M2M model, facilitation of tenant meetings, and closings.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- The Eastward Court Apartments were referred to CHFA in December 2002.

- The third party Physical Condition Assessment was completed on January 21, 2003. A draft report was submitted to the PAE on February 19, 2003. After some comments and directives provided by the PAE, the final PCA report was submitted to the PAE on April 29, 2003.

- Housing Authority personnel also performed a physical review of the property on March 24, 2003. The primary maintenance needs noted during the PAE inspection involved the property's exterior siding, parking lots, windows, kitchen cabinets, and unit floor coverings. PAE staff also believed that the property would benefit from additional maintenance and office space. All of these items were included in the near-term rehab plan for the property.

- The owner received notice of the immediate and long-term physical needs of the property on June 3, 2003. The owner form concurring with this plan for near- and long-term rehab work was executed on June 6, 2003.

- The PAE had a third party rent comparability study performed in January 2003. There was some difficulty in establishing true “comps” for the Eastward Court property since the property has only two- and three-bedroom units. There are virtually no comparable units in the general Casper area. However, the appraiser did obtain data on several properties in the Casper area and made adjustments for the differing unit compositions.

  This was a comprehensive analysis, however, the PAE had some questions about details of the analysis provided. On March 24, 2003, PAE staff visited the seven “comp” properties and found that some of the cost figures for these properties were troublesome. For example, the comparability study had not noted that at a number of these properties tenants had to pay all utility costs for their units. Subsequently, PAE staff gathered additional cost data from the seven properties and adjusted the conclusions of the comparability study accordingly.

- The first Tenant Meeting was held on March 24, 2003. (See the Tenant Involvement section below for details.)

- Utilizing the rehab requirements data and the rent comparability analysis, the PAE submitted a draft Restructuring Plan to OMHAR on June 11, 2003.

- After several minor revisions, the Restructuring Plan was finally approved on August 12, 2003.

  The central feature of the Plan is that, even though there are sharp reductions in the HAP rents, the financial viability of the property requires the approval of Exception Rents. The primary justification for the exception rent levels was the amount of annual potential rent necessary to produce, at least, a 1.20 debt service coverage ratio. In this case, the determined amount needed was calculated to be $231,478.00, which produces a 1.20 Debt Service Ratio using a 5 percent vacancy/bad debt rate.

  The main justification for the approval of the Exception Rents on the part of OMHAR was a severe shortage of affordable housing for low-income households in Casper. The 2000 Census documented that of 20,343 households in Casper, 8,551 had incomes from $0 to $32,400. The $32,400 figure is the maximum income limit for residence at Eastward Court. Thus, approximately one-third of the households in Casper had incomes that would make them eligible to apply for a housing subsidy at Eastward Court. There are seven HUD Section 8 project-based properties in Casper. All of the properties but one have long waiting lists. For the last several years the Eastward Court apartments have had virtually 100 percent occupancy, resulting in a wait of up to 6 months for a 2-bedroom unit, and up to one year for a 3-bedroom unit.

In addition, a PAE survey indicated an overall occupancy rate of 97 percent in rental properties in the Casper area. In the local area there are also 75 family Public Housing units with an overall occupancy rate of 100 percent and a waiting list of 75 individuals. The Casper Housing Authority has been allocated 481 Section 8 vouchers. They currently administer 500 such vouchers with a waiting list of over 800 applicants. The PAE staff also noted that without the funding provided by the Exception Rents, the owner might have an option to move the property to the private sector. This would be an expensive option, given the rehab needs of the property, but given the "tight" rental market in Casper such a move might be financially feasible.

- The details of the OMHAR-approved restructuring were presented at a second tenant meeting held on August 22, 2003.

- The restructuring formally closed on September 24, 2003.

Tenant Involvement in the M2M Restructuring

The first tenant meeting was held at the property on March 24, 2003. Six residents attended this meeting. They expressed general satisfaction with the property management. Several residents indicated that they wanted the restructuring agreement to address problems in their individual units.

The second tenant meeting, on August 22, 2003, was also held at the property, and there were eight attendees. The residents expressed general satisfaction with the terms of the restructuring agreement. As before, several residents expressed hope that the restructuring would address repairs or replacements in individual units.

Details of the M2M Restructuring

Rent Levels

Table 2 provides the rent levels pre- and post-M2M restructuring.

Table 2. Rent Levels Pre- and Post-M2M

Unit Type	HUD-Established FMRs	PAE Market Rents	New Contract Rents		Previous Contract Rents	
			Rent	Rent as Percent of FMR	Rent	Rent as Percent of FMR
Two-Bedroom	$519	$400	$582	112%	$944	181%
Three-Bedroom	$711	$489	$648	91%	$1,160	163%

Estimated Savings

Based on this rent schedule and project costs, the OMHAR model estimates a total savings to the government of $351,295.00 over 20 years of operation. This works out to a per-unit savings of $10,332.00.

Financing

The restructuring was concluded with the issuance of new first, second, and third mortgages. Details of the financing were as follows:

- The new first mortgage was set at $506,200.00 with an interest rate of 6.60 percent and a term of 30 years.

- The new second mortgage was set at $545,200.00 with a 1 percent interest rate and a term of 30 years. The second mortgage was derived by reducing the amount reasonably expected to be paid, $560,190.00, to a level that would produce a project UPB at the end of the 30-year term that is 80 percent of the residual value of the property.

- The new third mortgage was set at $879,172.00 at a 1 percent interest rate and a term of 30 years. The third mortgage was required since the total amount of the calculated Partial Payment of Claim exceeds the principal amount of the second mortgage.

The Partial Payment of Claim on the existing mortgage was set at $1,424,372.00 on an UPB of $1,459,448.00.

Renovation Items and Costs

A total of 13 specific items appeared on the short-term rehab list. These items were:

- Installation of lighting for east side and between buildings: $2,400.00.

- Installation of ceiling-mounted heater in maintenance shop: $200.00.
- Installation of central air conditioning in the units: $57,600.00.
- Installation of additional attic ventilation: $6,000.00.
- Replacement of wood siding with metal siding: $55,000.00.
- Replacement of windows: $48,000.00.
- Replacement of broken, heaved, and settled walkways: $24,000.00.
- Repair of parking lots: $20,000.00.
- Expansion of existing maintenance shop: $20,000.00.
- Installation of accessible play structure: $14,000.00.
- Repair one fire separation unit: $100.00.
- Installation of three video cameras and taping equipment for security: $3,500.00.
- Replacement of unit furnaces (along with air conditioning): $56,100.00.

These items represented a total expense of $307,000.00 or $9,593.50 per unit for the near-term rehab package. For these items the owner was required to assume 20 percent of the costs save for the air conditioning expense. The air conditioning installation was deemed to be a "Significant Addition," and thus the owner's portion of this cost was only 3 percent.

Outcomes for Tenants

The tenants should receive substantial benefits for the 12-month rehab package. The per-unit allowance of nearly $10,000.00 is near the top end of rehabilitation programs. In particular, the installation of air conditioning will be a major property enhancement. The rehab package also addresses some long standing security concerns of the tenants.

Perhaps most importantly, the conclusion of the restructuring agreement preserves this low-income unit in what is an extremely "tight" rental market in Casper. The use of Exception Rents to preserve this low-income property particularly serves tenant needs since it has historically been a well-managed and well-maintained property.

Viability of the Project after M2M Restructuring

The Exception Rents granted for this property have the express purpose of ensuring the viability of this property based on historic expense levels. The long waiting lists at Eastward Court would indicate that, at least for the near term, cash flow from rents should be more than adequate to maintain operations. Another indication of the likely viability of the restructuring is the interest of several entities, both for-profit and non-profit, to purchase the property once the restructuring was concluded.

Lessons Learned from This Site

Lessons learned at this site include the following:

- Exception rents can be a necessary tool in preserving affordable and good quality housing in communities with a high proportion of low-income households. As mentioned above, approximately one-third of Casper households could qualify for subsidized housing at Eastward Court. Both the private and subsidized rental markets are extremely "tight." (In fact, the city of Casper has made the construction of rental housing a priority in its most recent Community Development Block Grant.) Options for low-income families in this area are few given the long distances between towns and cities in Wyoming, and the low quality of much rural rental housing. The preservation of this property ensures that the tenant population can remain reasonably close to schools and employment opportunities. In addition, the quality of the Eastward Court property appears superior to much of the private sector rental stock.

- A relatively high investment in the near-term rehab program can still result in significant savings for the government. The high per-unit investment at Eastward Court (nearly $10,000.00 per unit) still ended in an estimate of over $350,000.00 in savings over 20 years. This savings was generated at the same time that the short-term rehab program will bring significant, immediate benefits to the tenant population.

Case Study Three: Fair Park Apartments
Sardinia, Ohio—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

Fair Park Apartments is a multifamily apartment complex located in Sardinia, Ohio. Sardinia is a Village with a population of only 3,000 and is located an hour east of Cincinnati. It is in a rural area, but is close to several major highways that provide access to neighboring towns and to Cincinnati. Many residents commute to Cincinnati, as employment in Sardinia is very limited. Downtown Sardinia had only 3 blocks of retail and commercial businesses, and most are now closed. A train station, churches and residential neighborhoods make up the rest of the community. A sign on the road into Sardinia states that it was the home of the Underground Railroad.

Census data for 2000 indicate that the population of the census tract in which Sardinia is located has a non-Hispanic white population of 98.1 percent, a slight drop from 99.4 percent in 1990. The non-Hispanic black population and the Hispanic population each account for only some 0.5 percent of the population. The tenant population of Fair Park reflects the racial make-up of the general population, it is all non-Hispanic white.

The property was constructed in 1981 and consists of three two-story buildings which contain a total of 41 units. The one- and two-bedroom units are garden-style, and the three-bedroom units are designed like townhouses, but share a roof. Of the 41 units, 8 are one-bedroom units, 24 are two-bedroom units, and 9 are three-bedroom units. There are two handicap units with bathrooms that have roll-under sinks, wider doorways and grab bars. Each unit has sprinklers and a smoke alarm. Only 40 units are covered under the current HAP contract, as one of the three-bedroom units is currently rented as a market rate unit.

The one-bedroom units have living areas of 625 square feet. They each contain a living room, a galley kitchen, one bedroom, and a bathroom. The two-bedroom units have a living area of 842 square feet, and include a living room, an eat-in kitchen, two bedrooms, and one bathroom. The three-bedroom units have a total of 910 square feet, with a living room, eat-in kitchen, three bedrooms, one full bathroom, and one half bath. Every apartment has a balcony or patio. All units have an electric forced-air furnace and central air-conditioning.

The property includes a parking lot with a total of 61 spaces, or 1.5 spaces per unit. The property also contains two playgrounds, a laundry facility, and a small management office. Overall the property is in good condition. The Property Condition Assessment noted that there were no critical or immediate repair needs, and 12-month needs were minimal. Property staff is all part-time, and includes a Property Manager, a maintenance employee, and a cleaning employee.

The Neighborhood

The property is located close to the center of Sardinia, on one of the few main streets in this small town. It is situated in a residential area, and the properties in the immediate vicinity are single-family homes that range in age from 20 to 100 years old. A few units of manufactured housing are also nearby and sit on relatively large lots. Almost all of these properties appear to be well maintained, as are most of the residential properties in Sardinia. Within walking distance of Fair Parks are a U.S. Post Office, the city government office building, a church, a bank, and the Sardinia Elementary School. Students must take buses to the Middle School and High School. The closest hospital is a 15-minute drive away.

The handful of retail and commercial businesses remaining in the downtown area include a restaurant and a bank. Several other businesses are located along the highway into town, including a large grocery store and a gas station. Other businesses are located on the major highways close to Sardinia, including the same fast-food chains and strip mall shopping seen all over the country.

The Housing Market

According to Census data, the census tract in which Fair Park is located had a 16.9 percent poverty rate in 2000, up from 14.4 percent in 1990. The homeownership rate was 76.6 percent in 2000, almost identical with the 76.4 percent census rate for 1990. Census data also indicate that 6.1 percent of housing units in the census tract were vacant in 2000, a drop from 7.8 percent in 2000. Rental housing vacancy rates went up to 6.9 percent in 2000, from a 5.8 percent rate in 1990.

Development of new housing in Sardinia is extremely limited, and many households live in manufactured housing. Fair Park is the only apartment complex in the town. Other rental housing is limited to some manufactured housing units, and apartments in houses that were previously single-family.

Financial History of the Property

The property is owned by Fair Park Associates, an Ohio Limited Partnership. The managing general partner is W. Scott Liming. The property manager is Stern-Hendy Management Company, Inc., a third-party, fee-paid managing agent. At the time the M2M process was being conducted, an affiliate of the management company was in the process of trying to secure financing in order to purchase the property. Closing was expected to occur in August 2003.

Fair Parks has two HAP contracts in place, one covering 32 units, and the other covering the remaining 8 units. The property manager stated that rents on the 32 units covered by the first contract were reduced to market rents by HUD several years ago. She did not know why rents for the other 8 were not reduced, nor did the PAE underwriter. The contracts are not based on unit size, and each contains units of all three sizes.

The original mortgage was in the amount of $1,262,700, with an interest rate of 7.5 percent, and was to mature on July 1, 2003. According to the Owner's audited financial statement, dated December 31, 2002, the outstanding mortgage balance was $1,022,039, and the debt service in 2002 was $104,868. In 2002, the Adjusted Net Operating Income (ANOI) reflected on the Owner's audited statement was $101,793, resulting in a DSCR of 0.97.

When the PAE first contacted Stern-Hendy regarding the HUD request for an M2M review, the management company representative explained that because the HUD rent reduction on the 32 units had occurred only a few years ago, it was the owner's understanding that just the remaining 8 units were to be analyzed in 2003 for market rent reductions. However, the PAE states that during conversations with the OMHAR Chicago office, it was decided that rents were to be revised for all 40 units because the original rent reduction by HUD was not undertaken as part of the M2M program.

The Participating Administrative Entity (PAE): Credit-Vest

Credit-Vest is a private PAE. It is a large real estate company with a great deal of experience handling the due diligence process. Credit-Vest was one of the first companies to become a PAE for the M2M program, and it has completed hundreds of M2M restructurings. The underwriter who handled the Fair Parks deal was very experienced, and was handling some 15 M2Ms during the same time period.

Reason Why the Owner Chose a Lite Restructuring

The PAE underwriter stated that she believed the owner's preference for a Lite may have been due to a desire to opt out of subsidized housing as soon as possible. The PAE underwriter also stated that she thought the property could succeed without subsidies under the right financial circumstance. The owner's representative did not return calls regarding this issue or others once the M2M process was begun. The PAE stated that they assumed the owner felt the recommendations might jeopardize his efforts to secure financing and purchase the property.

The analyst who prepared this study was able to reach the owner's representative after the M2M process was completed. He stated that they chose a Lite simply because they wanted the thing to move as quickly as possible. He also said he wanted the property to remain subsidized because there is a great need for subsidized units in the area.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- The property was referred from the HUD field office to OMHAR in January 2003.

- The PAE accepted asset assignment in March 2003.

- Tenant input was provided as follows:

  The PAE sent tenant surveys to management on April 19, 2003, for distribution to tenants. Six responses were received back, representing 15 percent of the units. The PAE stated that generally the survey results indicated that tenants were satisfied with the property, management, and maintenance.

  During the site visit for this study, four tenants were interviewed. They included an elderly woman, an elderly man, and two single mothers each with one child. All of these tenants were living in one-bedroom apartments, and each of the units was in very good condition with no observable repair or renovation needs. All of the tenants said they were happy living at Fair Park and had no complaints about management or maintenance.

  None of the tenants understood anything about the M2M process, except that some repairs and renovations might occur. One tenant was pleased that her kitchen might be updated, the others were content with their units as is, and hoped that repairs would not be disruptive.

  The tenants were asked whether they thought they could find another suitable unit nearby if given a housing choice voucher. Three of the four were unfamiliar with the voucher program but, when it was explained, said they could not find another apartment in Sardinia, and might try to find an available manufactured housing unit. The one tenant who had some familiarity with the voucher program stated that she could probably find a unit in a nearby town, but not in Sardinia.

- The PAE did not accept justification for a Lite restructuring. Instead they made a case for a Full restructuring. (See discussions below about the restructuring data and the PAE's justification for recommending a Full restructure.)

  As all attempts to speak with the owner's representative had failed, the PAE assumed they were going to appeal the recommendations, accept a Watch List contract, or opt out. In the summer of 2003, the process was begun to place the property on the Watch List.

  The Watch List contract was signed in September 2003. At about the same time, the purchase deal fell apart. In November, the owner, through the managing agent, sent HUD a request for a Full M2M restructuring. The managing agent, who has purchased two other properties from this owner, expects to purchase the property after the M2M is completed.

Details of the M2M Restructuring

There is no restructuring plan for Fair Park. As noted above, the PAE recommended against a Lite restructuring, and the owner refused to speak with the PAE to discuss either the details of the recommendation, or the option of moving to a Full restructure plan. Instead of describing a restructuring, this section summarizes the data on rent levels and the Physical Condition Assessment data compiled by the PAE.

Proposed New Rent Levels

Table 3, developed by the PAE, details the rents under both of the HAP contracts, along with a weighted average rent, and the PAE's concluded market rent.

Table 3. Rent Levels of HAP Contracts

Unit Type	HAP Contract OH10M000189		HAP Contract OH160019120		Weighted Average Rent	Concluded Market Rent
	Number of Units	Rent	Number of Units	Rent		
One-Bedroom	6	$406	2	$502	$430	$365
Two-Bedroom	20	$473	4	$578	$491	$500
Three-Bedroom	6	$602	2	$703	$628	$546

The recommended new market rents result in a slight decrease in gross potential rent of approximately $11,304 a year ($942/month,) or some 4.6 percent. The new market rents for the one- and three-bedroom units are lower than the existing contract rents under both of the HAP contracts. However, the rent for the two-bedroom units is slightly higher than the larger of the two HAP contract rents.

Property Condition Assessment Review

A Property Condition Assessment of Fair Park Apartments was completed on May 16, 2003. The report concluded that the property was in good condition, showing normal wear and tear for a 22-year-old property.

The Assessment did not identify any areas of critical repair affecting life or safety. The only repair item required during the first 12 months was the replacement of windows in 10 units at an estimated cost of $5,500.

The cost of capital items judged necessary in the first five years was some $54,372, or $1,326 per unit.

The major repair items anticipated over a 20-year term include new roofs, bathroom fixtures, pad mounted unit condensers, and new carpeting. It was estimated that the costs of these items would total $618,557, or $773 per unit per year, on a non-inflated basis, and $746,080, or $933 per unit per year, on an inflated basis using a 2.50 percent inflation rate. (In November, the owner's agent, who had not seen the Restructure Plan, indicated that based on similar work on another project, he expected the costs at Fair Park to total some $250,000 to $300,000.)

PAE Justification for Recommendation of Full Restructure

The following discussion of the Credit-Vest justification for a Full Restructure is adapted from their Narrative Report, supplemented by information from the underwriter.

The basis for the PAE rejecting a Lite restructure and recommending a Full, was the imbalance between the costs of the physical repairs needed and the size of the current replacement reserves. Credit-Vest noted that the long-term physical need requirements of the property were heavily concentrated in the earlier years of the 20-year term. As noted above, the costs of repairs over the first 5 years were estimated at $54,372 per year. These costs could not be funded out of the current replacement reserves of some $43,350, and the PAE believed the property would suffer from deferred maintenance unless replacement reserves were increased. The PAE noted they did not make any adjustments to the 20-Year Replacement Reserve Schedule set out in the assessment report.

The PAE then considered two scenarios for increasing the replacement reserves. The first was to increase the initial deposit to the replacement reserve account by $200,000, thus requiring annual deposits of $20,000 ($488/unit), versus the current figure of $4,006 ($100/unit). They calculated that under this scenario, based on the current underwriting, the DSCR would decrease from the 2002 number of 0.97, to approximately 0.73.

In their second scenario, the owner would increase the annual reserve deposit amount from the current figure of $4,006 ($100/unit) to $47,770 ($1,165/unit). The DSCR would decrease from 0.97 to approximately 0.47. They noted, however, that this scenario, while not requiring such a large IDRR, results in a potential over-funding of the reserve account in Year 20 (balance of $656,985 or over $16,000/unit). The PAE did attempt to change the timing of some of the items in the 20-year physical needs schedule, but could not alleviate the heavy up-front costs; therefore, no adjustments were made.

The PAE stated that due to the small size of the property, they did not view either of these recommendations as economically beneficial for the property. They did not think the property could achieve the 1.20 DSCR required to be approved as a Lite under either scenario.

The PAE reiterated that under normal circumstances they would review the reserve schedule at length and negotiate with the owner, but this had not occurred. As noted earlier, the process was begun in late summer to place the property on the Watch List, the Watch List contract was signed in September, and in November the owner requested a Full M2M restructure.

Lessons Learned From This Site

The restructure process for Fair Park has taken a circuitous route from requested Lite, to rejected Lite and recommended Full, to a Watch List contract, and now to a request for a Full restructure. Also unusual was the fact that rents on most of the units had been reduced by HUD a few years ago, and anticipated savings would only be in the range of 4.6 percent per year or $11,300 a year. Add to this the fact that the owner’s representative was attempting to arrange financing and purchase the property and never communicated with the PAE during the restructure assessment, and we have a very atypical M2M process. It many never yield lessons that can be applied to other M2M restructurings. However, it does raise questions about the way this project has been handled so far, and highlights a problem in the M2M process that has been noted in other case studies.

Should Fair Park have been refused a Lite restructure, given how close the rents were to FMR’s and the small savings ($11,000 annually) that will be realized after a Full restructure? Additionally, costs projected for the recommended rehab items appear quite high: a total of some $600,000 for a short list of items (see Property Condition Assessment Review above) for only 40 units. Given these numbers one can assume that with a Full restructure the government will lose a considerable amount of money over 20 years.

On the other hand, there is no other subsidized housing in the area and if a Lite restructuring had been approved, the owner may well have opted out of Section 8 at the end of the 5-year commitment. Keeping the units subsidized for an additional 15 years would seem to be a good outcome. However, it was not the purpose of the PAE in making its decision. In fact, no one involved in the early stages of the M2M process seemed to focus on the difficult decision about the need for the units to remain subsidized. Only when a RAAP is prepared is this question considered.

A peripheral question raised by this case is the way tenants are selected for project-based subsidized units. Although Fair Park offers the only subsidized units in the area, at least one of the tenants interviewed for this study seemed not to need subsidized housing. She stated that prior to coming to Fair Park she had sold her home and came to the project because she did not want to move out of Sardinia or into manufactured housing.

Because the Property Manager keeps her own waiting list, people can be chosen because they will make good tenants rather than because they have the greatest need. This situation is not unusual.

Case Study Four: Genesse Towers
Utica, New York—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

Genesse Towers is a 66-unit project for the elderly and handicapped located in Utica, a city in central New York State. According to Census data, the population of Utica was 60,651 in 2000. Historically, the area depended on manufacturing jobs that, for the most part, are no longer available. Current unemployment is 7.3 percent, and Census data for 2000 indicate that the poverty rate was 24.5 percent. According to the PAE assessment, there will be no substantial job growth in the foreseeable future. Census data for 2000 showed racial characteristics for Utica as 76.5 percent non-Hispanic white, 12.4 percent non-Hispanic black, and 5.8 percent Hispanic. Tenants in the project reflect the racial make-up of the general population and are elderly, handicapped, or mentally/ developmentally impaired.

The project is an 11-story, narrow brick structure that was built in 1920 as a bank building on the main street in Utica. The building was gut-rehabilitated in 1981 by the current owner. The first floor consists of a dining room, commercial kitchen, and management office, and the mezzanine serves as a library. In the basement are a laundry room and storage bins for tenants. The 66 units take up the remaining 9 floors of the building, with 6 to 7 units per floor. There are 49 studios, and 17 one-bedroom units. A parking lot to the rear of the building is used by management, although the land on which it sits is a separate parcel of land belonging to the property's owner.

Genesse Towers has some seven different apartment configurations due to differences in the original floor plans. The units are relatively small, but adequate for one tenant. Efficiencies are 338 sq. ft., on average, and have a living/kitchen/sleeping area and a bathroom. The one bedroom units average 460 sq. ft., and have a small bedroom in addition to a living/kitchen area and a bath. The kitchens in all of the units are Pullman-type arrangements set along one wall, consisting of a storage closet, refrigerator, 9-inch wide sink, and a small stove. There is no counter space, which combined with the small sink size, makes meal preparation and clean-up very difficult. Staff at the Utica Housing Authority believes that the small size of the efficiency units is one of the two reasons the building has some problems attracting and retaining tenants. (The other reason is location, which is discussed below.)

Seven units are partially handicapped-accessible and those doorways, sinks and toilets have been adapted. However, the showers are not the roll-in type needed by most handicapped individuals. Furthermore, the assessment report states that "routes available to tenants partially comply with handicapped accessible requirements." This seems inadequate in a building that had been approved for congregate housing, and continues to house many residents who are elderly and/or physically handicapped.

The REAC score given the property in 1999 was 86, and in 200l the score was 96. The building is clean and well maintained. The Physical Assessment found no outstanding code violations, and the heating, plumbing and electrical systems were found to be in good working order. All the windows were replaced in 1993 with double pane aluminum units that are still in very good condition. The roof was replaced several years ago, and the outside of the building was totally scraped and re-painted in 2001.

An inspection of the property was conducted in July 2003 as part of this study, and the following observations were made. The kitchen and the social area/dining room were clean, and the latter is pleasant looking. These rooms are used daily because lunch is served for residents and non-residents, at a nominal price, by a non-profit organization. There is a sitting area across the front of the dining area with a large window looking out to the street. The area is up a few steps, but there is no ramp for those who use wheelchairs or walkers. The other common areas and the hallways throughout the building are clean, but need repainting.

The hallways, public areas, and basement areas have sprinkler systems, but the apartments and stairwells do not. This arrangement apparently meets applicable local codes and HUD requirements. However, given the height of the building, and the age and condition of the residents, it would seem prudent to extend the sprinkler system into the units. This was not noted in the Assessment Report.

The units and hallways have no air conditioning, and the cooling system for the common area is not adequate to keep the space cool on very warm days. The day the inspection for this study was conducted, it was miserably hot virtually everywhere in the building. None of the inspected units had more than one window, and some tenants had propped their doors open with fans to try to improve air flow. There appeared to be some prohibition against individual window air-conditioning units, perhaps due to inadequate wiring or insurance costs. The Physical Assessment Report noted the need for upgrades to the air conditioner for the social area/dining room.

The property is managed by an identity-of-interest company, Buck Property Management.

The Neighborhood

The project is located on the main street in Utica, in an area that is mainly commercial, with industrial remnants. The area is zoned “Commercial Highway” and a variance was needed to allow the building to be used as a multifamily residence. All of the buildings in the area appear to have been built prior to WWII. On each side of the project there are two three-story buildings with retail space on the ground floor and mostly vacant commercial space on the top floors. Directly next door is the National Long Distance Racing Museum, which was established some 10 years ago in the hopes of bringing new life to the area. That has not happened. The rest of the block includes a strip bar, an appliance repair shop, a liquor store, and an empty commercial storefront. To the rear of the building are the project's parking lot and a block of very old, virtually empty, buildings. Within a few blocks are a small, low-rise public housing project, several neglected lots, and the bridge leading out of the city.

In general, the area has a neglected, deserted feel to it, and the immediate few blocks provide no retail shopping or recreation opportunities for residents. Several blocks up Genesse Street, the area becomes better maintained with city government offices, commercial buildings and some retail businesses. Residents can find convenience shopping, a drug store and banks in this area. A bus that stops less than a block away from the project provides residents with transportation up to this area.

The Housing Market

According to Census data, the census tract in which Genesse Towers is located had a 44.4 percent poverty rate in 2000. The 2000 homeownership rate in the tract was only 29.7 percent. Census data also indicate that the total housing vacancy rate for the tract in 2000 was 17.5 percent, and the rental vacancy rate was 7.3 percent. The housing stock is very old, and much of it is in poor condition. The appraisal stated that 73.3 percent of Utica's housing was built before 1949 and that much of it is in disrepair and/or abandoned.

The Housing Authority has 243 elderly units, and administers 174 Housing Choice Vouchers. The city government administers an additional 880 vouchers in a program transferred to them by the HUD Buffalo Area Office some years ago. The average time on the waiting list for public housing is between 1 and 1.5 years. Elderly applicants usually prefer help in place and, thus, prefer a voucher. Staff for the city stated that the success rate for displaced elderly in finding a suitable unit with a housing choice voucher is 50 percent, at best. For the handicapped, the likelihood of finding a unit is much lower. There are very few handicapped-accessible rental units in Utica, and the public housing program has only some 13 accessible units.

Therefore, if tenants of Genesse Towers were given vouchers and told to find another unit, they would have great difficulty. Some tenants could probably be placed in one of the two other elderly/handicapped projects owned by the same partnership. If tenants could not find suitable rental units, the Housing Authority could eventually absorb many into the public housing program, but it would take considerable time as there is no preference for displaced persons.

The PAE Case Memo indicated that the HUD Buffalo Area Office, the Appraiser and the PAE all agreed that the project offered one of the best housing options in Utica for elderly tenants, and was worth preserving as subsidized housing.

Financial History of the Project

The building is owned by a limited partnership, the Genesse Towers Redevelopment Co., which includes the principal owner Richard Buck, his wife Kathryn Buck, the Richard M. Buck Construction Co., and the Buck Property Management Company. The property was purchased in 1980 by the partnership for $1 for each of the two parcels. In September of that year, the city of Utica entered into a tax-exempt agreement with the partnership under which city, county, and school taxes would be paid only on the assessed value of the property at the time the agreement was signed, or $58,300. The exemption remains in effect as long as the Federally-assisted mortgage on the property is outstanding. In addition, the developer was to pay 3.6 percent of the “gross sheltered rents,” but only after subtracting from that figure the amount in taxes already paid on the $58,300.

The project was financed under the 221(d) (4) program, with the intention of housing elderly tenants. Presumably that is why approval was given for the very small kitchens in the units, and the commercial kitchen and dining room. Upon completion of the rehab, the owner was approved to receive funds under the Congregated Housing Services Program. However, according to the Senior Property Manager, the needs of both the tenants and the general population changed gradually through the 1980’s. As a result, at some point in the late 1980’s, the project stopped providing congregate services. The PHA staff interviewed did not know anything about this situation. In fact, many of the current residents appear to need social service support and/or some assistance with daily tasks.

The HAP contract, which was to expire in June of 2003 but was extended during the M2M process, set rents at 189 percent of FMR. The Project Manager advertises vacancies in a variety of community papers and social service centers. As noted earlier, the PHA Contract Manger believes that it takes effort by management to keep occupancy up at this property.

In 1998 the project was refinanced, and the interest rate was dropped to 6.5 percent. The outstanding principal balance on the mortgage was $1,690,613 in August 2003. The owner is elderly and ill, and his wife runs the business with considerable assistance from the Senior Property Manager. The owner has 11 other properties, all subsidized, and 8 of them were in the M2M program as of August 2003. The owner stated, through her Senior Property Manager, that she and her husband entered the subsidized rental market in order to get business for their construction company and to provide housing for those in need. The Property Manager also stated that they entered the M2M Program under duress.

The Participating Administrative Entity (PAE): NW Financial

NW Financial is a private PAE located in Jersey City, New Jersey. It is structured with two working groups. The first has been in operation since 1996, and does public finance and advisory work for municipalities, primarily bond work. The second working group is the M2M group, which has been in operation since 2001. The firm originally got into M2M work as a Teaming Partner with a large PAE. Currently, the M2M group is staffed with a Managing Director, four underwriters, two closing coordinators and support staff. Each underwriter was working on some 10 to 15 active files in the summer of 2003. The total number of active files at that time was 82, with 7 Lites and 75 Fulls. (One was handed to them when the Massachusetts Housing Authority opted out of the M2M program.)

The underwriter who was assigned the Genesse Tower project has been with NW for 2.5 years. This was one of the first restructurings assigned to him. He was handling 12 Fulls at the time he was working on Genesse Towers. The Managing Director also worked on this restructuring.

Milestones in the M2M Restructuring

The following are key milestones in the M2M restructuring process:

- NW Financial accepted assignment of Genesse Towers on March 14, 2002.

- Residents were notified on March 25, 2002 about the M2M program and the upcoming meeting. The Notice to Tenants written by the PAE was very clear and free of bureaucratic jargon. It was posted on tenants' doors by management.

- The first tenant meeting was held on April 18, 2002. (See the Tenant Involvement Section below for details about the meeting.)

- Due diligence was completed on May 23, 2002. According to the underwriter, this was not difficult as the project is bond-financed and the owner had all of the necessary paperwork available.

- The Physical Needs Assessment was completed on September 8, 2002. The assessment was prepared by a firm of construction and building consultants that is frequently hired by NW to prepare these reports. No significant deferred maintenance needs were reported, but certain building components were found to have limited remaining life, and immediate repair or replacement was recommended for a few items.

- The report noted that a market-driven improvement, renovation of the kitchens, was required. The desirability of a second elevator was also mentioned, but not categorized as required.

- The PAE submitted a Restructure Plan to OMHAR on November 8, 2002. The Underwriter stated that the process had been slowed down during the summer by two factors. First, the Senior Project Manager for the property, who was the owner's representative throughout the deal, underwent surgery and was unavailable for more than six weeks. More significantly, the owner and her representative were already questioning and debating the PAE regarding many items in the restructure plan. As noted earlier, the owners did not want to become involved in a restructuring. The restructure plan set exception rents at 136.3 percent of FMR's, a decrease of some 28 percent from those in the current HAP contract. The owners were very concerned about the lowered rental income, and due to their age, did not view the long-term tax advantages as an offsetting factor.

- The second tenant meeting was held on November 12, 2002. (See the Tenant Involvement Section below for details.)

- OMHAR approved a Restructure Plan on February 26, 2003. This followed a series of detailed and somewhat acrimonious negotiations. The owners disagreed with the figures used to calculate the underwritten vacancy rate and the costs for many items, including: real estate taxes, property insurance and liability, utilities and garbage removal, salaries and benefits, operating repairs and maintenance, and the underwritten vacancy rate.

  Additionally, they claimed to have virtually no funds available for upfront rehab costs. The most contentious discussions involved the financing arrangements for the renovation of the kitchens. The Restructuring Agreement categorized the kitchen renovations as a market-driven improvement to an existing item and, as is typical in the program, required that 20 percent of the costs be paid for by the owner. The owners felt the kitchens should be categorized as significant additions, which require only a 3 percent owner contribution.

- First Appeal by Owner—March 28, 2003; OMHAR Response—June 9, 2003. The appeal letter was sent to Donna Rosen, the Portfolio Director at OMHAR in Washington, DC. Sue Shinderman, the Relationship Manager, was involved in the appeal review as well. Dawn Robertson, Senior Underwriter was copied on the response. The first appeal covered seven categories, the most important of which are described below, along with the OMHAR response to each item.

1) Kitchen Renovations—The Property Manager stated that the owners could not afford to pay the 20 percent of the rehab costs, some $36,000, as required in the agreement. She argued that the work was a significant addition, rather than a repair and stated that the owners could afford the 3 percent contribution that is required.

OMHAR Response—The renovation was not reclassified as a significant addition. However, the decision stated that because of the extent of the work to be done, the Restructure Plan was being modified to include one-half of the kitchen work in the rehab escrow, and half in the 2nd year of the replacement reserve.

2) Real Estate Taxes—The figure set in the Restructure Plan was $12,217 annually, based on the OMHAR reading of the old PILOT Tax Agreement which, as noted earlier, had set the assessed value of the property at $58,300. Management presented data indicating that the current assessment on which taxes were being paid was $515,332.

OMHAR Response—OMHAR increased the real estate tax figure to $25,180 annually based on the figures presented. However, they went on to note that the town's tax liabilities and billings were not in conformance with the PILOT Agreement and would have to be clarified prior to closing. The clarification was made a condition of the Restructuring Commitment.

3) Benefits—The figures set in the Restructure Agreement were arrived at by applying an OMHAR-approved formula to current costs. Management argued that the figures were artificially low and would require cutting down on numbers of staff, and hours worked, for maintenance and support staff. They asked for an additional three full-time employees, as well as higher salary and expense figures in several categories.

OMHAR Response—OMHAR added costs for three full-time employees and a painting/cleaning crew. Bookkeeping service costs were set at a $3.35PUPM per the Buffalo office guidelines. No additional salary or expense adjustments were allowed.

- Second Owner Appeal—July, 2003. Within a week of receiving the OMHAR response, the Property Manager requested an Administrative Review by OMHAR's Director of Underwriting and Finance. Subjects to be appealed were: funding of the kitchen renovation costs and calculation of real estate taxes.

Regarding the kitchen work, the Property Manager proposed that one of two plans be approved. First, that "the kitchens be added in the 1st and 2nd years (of the replacement reserves), enabling the work to be done in a timely manner, yet not financially bankrupt the owner." Or second, as requested earlier, that the work be classified as a Significant Addition, not a repair. The telephone appeal was conducted in July 2003, and a response was forthcoming within the 20-day required time period.

OMHAR Response—OMHAR again declined to categorize the kitchen improvements as a significant addition, or to make any other changes to their first decision.

- The closing was expected to occur at the end of November 2003.

Tenant Involvement in the M2M Restructuring

The first tenant meeting was held on April 18, 2003, in the community/dining room at the property. Participants included the Senior Property Manager, the Site Manager, two underwriters from NW Financial Group, and the Contract Administrator for the Utica Municipal Housing Authority. The New York State Outreach and Training Grantee was notified, but did not send a representative. Eight tenants attended the meeting.

At the meeting, the senior underwriter for NW explained the M2M program and asked tenants to express any concerns they had about the program, and to make general comments about the property and management. Tenants expressed no concerns about the program, and indicated that they were happy with the property and the management. Some cited the difficulty of finding affordable senior housing in the area.

The two project-related issues raised by tenants were inadequate kitchens, and security concerns. Tenants explained the difficulty of cooking without counter space, and cleaning up in the 9-inch sinks. Some said they had to wash pots and pans in the tub.

Security after regular daytime hours was the second concern raised by tenants. They wanted a security guard on duty all night and on the weekends.

The second tenant meeting was held on November 12, 2002. Again, management posted notices for tenants on their doors. Eight tenants attended, as did the underwriter and the property manager. A representative of the New York State Tenants and Neighbors organization attended as well. Tenants were informed about the status of the restructuring, and what the PAE was recommending regarding renovations. The tenant representative indicated that she would help tenants in creating a tenant organization. Tenants did not raise any new issues or concerns.

Despite the very good efforts by the PAE to involve tenants in the process, the level of tenant involvement was quite low. With regard to their impact on the process, it was limited to recommendations regarding staffing and physical improvements at the property. The security issue they raised may well not have been mentioned or addressed without their input, and money for added security personnel was included in the restructure plan. The renovation of the kitchens had already been raised by the Property Manager.

Five tenants were interviewed for this study in June 2003. The interviews took place in the dining room and the Property Manager was not present. With one exception, the tenants who came to be interviewed were not those picked randomly by the interviewer from the tenant list prior to the site visit.

None of the tenants interviewed had any real understanding of the M2M program. However, four were aware that improvements might be made at the property. The areas in which they most wanted to see changes were the same mentioned by tenants at the meetings—kitchens and security. Difficulty getting into the very old mailboxes was also mentioned. One tenant indicated that because her apartment was very small she wanted to move, with or without improvements. She was on the waiting list for a housing choice voucher. Three of the other four tenants were generally satisfied with the property and their units. The tenants were asked whether they would choose to remain at the property or look for another unit if they were given a housing choice voucher. As noted above, one tenant was already waiting for a voucher. One other replied that she would look for another unit, but was unsure whether she would be able to find one. Two tenants said they would choose to stay, and one was unsure. The tenants rated management as good, and maintenance as good to fair.

Details of the M2M Restructuring

Rent Levels

Table 4 provides the rent levels pre- and post-M2M restructuring.

Table 4: Rent Levels Pre- and Post-M2M

Unit Type	HUD-Established FMRs	PAE Market Rents	New Rents		Current Contract Rents	
			Exception Rent	Exception Rent as Percent of FMR	Rent	Rent as Percent of FMR
Zero-Bedroom	$338	$400	$476	141.2%	$707	189%
One-Bedroom	$400	$475	$565	141.2%	$799	189%

Estimated Savings

Savings to the Section 8 payments for the initial year of the new HAP Contract have been estimated by the PAE at $183,564. The present value amount of that savings over 20 years would be $2,116,378. However, the mortgage restructuring payment, or write-down totals, is $1,717,362. As a result, the 20-years savings to HUD will be $700,442. Of course, increases in costs at higher-than-projected levels, and the resulting higher rents, would reduce the savings. A potential cause of higher costs in this project might well be higher energy costs.

Financing

The terms of the mortgage under the restructuring as of November 1, 2003, include:

- A first mortgage in the amount of $482,000, insured under Sec. 223(a)(7), or Sec. 221(d)(4), and amortized over 30 years at a rate of 6.50 percent, plus a 0.50 percent MIP.

- A second mortgage in the amount of $801,585, amortized over 30 years, with an interest rate of 1 percent.

- A third mortgage, a HUD-held Contingent Repayment Mortgage Note in the amount of $915,776.

Renovation Items and Costs

The renovation items and costs are as follows:

- $320,000: Kitchen upgrades.
- $100,000: Added security on weekends and holidays.
- $100,000: Apartment floors (over ten years).

- $65,000: Elevator Upgrade (year 5).
- $198,000: Bathroom Fixtures (years 2-5).
- $30,000: Exterior Paint (year 7).
- $28,000: Refrigerators (over 10 years).

The commitment requires an initial deposit to Reserve for Replacement (R4R) of $215,000 and annual R4R deposits of $34,450.

Outcomes for Tenants

The primary benefit for current and future tenants from this restructuring is that the project will remain subsidized with a new 30-year commitment. Additionally, the renovations and repairs will be of considerable benefit to tenants, particularly the kitchen renovations and increased security.

Viability of the Project after M2M Restructuring

The PAE believes that the prospects are good at Genessse Towers for long-term viability. The rents, although lower than pre-M2M rents, are still exception rents. The expanded kitchen facilities will make it easier to keep the project fully occupied.

Lessons Learned from This Site

Two lessons can be taken away from this site. The first has to do with the timing of the process and OMHAR requirements. An owner can slow down the restructure process considerably with detailed analyses of, and arguments about, each item in the Restructure Plan. These delays are legitimate, but basically are out of the control of the PAE. Perhaps some adjustments to PAE timing requirements should be considered in circumstances like these.

The second lesson has to do with tenant participation. In this project only 10 and then 8 tenants attended the tenant meetings, despite the fact that the PAE had done a very good job of writing a clear letter, attaching a survey, and contacting PHA and tenant groups about the meeting. The method for notifying tenants that was chosen by management was to place the notices on tenants' doors, as was done at many other sites. Perhaps this method should be replaced by a requirement to the effect that some 10 days before the meeting the notices are to be put into tenant mailboxes, as well as posted prominently in several designated places around the property. Furthermore, it would appear that tenant comments are often most useful in the areas of management and maintenance at the project, and needed renovations. Although property staff can be asked to leave the tenant meeting during certain discussions, this does not always occur. Perhaps the information would be more forthright if tenants were interviewed individually, or in small groups, by PAE staff after the tenant meeting.

Case Study Five: Kingsley Park
Essex, Maryland—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

Kingsley Park is a 312-unit development that was built in 1943 under HUD's Section 608 mortgage insurance program and served as WWII military housing. It is located several miles from downtown Baltimore, in an older suburban community called Essex, in Baltimore County.

The property consists of one- and two-bedroom units in two-story garden-style buildings. There are four units in each entryway, two on each floor. Unit sizes are very small—686 sq. ft. for the two-bedroom units, and 640 sq. ft. for the one-bedroom units. The development consists of two long streets forming an elongated U, with the two-bedroom units on one street and the one-bedroom units on the other. There is a playground at the end of the "U," in front of a screen of trees at the property's boundary, but no community facilities on site. The property is pleasant, with green lawns and beautiful trees shading the sidewalks.

In 1988, the property came under the Section 8 Moderate Rehabilitation program, and HAP contracts were attached to 100 percent of the units. Rehabilitation at that time removed asbestos hazards, added gabled roofs, replaced kitchen cabinets and counters, and replaced windows. A portion of the heating system was replaced.

A small portion (12 units) of the one-bedroom structures that were part of the original 1943 property remained privately owned. They are in dramatically deteriorated condition (e.g., no grass, broken windows), in contrast to Kingsley Park, which is rated in fair to good condition by the M2M Program's Physical Needs Assessment.

The Baltimore County PHA, the Housing Department of the Department of Social Services, has administered the Section 8 contract since 1988. This is important, because County officials have asserted throughout the M2M process that they have the authority to decide whether the HAP contracts will be renewed.

The Moderate Rehabilitation developer is the current owner of the property, the general partner for a limited partnership called Kingsley Park Associates. She also manages Kingsley Park, through an identity-of-interest management company, Landex Corporation. The owner is a seasoned developer of low-income housing and has taken part in recent redevelopment projects under the HOPE VI program.

The Baltimore County Housing Department uses Kingsley Park as transitional housing for people who get on the waiting list for a voucher. They are told they can occupy a unit in Kingsley Park while they are waiting for their turn to receive a tenant-based voucher. Not all residents come to Kingsley Park this way. Some choose the development directly, because they know about it from friends or respond to newspaper ads.

Kingsley Park has a very high turnover rate for an assisted housing development. According to the owner, and rent roll data in the appraisal, it may be as high as 40 percent per year. The Landex regional manager and the on-site manager both said that the turnover rate resulted from families getting their voucher and moving on.

In addition to using Kingsley Park as temporary housing until a tenant-based voucher becomes available, Housing Department staff appear to have been sending to Kingsley Park people who they believe will not be attractive to private owners immediately (e.g., until they have been lease compliant tenants for some period of time). Two of the people we interviewed said that their last address before Kingsley Park had been in a homeless shelter, and two appeared to suffer from chronic mental illness.

According to one observer, the owner/manager could have resisted the use of Kingsley Park as transitional housing, but chose not to do so. Issuing vouchers to families who have already been placed in Mod Rehab developments is an unusual practice, as housing authorities usually take such families off the voucher waiting list. In addition, according to this observer, Landex did not do the tenant screening that is an owner responsibility under the Mod Rehab program. Another observer, however, said that the owner had no choice because the County Housing Department controls the waiting list and Landex has had to accept the stream of tenants referred by that office in order to keep the property occupied. The owner also says that efforts to evict problem tenants have been thwarted by the County Housing Department.

Kingsley Park has a mixed-race, multi-ethnic resident population. Among those interviewed during the site visit were three white, non-Hispanic single mothers, two African American single mothers, one near-elderly African American woman, and one young Hispanic man.

Kingsley Park appears to provide a reasonably safe living environment during the day, but at night there is an open-air drug market on the street that runs through the property. In late spring, Baltimore County stationed police cars on the property every night. Two of the residents we interviewed complained about this, saying that they felt this level of police surveillance was invading their privacy. Because of constraints on the operating budget, Landex provides no security patrols.

PAE staff expressed the opinion that the drug problem could be solved as part of a redevelopment in which the County would cede ownership of the public streets to the property. The site configuration would make it easy to turn Kingsley Park into a gated community without much additional fencing.

The Neighborhood

The census tract had a high poverty rate in 2000, 30 percent, but the rate was down from 36 percent in 1990. Because Kingsley Park has 500-600 residents, most of whom have incomes below the poverty level, the continued high poverty rate of the census tract is attributable in part to the continued existence of the development itself. According to the 2000 census, the Kingsley Park census tract is 57 percent non-Hispanic white, 33 percent black, 3 percent Hispanic, 2 percent Asian, and 5 percent multi-racial. Observation during the site visit suggested that the streets around the development have a mainly white, non-Hispanic population.

The homeownership rate declined slightly between the 1990 and 2000 censuses, from 28 to 24 percent. On one side of the property (not connected by a through-street), there are single-family detached houses under construction, which are expected to sell for $200,000-300,000. On the next side (again, with no through-street) is an older single-family neighborhood with a wide mixture of housing ages and sizes, including some large new houses. On the third side is a main road with various commercial uses. The neighborhood behind the road has well kept, modest brick townhouses, probably built in the 1960s, and a large, new elementary school. On the fourth side, across a street from the project, there is a large wooded parcel of land that is used as a park. This had been the site of an assisted multifamily development, Tall Trees, which was taken by the County through either eminent domain or a tax foreclosure and demolished. The former site of the Tall Trees development is heavily wooded and currently used as a park.

Thus, it appears that the immediate Kingsley Park neighborhood is “gentrifying,” as affordable multifamily developments are retired from use (in addition to Tall Trees, another assisted multifamily project has been redeveloped) and as new mid-market homeownership units are built. Several neighborhood residents told us that schools in the neighborhood have a good reputation.

According to both the developer and County officials, the County’s objectives are to eliminate dense multifamily rental housing and to create a neighborhood primarily of homeowners. At some time in the past few years, the County put Kingsley Park on a list of properties for which it sought voter approval, through a referendum, for eminent domain takings. The referendum was defeated, but debate over it did not focus on Kingsley Park. County officials continue to assert that the continued operation of the development with its current size and resident income restrictions is detrimental to health of the neighborhood.

The Housing Market

Census data for 2000 indicate that the total vacancy rate for the tract was 9.9 percent, an increase from 6.7 percent in 1990. The rental vacancy rate in 2000 was 8.3 percent, a slight increase from 1990. While Baltimore County appears to have a fair amount of rental housing that could be afforded with a voucher, both the tenants we interviewed and other observers believe that there is substantial resistance by owners of rental housing in the County to accepting families with vouchers, including racially motivated resistance. Tenants told us that they believed that they could easily use vouchers in Baltimore City, or perhaps in other suburban counties, but not in the neighborhood immediately surrounding Kingsley Park.

Without a Rental Housing Assessment Plan (RAAP), we have no detail on numbers and locations of vouchers in use in Baltimore County and locations of other affordable housing units. (See below. As of October 2003, there was no RAAP. OMHAR reports that processing has been put on hold several times by senior HUD officials as negotiations continue.)

Financial History of the Project

In 1995 or 1996, the Housing Department stopped providing annual adjustments to the HAP contracts based on a market comparability study. The third-party appraisal suggests that the rents are still above market, but only by 4 to 7 percent: $594, compared to $570, for one-bedroom units, and $686, compared to $640, for two-bedroom units. In effect, the property has been gradually reduced toward market rents over a period of several years and, in the absence of financial restructuring, is in serious financial distress. In 2003, the owner hired a Washington, DC law firm with a large housing practice to help make the case that the rules of the Moderate Rehabilitation program permit a development to retain the ratio between market and HAP rents originally agreed to. It is not clear why she did not do this earlier.

The owner continued to pay debt service of close to $1 million annually on the $10 million FHA mortgage, but let other payables accumulate ($400,000 as of June 2003) and trimmed expenditures on maintenance and security. OMHAR reports that in late 2003, shortly after the study period ended, the owner's mortgage payments stopped.

In the view of the owner of Kingsley Park, the neighborhood is gradually increasing in value, but not to the point where she would be able to find a buyer for the property at a price that would enable her to pay off the $10 million FHA-insured mortgage. Thus, a simple opt-out of the Section 8 contract was never a feasible option.

The property's REAC inspection scores have varied: 61 in 1999, 79 in 2000, 69 in 2001, and 89 in 2002. Despite the 89 score in December 2002, HUD conducted another REAC inspection in October 2003. This was in response to tenant complaints that, the owner believes, were instigated by County officials as part of an effort to force her to default on her FHA-insured mortgage and abandon Kingsley Park.[24]

[24] The study team does not know the result of the 2003 REAC inspection.

The Participating Administrative Entity (PAE): First Housing

HUD referred Kingsley Park to First Housing, a private PAE located in Florida. First Housing's M2M staff joined the company in 1999, when the company's role as a PAE began. First Housing's earlier (and other current) business appears to be largely as a contractor to the Florida Housing Finance Agency, underwriting HFA loans and doing LIHTC compliance. The company also provides bridge financing for FHA multifamily loans.

First Housing has completed 150 M2M restructurings, more than three quarters of which have been Fulls. The company currently has about 32 M2M deals in progress. The underwriter in charge of Kingsley Park has been with the company for several years and was handling about 12 cases in the summer of 2003. She was very responsive to requests for information during the study period. However, she has been challenged by several factors: her distance from the events (e.g., not being able to join meetings on Kingsley Park in person), the differences between Kingsley Park and other First Housing deals, which are heavily rural and southern, and the highly politicized nature of this deal, which has required many of the discussions within HUD and between HUD staff and the other stakeholders to be confidential. The PAE has had to wait for the directions that result from these discussions.

The OMHAR relationship manager for all of the First Housing M2M deals has been actively involved in the Kingsley Park restructuring, since this is a "problem deal." She believes that First Housing has handled Kingsley Park well, under difficult circumstances. The owner agrees. Her opinion is that M2M is fundamentally a good program and that First Housing has done well the job defined for it under the program.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- Failed attempt at prospective M2M.

According to the owner, she would have been willing to go into the M2M process three years before the HAP contracts began to expire in March 2003. In February 2000, she convened a meeting that included representatives of the County, the State, and the Baltimore HUD field office, in order to plan for the future of the development. She says she got nowhere with either HUD or the County, but in retrospect may not have pushed hard enough. In November 2002, she submitted a formal request to the Baltimore County Housing Department, as the HAP contract administrator, to enter the M2M program. According to the owner, the Housing Department did not forward a signed copy of the request to OMHAR until February 2003.

- Notice to tenants of HAP contract expiration.

In March 2002, Landex gave notice to the residents that the contract expiration date was a year away. According to Landex staff, this did not mean that the owner intended to take the property out of the Section 8 program. Rather, the letter sent and posted was simply the letter required by HUD.

- Start of M2M process—referral to PAE.

In February 2003, OMHAR assigned Kingsley Park to First Housing.

- Short-term extension of HAP contracts.

In March 2003, the owner and the Housing Department signed extensions that continued all contracts through the expiration date of the last cohort, August 31, 2003. According to the owner, she had a “gun to her head.” She either had to agree to this very short-term extension of the contracts or immediately begin losing HAP payments. The M2M process envisions a one-year extension of the HAP contracts while the process is under way.

- PAE’s Due diligence.

The PAE completed the third party appraisal on March 31, 2003. The appraisal rated the maintenance of the property as “adequate” and the appeal of the property as “average,” compared with market rate apartments in the area. Rents were found to be above market by 4 to 7 percent.

The Physical Needs Assessment was completed on April 2, 2003 and found $4,765 per unit in immediate (12-month) repair needs and market-driven capital needs, and $9,727 per unit in estimated capital needs (adjusted for inflation) over the next 20 years. Market-driven needs include air conditioning, carpeting, exhaust fans in kitchens, vanities in bathrooms, and an upgrade of the electrical system.

The audited financials and bond documents from the owner were received April 15.

- PAE submission of a restructure plan to OMHAR.

Following the completion of due diligence, the PAE underwriter began entering data into an underwriting model for Kingsley Park. Then, during the summer of 2003, the PAE waited while the owner, the County, and HUD negotiated about the future of Kingsley Park.

The County’s position was that the Housing Department would not extend the HAP contracts beyond August 31 without assurance that the property would be transformed in an acceptable way within a reasonable time period. At the same time, the HUD officials pointed out that the owner of a Moderate Rehabilitation development, like other Section 8 owners, has a unilateral right to a HAP contract extension, unless denied for cause.

The owner developed a conceptual development plan for Kingsley Park and circulated it on June 25. The plan would have demolished about half the Kingsley Park buildings and turned the remaining buildings into 75 two- and three-bedroom townhouses by cutting additional stairways. On the land cleared by demolition, she would build 45 homeownership units. Through-streets would be cut to the road on which the park replacing the former Tall Trees development is located, and some of the homeownership units would face the park.

The homeownership units would sell for approximately $150,000 and would be sold to first-time homebuyers with incomes below 80 percent (or possibly 115 percent) of area median income. The 75 rental units would be financed by the Low Income Housing Tax Credit, and occupants would have incomes below the Tax Credit limit of 60 percent of area median income. There would be no project-based Section 8 subsidies attached to the units. Working households with tenant-based Housing Choice Vouchers would be eligible to live in the rental townhouses, which would have market rents ranging from $530 to $690.

The feasibility of this redevelopment plan evidently would have depended upon an allocation of Tax Credits from the State, but the owner was unable to apply for the Tax Credit during 2003 because of the uncertainty about whether a redevelopment plan could be devised that was acceptable to both the County and HUD.

Reportedly, by the end of the summer, the owner and the County had agreed in principle to a redevelopment plan that would have retained only 60 rental units, and these would have been rent-to-own units. As of November, the owner and the County were discussing a redevelopment plan that would include 50 market-rate, single-family homeownership units and a 100-unit building for occupancy by low-income elderly households.

During the summer, OMHAR first instructed the PAE Housing to stop work on Kingsley Park and then asked the PAE to develop a “baseline” restructure plan for a M2M deal under which all 312 units would continue as project-based Section 8 and without additional funds. According to both the PAE and the OMHAR relationship manager, retaining only 60 rental units is unacceptable under an OMHAR M2M restructuring, although OMHAR would agree to some reduction below the current 312 units and would not necessarily insist that the rental units have project-based Section 8 assistance. The owner, in the meanwhile, told HUD that her default option was to proceed with a straightforward M2M restructuring plan that would retain 312 units of project-based Section 8. Her preference is to redevelop the property, reducing substantially the number of affordable rental units on the site, and she continued to make that clear to County officials. However, her overwhelming motivation appears to be to stop operating the property with a negative cash flow and to avoid defaulting on the property’s FHA-insured mortgage.

By October 2003, the PAE had used the underwriting model to develop a baseline plan. The underwriting model showed that mortgage restructuring, together with some level of exception rents, would make it feasible to take care of the property’s capital needs as identified by the Physical Condition Assessment and would provide enough cash flow to operate the property.

The owner told the study team that she had seen the "baseline" restructuring plan and considers it fair. She does not believe Kingsley Park should continue as 312 very small rental units with attached Section 8 subsidies, because she considers mixed income housing as developed under the HOPE VI program a superior program model. However, she says that she could operate the property successfully if the "baseline" restructuring plan were to go forward. For example, she says that, in cooperation with the police department, she would be able to provide sufficient security to expel the nighttime drug market from the development.

As of early November 2003, a Rental Housing Assessment Plan (RAAP) had not yet been developed as part of the restructure plan. According to PAE staff, they were waiting for the County to make its case for why retaining Kingsley Park as project-based assisted housing is not necessary.

The County waited until the last minute before extending the HAP contracts beyond August 31 and then extended them only through November 30, 2003. The owner had written to the County and HUD, asserting her legal right to an extension of the contracts for the full year contemplated by the M2M process, but agreed once again to a short-term extension rather than litigating.

At any point during the M2M process, the HUD field office could have taken over administration of the HAP contracts or reassigned them to another entity. In the view of one observer, this action will be needed sooner or later if the M2M process is to move to a successful conclusion. However, the OMHAR relationship manager explained that HUD is reluctant to move against the County, believing that, regardless of who administers the HAP, the County is a stakeholder in the future of Kingsley Park and must agree to any restructuring or redevelopment plan.

As of November 2003, an editorial about Kingsley Park had appeared in the *Baltimore Sun,* and the County, the owner, and county councilmen representing Essex had turned to one of Maryland's U.S. Senators for help in bringing about an agreement for the future of the development that did not include the continuation of any type of Section 8 subsidy.

Tenant Involvement in the M2M Restructuring

The PAE conducted a first tenant meeting at a church adjacent to Kingsley Park on April 14, 2003. About 40 resident adults were present, as were representatives of the on-site management office and Legal Aid. According to PAE staff, issues raised at the meeting included complaints about the difficulty of controlling the heat level in the units and concerns about whether relocation will be needed and, if it is, whether relocated households will succeed in using vouchers.

In March 2003, as required by HUD, the management company (Landex) sent and posted additional notices that the HAP contracts would expire on August 31, 2003. The Baltimore County Housing Office then invited residents to come to the church to pick up their voucher packets, on June 6, 2003. However, when residents arrived at the church, they were told that "everything was on hold" and that they would not receive their voucher packets at that time.

On June 13, Legal Aid held a meeting at the church to attempt to organize the residents of Kingsley Park around the future of the redevelopment.

When we conducted the site visit, later in the day on June 13, all residents with whom we spoke were aware that something was going on that would affect the future of Kingsley Park. They did not recall the April 14 meeting, but knew about the June 6 happenings, about the Legal Aid meeting that morning, or both. Few tenants with whom we spoke had been at any of the meetings. Some were on the voucher waiting list and were disappointed that they were not receiving a voucher immediately. Others wanted to stay at Kingsley Park and were concerned about whether a voucher would permit them to do so. The assistant manager of Kingsley Park, who was present at the interviews, assured people that they would be able to stay in Kingsley Park with their voucher. She seemed to be unaware of redevelopment plans under discussion at that time that would eliminate all of the one-bedroom units and, therefore, make it impossible for those qualifying only for a one-bedroom unit to continue to live at Kingsley Park.

All of the residents with whom we spoke wanted to stay in Baltimore County or to move to other suburban counties where they believed landlords of desirable units would be more willing to rent to voucher holders. None wanted to move "back" into Baltimore City. One woman was unaware that a Housing Choice Voucher is essentially the same thing as a "Section 8." She thought she was about to receive something that would be more attractive to Baltimore County landlords. Reasons cited for wanting to live in the County included good schools, low crime, and "peace and quiet." Almost everyone complained about the nightly drug market and accompanying noise at Kingsley Park.

When encouraged to describe rehabilitation needed at Kingsley Park, residents mentioned improvements to the playground and new mailboxes. One resident mentioned that, because of the old piping, water is rusty when it first comes out of the faucet. Several mentioned the small size of the units, but it had not occurred to them that this was something that could be altered.

Details of the M2M Restructuring

As of early November 2003, Kingsley Park had not reached the stage of OMHAR approval of a restructure plan, and the future of the development was uncertain. Possible outcomes include:

- HUD/OMHAR, the County, and the owner may reach a compromise on a redevelopment plan that includes more than 60 but fewer than 312 units of affordable rental housing—either project-based assisted rental housing or rental units affordable for households with vouchers.

- HUD/OMHAR and the owner may go ahead with the "baseline" restructuring plan, retaining all 312 units as project-based assisted housing. This scenario may require HUD to withdraw the HAP contract from the County Housing Department and assign it to another HAP contract administrator.

- The owner may default on the FHA mortgage. In this case, the rules affecting mortgage assignment and, possibly, property disposition would be overlaid on the M2M process.

If the outcome is the adoption, in essence, of the "baseline" restructuring plan, the future Kingsley Park will have exception rents but, probably, rents that remain below the FMRs for the Housing Choice Voucher program.

Table 5 presents the proposed rent adjustments contained in the draft Restructuring Plan.

Table 5. Rent Levels Pre- and Post-M2M

Unit Type	HUD-Established FMRs	Market Rents*		Previous Rents	
		Rent	Rent as Percent of FMR	Rent	Rent as Percent of FMR
One-Bedroom	$691	$570	82%	$594	86%
Two-Bedroom	$844	$640	76%	$686	81%

*Market rents from the third-party appraisal. The study team has not seen the baseline restructuring plan prepared for OMHAR by the PAE and does not know the level of exception rents it would require.

The restructuring plan that would retain all 312 units as project-based assisted housing and provide for the development's short-term and 20-year capital needs would result in a substantial cost to the Federal government as calculated under the M2M program. Because the rents for the property had already been "marked down" almost to market as the County Housing Department provided no rent increases between 1995 and 2003, even without the need for exception rents there would have been little room for Section 8 savings to offset the loss to the FHA Fund from the restructured mortgage. However, without a mortgage restructuring it is highly likely that the owner will default on the FHA-insured mortgage.

Lessons Learned From This Site

The key issue is whether Kingsley Park is needed as project-based affordable rental housing. County officials claim that revitalization of Essex as a community must include redevelopment and lower density for Kingsley Park. It is not clear whether this view is justified. It could be argued that elimination of affordable rental housing in this community has already gone far enough. It appears that Kingsley Park, despite the problems of the current development, is not standing in the way of investment in the neighborhood by existing homeowners or developers of market rate housing. The drug market at Kingsley Park might be eliminated by gating the community or by increasing security in other ways.

On the other hand, the development concentrates 312 households with extremely low incomes in a development that is physically somewhat isolated from the surrounding community. Some downsizing may be appropriate, and it might be possible to create a mixed income community on the Kingsley Park site that, together with tenant-based housing vouchers used elsewhere in the county, does a good job of meeting the needs of extremely low-income renters in general. There might be a few residents whose special needs would create challenges for relocation with vouchers and who would not meet the occupancy requirements of a redeveloped Kingsley Park.

The M2M process does not appear to be structured to help resolve these issues. The Rental Housing Assessment Plan (RAAP) is intended to provide information on whether the development needs to be retained as project-based rental housing or whether an equivalent number of Housing Choice Vouchers would play the same role in meeting the community's housing needs. However, a RAAP was not produced early enough in the process to inform these judgments, nor is it clear that the RAAP that is specified by the M2M process will include all of the information needed.

Another lesson from the M2M process for Kingsley Park is that the M2M program is not structured as well as it might be to handle properties that need substantial redevelopment that would depend on "additional funds" such as the Low Income Housing Tax Credit. There have been many M2M deals closed that involve additional funds. However, unless the redevelopment plan can be produced and agreed to by all parties at the very outset of the process, it is very difficult to coordinate the timing of the M2M restructure plan and the applications for LIHTC or other additional funds.

Furthermore, this story has some missing characters. No developer other than the current owner (for example, a preservation-minded national non-profit) has become involved in an attempt to preserve Kingsley Park as affordable rental housing or to redevelop it in a way that retains a substantial affordable component. This may be because the need for continuation of Kingsley Park as affordable rental housing is ambiguous. It also may be that the high degree of political controversy around the future of Kingsley Park makes other entities hesitate to take it on. Or it may be that the information flow about properties reaching the end of their Section 8 contracts is not sufficiently developed for the future of Kingsley Park to have become a subject of wider interest.

The original concept for the M2M program envisioned the Outreach and Training Grantees helping to determine the future of assisted housing developments. In the case of Kingsley Park, the Outreach and Training Grant grantee (statewide Legal Aid) reportedly was stretched too thin to play this role. The Baltimore County Legal Aid organization became involved some months into the M2M process. Its staff appeared quite knowledgeable about what was going on at Kingsley Park. However, Legal Aid staff observed that many of the tenants want to use vouchers to move away from Kingsley

Park, having come to Kingsley Park in the first place thinking of it as a starting point on the way to something better. Legal Aid staff members were concentrating on trying to provide accurate information to the current residents. They were not able to comment on the broader issue of whether Kingsley Park is needed as part of the overall housing affordability strategy for Baltimore County.

Case Study Six: Lynne Acres
Shelbyville, Kentucky—Full Restructuring

The Property, Neighborhood, Financial History, and Housing Market

The Property

Lynne Acres is a 40-unit family property located in Shelbyville, Kentucky, a town of 10,085, approximately 30 miles east of Louisville. Shelbyville is small city that has experienced population growth of 6.1 percent over the past five years. Data from the U.S. Department of Labor's Bureau of Labor Statistics show that the city had an unemployment rate of 2.4 percent in 2000. The largest employers in the area are in the manufacturing sector. Census data indicate that the population of Shelbyville in 2000 was 75 percent white and 16 percent African American. Lynne Acres is 20 years old, and was built by the current owners under the HUD-financed 223(a) 7 program. It is located on five acres, and includes five two-story buildings that contain 22 two-bedroom townhouses, 8 three-bedroom townhouses, and 10 one-bedroom apartments. All of the units remain assisted under the Section 8 program, and the Kentucky Housing Finance agency is the Section 8 contract administrator for the property.

The Property Condition Assessment rated the property as good or fair along all dimensions examined. The building was rated fair in most aspects of code compliance and accessibility, as well as in areas of site improvement (parking, paving, sidewalks; landscaping and topography; and general site improvements). On the other hand, mechanical, electrical and plumbing systems were rated good, as were most interiors and several architectural and structural systems (foundation, upper structures and floors, roofing exterior walls, and common areas, entrances and corridors).

REAC inspection scores were 70 in 1999, 87 in 2000, and 73 in 2002. The PAE representative described the property as being in good condition, with only minimal rehab being required in the restructuring plan. This assessment was confirmed by the site visit, during which all of the buildings and units observed were in good condition. The building exterior is brick and both the exterior walls and roofs appeared to be in good repair. The interior units observed were townhouse units and all had carpeted floors, kitchens in good condition, and air conditioning. The property has a large parking lot and playground area with a lot of open space and the building seemed appealing and well maintained. The only sign of wear was in some rust observed on the exterior staircases to upper floor apartments.

Of the tenants interviewed for this study, three said the property was in good condition and the fourth considered the condition to be only fair. Each of the tenants also reported that a new on-site property manager arrived in the spring of 2003, and management had improved substantially since that time. In particular, tenants reported that lawn care had improved and trash was being removed more quickly. Tenants also said that a swing set had been added to the children's play area, and new trash dumpsters had been installed. Three of the four tenants also said they had noticed more rental vacancies in the property since the new property manager started, and they attributed this to "problem tenants" having moved out.

The Neighborhood

The area surrounding the property includes a mix of commercial and residential development. The immediate neighborhood is perhaps best described as a suburban neighborhood with most properties in the same age range as Lynne Acres. In addition to the commercial and residential uses, there is also a substantial amount of vacant land immediately adjacent to the property on three sides. A 68-unit, conventional multifamily property is being constructed on the north side of Lynne Acres.

Lynne Acres is accessed via a small road at the back of a large shopping center, and is somewhat isolated as a result. However, there are residential neighborhoods nearby which include a mix of single-family homes and duplexes. The shopping center offers a variety of services within 4 blocks of Lynne Acres, including grocery stores, drug stores, fast food restaurants, banks and laundries. In addition, schools, churches and libraries are within walking distance of the property. The property appraisal notes that there are no major adverse influences or hazards in the immediate neighborhood that detract from the neighborhood.

The Housing Market

According to Census data, the census tract in which Lynne Acres is located had a 20 percent poverty rate in 2000, down from 28.6 percent in 1990. Census data also indicate that 7.1 percent of the housing units in Lynne Acres' census tract were vacant in 2000, and that the rental housing vacancy rate was 4.8 percent, and that the homeownership rate in the tract in 2000 was 45.4 percent. A substantial increase in the proportion of Hispanic residents resulted in a change in the racial composition of the census tract from 1990 to 2000. In 1990, less than one percent of the individuals residing in the census tract were of Hispanic origin, while nearly 12 percent of the residents in the tract in 2000 were Hispanic. In 2000, the census tract was 65.6 percent white (down from 74.3 percent in 1990) and 19.3 percent black (down from 25.3 percent in 1990).

Based on information from the property appraisal documents and observations during the site visit, other rental property in the Shelbyville area appears to be in similar condition to the Lynne Acres property. The owner said that most apartment buildings in the area have washer and dryer hook-ups, something Lynne Acres lacks.

Of the four tenants interviewed during the site visit, three were white and one was African American. All of the tenants interviewed said that affordable housing is difficult to find in Shelbyville. On the other hand, the waiting list for Lynne Acres had only nine people on it at the time the appraisal was completed, and representatives of the Shelbyville Housing Authority report that there are two other Section 8 properties in

Lynne Acres. Indeed, one of the tenants interviewed during the site visit reported only waiting two months for her apartment in Lynne Acres. In addition, the housing authority manages a 102-unit public housing property, with a current waiting list of 8 individuals, and estimates that a person entering the waiting list at the current time might expect to wait up to one year for a unit. Several years ago, the housing authority tried to take over a 44-unit conventional building that was going through foreclosure proceeding, but failed to get the property when it was sold at auction. This would have further increased the supply of affordable housing in the community. Nevertheless, despite the opinions of residents, there do appear to be several affordable housing options in Shelbyville.

Financial History of the Project

The property was built in 1983, under what the owner describes as a minority set-aside program in which two properties in Kentucky were set aside for the Section 8 program. Lura Roland, one of the owners, was awarded the HAP contract. He joined with three other developers as owners of the property in a limited partnership, and ownership has not changed since that time. The chief partner is Michael Hess, and it was he who spoke for the partnership to provide information about the property and the M2M restructuring for this study. Management of the property is provided by an identity-of-interest company that is owned by the same partnership as the project.

According to the owner, he entered the M2M program because there were few other options available as the HAP contract was due to expire. The owner does not consider it economically feasible to opt out of the Section 8 program, because lowering the rents to market rent without the debt restructuring would make it impossible to operate the property. In addition, the owner does not think the properties can compete with other properties in the unsubsidized market, primarily because of the lack of washer and dryer hook ups.

The Participating Administrative Entity (PAE): The Siegel Group

HUD referred the restructuring of Lynn Acres to the Siegel Group, a private PAE that specializes in real estate development, finance, and real estate analysis. In addition to the M2M program, the Siegel Group works on: market studies; real estate asset management; risk evaluation and due diligence reviews; and, residential real estate acquisition and rehabilitation. The Siegel Group staff includes a combination of real estate professionals, affordable housing specialists, former State housing finance agency officers, former bankers, and real estate development practitioners. They have completed more than 50 restructurings through the M2M program, most of which have been Full restructurings.

An underwriter who has been with the Siegel Group since January 2001 is managing the Lynne Acres deal. He has worked on 25-30 M2M deals that are now completed. The underwriter currently works full-time on M2M work, but previously spent part of his time doing asset management compliance reviews for the Low Income Housing Tax Credit Program. Concurrently with Lynne Acres, the underwriter assigned to the property was also working on four other Full restructurings. He worked with the owner of Lynne Acres on three other restructurings, and had a relatively good experience working with this owner. The PAE has expressed some concerns about the capacity of the owner to manage the property, with respect to keeping the property fully occupied, and issues related to financial management of the property.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- The property was assigned to the PAE in March 2003, and a Full M2M restructuring process began at that time. (The HAP contract was to expire in June.)

- The PCA was completed on April 8, 2003. (Comments about findings appear above in the section on The Property.)

- The property appraisal was completed on April 29, 2003.

- The first Tenant meetings were held on May 27, 2003. (Details are below in the Tenant Involvement section.)

- The second Tenant Meeting was held on June 26, 2003. (Details below.)

- The restructuring plan was submitted on August 13, 2003. OMHAR reviewed the plan and provided comments to the PAE. In its comments, OMHAR asked for clarification about the rehab costs, timing of rehab work, and rationale for having some rehab items in year one. OMHAR also asked the PAE to give less consideration to one of the comparable properties used to establish market rents, and to comment on whether expenses included in the restructuring plan were adequate to properly maintain and operate the property.

- A revised plan, and responses to OMHAR's questions, were submitted on August 25, 2003.

- OMHAR responded with additional questions, focusing on reasons for the current vacancy rate of 10 percent and the sources and uses of financing.

- The PAE responded to the second set of questions from OMHAR in September 2003 by clarifying the sources and uses of the financing section of the plan and by explaining that the currently vacant units require "make ready" repairs and cannot be rented until these are completed. The PAE believes that the vacancies will not be filled until after the closing is conducted and the repairs can be made.

- As of October 15, 2003, the PAE reported that the plan was to be referred to the portfolio office loan committee for review. No closing date has been set for the property, but the PAE expects that the property will end in a successful closing.

- The PAE's best estimate is that closing will take place in January 2004.

The PAE describes the restructuring process as having proceeded smoothly without excessive delay or complications. The property is in good physical condition and the PAE considers the amount of rehab required under the restructuring plan to be minimal. Five units require make-ready repairs such as painting and carpet replacement, and one of the buildings needs some foundation repairs. The owner reported that information provided by the PAE and by OMHAR on the M2M process had been helpful, and that he felt the process has worked smoothly.

Tenant Involvement in the M2M Restructuring

Members of the research team did not observe the tenant meetings, but instead collected copies of the meeting minutes, held discussions with PAE staff, and conducted interviews with four tenants to assess the tenant involvement in the M2M process.

The first tenant meeting was held on May 27 and lasted only 20 minutes. The PAE's underwriter for the Lynne Acres deal led the meeting. The Lynne Acres property manager and maintenance staff person also attended. Only four tenants attended the meeting and they had few questions or comments. The meeting included an introduction to the PAE, an overview of the M2M program, and a description of the differences between project-based and tenant-based rental assistance. The PAE noted in the minutes that they informed tenants that there were three potential outcomes of the M2M program for the Lynne Acres property. First, it could end with a closed restructuring with little change to tenants. The second outcome would involve the owner opting out of the Section 8 program, in which case tenants would receive tenant-based rental assistance and/or the tenants could remain at the property. Finally, tenants were informed that the third option would be for the property to convert to tenant-based assistance. According to the PAE there was little discussion from the tenants about the information presented. The PAE also invited tenants to comment on the condition of the property and management and maintenance. According to the minutes, tenants reported being satisfied with the management and maintenance of the property, and they hoped that the property would remain in the project-based Section 8 program.

Seven tenants and a consultant to the PAE attended the second meeting, held a month later, on June 26. This meeting lasted more than one hour. In this meeting there was more emphasis on the rehabilitation needs of the property, and less on the M2M process. In fact, when asked to describe the purpose of the meeting, one of the tenants interviewed during the site visit said it was an opportunity to discuss maintenance needs at Lynne Acres. The minutes of the meeting list the types of repairs tenants said should be undertaken. All in all, these appear relatively minor and include items such as new carpeting, new kitchen flooring, painting the front door, and additional playground equipment. The most substantial requests were for a perimeter fence to be installed around the property, and that leaks in the door and window frames are repaired.

Additional information was obtained in the tenant interviews conducted for the study. Of the four tenants who were interviewed, one had lived at Lynne Acres since it was built in 1983, two had lived there for one year, and the fourth had lived there only 2 months. None had attended the first tenant meeting, but three had attended the second. The fourth tenant had not attended either meeting, but heard about the meetings from others who had attended. This tenant had concerns about the potential for rent increases as a result of the M2M process. Among all tenants interviewed, the chief concern was that the restructuring process would result in increases to their monthly rental payments. Even after assurances from the PAE at the meetings that this would not occur, some concerns remain among the tenants about whether the process will have a negative impact on their lives.

Details of the M2M Restructuring

Rent Levels

Table 6 compares the new rent levels proposed in the restructuring plan with the previous rents, and compares all the rents as a percentage of fair market rents. As shown in the table, the most substantial change is for the one-bedroom units. Prior to restructuring, the rents for one and two-bedroom units have been approximately 140 percent of market rents, with three-bedroom units closer to market rents. At full occupancy, the change in rents would result in a reduction in annual rental income of $40,320. This is the difference between annual rental income from pre-restructuring rents and annual rental income using post-restructuring rents, assuming the property is fully occupied. The typical historical vacancy rate for the property is 5 percent. At the time the restructuring plan was completed the vacancy rate was 10 percent, due to the number of units that require “make-ready” repairs (painting, new carpet, etc.) For the purposes of projecting income and expenses, the restructuring plan assumes a vacancy rate of 7 percent.

Table 6. Rent Levels Pre- and Post-M2M

Unit Type	HUD-Established FMRs	PAE Market Rents	New Contract Rents		Previous Contract Rents	
			Rent	Rent as Percent of FMR	Rent	Rent as Percent of FMR
One-Bedroom	$350	$350	$350	100%	$493	141%
Two-Bedroom	$393	$489	$489	124%	$552	140%
Three-Bedroom	$548	$525	$525	96%	$613	111%

Financing

The PAE estimates that the unpaid balance of the existing first mortgage at closing will be $1,095,197. This will be paid off at closing and the debt will be restructured in the form of a new 30-year first lien of $525,000, with interest rate of 6.75 percent. This will be a 223(a) 7 loan that also carries a mortgage insurance premium of 0.5 percent. A HUD-held second mortgage of $832,917 (30 years at 1 percent interest) will also be provided, representing 75 percent of the unpaid balance of the existing first mortgage. There is no third lien proposed in the restructuring plan.

Historical operating expenses for Lynne Acres have been $3,072 per unit per year based on the PAE’s review of the 2002 financial statement. In the restructuring plan, the PAE has underwritten operating expenses of $3,268 per unit per year, based on an increase in the annual reserve for replacement contribution from $5,562 ($139 per unit per year) to $19,250 ($481 per unit per year). This results in an adjusted net operating income for the property of $57,131 or $1,428 per unit per year.

The owner will be required to contribute $23,917 to the restructuring at closing. This includes 20 percent of the transaction costs and 20 percent of the rehab escrow. This cash contribution will be recovered over the first seven years at the rate of $4,438, paid as the capital recovery payment.

Renovation Items and Costs

The PAE is recommending expenditures of $32,410 for 12-month rehabilitation needs that include make-ready activities for five vacant units, foundation repairs to one of the buildings, and establishment of accessible parking spaces and common areas that will comply with the ADA. Total 20-year rehab needs are projected to be $507,683 (un-inflated). Table 7 displays the largest of the 20-year rehab items.

Table 7. Largest 20-Year Rehab Needs

Physical Needs	Total 20-Year Needs
Unit rear entry doors	$67,200
Carpet for living areas	$64,000
HVAC condensers	$66,000
HVAC fan coil unit	$36,000
Kitchen cabinets	$32,000
Roof covering-asphalt shingles	$24,000
Countertop and sink	$20,000

Source: Lynne Acres Restructuring Plan.

Estimated Savings Resulting From the M2M Restructuring

The restructuring plan projects annual savings to the Section 8 program of $40,320 resulting from the reduced rents (this represents a 15 percent reduction in rents and $84 per unit per month). The net present value of these savings over 20 years is projected to be $464,864. However, the HUD-held second mortgage of $823,917 represents a cost to the Section 8 program. The restructuring plan assumes a NPV of projected payments on the second mortgage of $266,688, and a net loss to the government (over 20 years) of $92,366.

Outcomes for Tenants

The primary benefit for current and future tenants from the Lynne Acres restructuring is that the project will remain subsidized with a new 30-year commitment. Additionally, the renovations and repairs will benefit tenants, ensuring that the units, which are currently in good condition, are maintained over time.

Viability of the Project after M2M Restructuring

The PAE believes that the underwriting used in the restructuring plan will ensure the long-term financial viability of the Lynne Acres property, assuming that the owners undertake the recommended rehab in an efficient manner and manage the occupancy of the property effectively. For example, they recommend that a contractor be hired to do the make-ready work on the five currently vacant units so that this can be completed quickly. If the owners rely on their management company for these repairs it will take much longer to complete the units and to rent them. The owner hopes that the restructuring will allow the property to remain financially viable over the long term.

Lessons Learned from This Site

The Lynne Acres property appears to be moving through the M2M process smoothly, with few serious impediments to a successful closing. The experience of the PAE, and the fact that the owner had several other properties undergoing M2M at the same time, may have contributed to the relative smoothness of this deal and the lack of obstacles.

The M2M process at Lynne Acres does not provide any specific lessons that could be applied to other M2Ms, except that it can be considered an example of a successful closing which will improve the long-term viability of the project and accomplish the goal of preserving subsidized housing.

Case Study Seven: Murphy Blair Rehab II
St. Louis, Missouri—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

The Murphy Blair Rehab II property is a 68-unit scattered site project located in St. Louis, Missouri. The property is located within the central city of St. Louis, in an area called Old North St. Louis. The property includes 15 low-rise buildings scattered across several blocks. Each building has between 3 and 6 units. Most of the units are large—31 (46 percent) have 3 bedrooms, 12 (18 percent) have 4 bedrooms and 5 (7 percent) have 5 bedrooms. The buildings were constructed in the 1920s.

The REAC financial scores for the property were 33 in 2000 and 50 in 2001, with no score for 2002. The property also had low physical scores of 29 in 1999 and 48 in 2000. (No score was provided for 2001 and in 2002 the physical score was 74). Consistent with the low REAC scores, all of the buildings and units visited as part of the site visit to this property were in very poor condition. The buildings have major foundation problems, which in turn, have caused other structural problems, such as uneven floors and separating walls. The roofs of many buildings have deteriorated and there are holes in interior walls. Mold and mildew are a problem. The units were in disrepair as well. Some kitchen floors were rotting, kitchen cabinets and countertops were in disrepair, and units need new appliances. Bathrooms, too, were in very poor condition, and carpeting throughout units was old and worn.

There has been a great deal of turnover in the property management over the last few years. Emerson Management Solutions took over on July 1, 2003. The residents interviewed for the study were skeptical that new management would lead to any improvement in conditions at the property.

For the past few years the property has been owned by AIMCO, a very large owner with properties across the country. AIMCO came to own the property through its acquisition of a large portfolio from another property owner. AIMCO is structured as a limited partnership, and all of the partnerships are about 20 years old. AIMCO is the general partner and all other partners are silent.

All of AIMCO's M2M deals are being managed out of their Beverly Hills office. AIMCO has about 150 M2M properties currently in the pipeline, and has closed on another 50. Some 150 more properties will be joining the program soon.

A Full M2M deal is really the only option for this property. The market would not support opting out, and with all the required repairs, a Lite is not an option. The owner may consider selling to a non-profit at some point.

The Neighborhood

Murphy Blair Rehab II is in a deteriorated, inner city neighborhood that has begun to see some renovation including the construction of some new tax credit properties and renovation of other properties. At the same time, numerous properties remain dilapidated and/or abandoned, and boarded up. The tract poverty rate for the property in the 2000 Census was 65 percent, and remained unchanged from the 1990 Census. The home ownership rate in the tract was only 8.5 percent in 2000, down from 12 percent in 1990.

About 80 percent of the properties in the area are residential, with the remaining split about evenly between commercial and institutional properties. The immediate surrounding neighborhood has a range of services including fast food restaurants, laundries, groceries, churches and schools, most within walking distance of the property. All of the residents interviewed at the property, and the vast majority observed in the surrounding area, were African American. According to the 2000 Census, 99 percent of tract residents are non-Hispanic, black.

The Housing Market

The City of St. Louis overall had a rental vacancy of over 10 percent from 1998 to 2001. According to the 2002 Census vacancy report, the citywide rental vacancy rate dropped to 6 percent in 2002. The vacancy rate in the property tract was much higher. According to the 2000 census data, the tract rental vacancy rate was about 30 percent. Although the vacancy rate is high, residents interviewed for this study, as well as local housing officials said that finding alternative housing would be difficult because most of the units at Murphy Blair have at least 3 bedrooms. It is reportedly difficult to use Housing choice Vouchers to rent large units in the area. The St. Louis Housing Authority manages about 5000 units each of public housing and Housing Choice Vouchers.

Financial History of the Project

As noted earlier, the current owner, AIMCO, acquired the Murphy Blair property several years ago as part of an acquisition of many properties from another owner with a large portfolio of Section 8 properties. The REAC financial scores for the property were 33 in 2000 and 50 in 2001.

The Participating Administrative Entity (PAE): RER

OMHAR assigned Murphy Blair to RER, a private PAE. RER is a commercial real estate consulting firm, headquartered in Herndon Virginia, with offices in Dallas, Boca Raton and Boston. The firm and its affiliates perform a broad range of services including: due diligence and underwriting of real estate assets for loan origination and asset acquisition;

commercial loan servicing on performing commercial real estate loans; asset management/disposition; real estate investments; GSA consulting services; and other government agency services.

This restructuring is being managed out of RER's Dallas office. The person assigned to Murphy Blair Rehab II has been with RER for four years, and has been working on M2M deals for the past two years. Prior to his work on M2M he worked on commercial real estate. Concurrently with the Murphy Blair deal, he was working on 21 M2M restructurings, mostly Fulls. Previously, he worked on another 15 to 20 M2Ms and these, too, were mostly Fulls.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- The owner submitted the original request to OMHAR in October 2002.
- The property was assigned to the PAE on March 12, 2003.
- The first tenant meeting was held on May 14, 2003. (See Tenant Involvement Section Below for details.)
- The draft Physical Condition Assessment report was submitted April 4. The physical inspection report found major structural problems at several of the buildings, requiring a more detailed inspection. These problems include unstable foundations which in turn have caused other structural problems, such as uneven floors and separating walls, and roofs that have deteriorated.
- The Appraisal Report was submitted April 15, 2003.
- The original due diligence was completed May 22, 2003.
- In mid-July the PAE received OMHAR approval for a time and fee waiver for the additional structural report that was recommended by the original PCA. The contractor was engaged shortly thereafter and the second structural study was completed in September.
- A draft restructuring plan was submitted October 20, 2003. The plan called for exception rents (4.5 percent above market), substantial rehabilitation (the required 12-month rehab is estimated at $244,032 or $3,589 per unit), and an overall cost to the government of $555,026 over 20 years.
- Within 1 week after the submission of the draft plan, one of the buildings was cited by the city for serous code violations. The management agent has relocated the tenants, and boarded up the building. The building will require either total renovation or demolition, either of which will have significant impacts on the underwriting.

- A second tenant meeting was scheduled for October 21, 2003, just after the restructuring plan was submitted. The PAE reports that, in spite of adequate notification, no tenants attended.

- As of mid-November, the PAE was waiting for instructions from OMHAR about how to proceed. They expect that the property will either be discontinued from M2M, or placed on hold until the owner resolves the issue with the condemned building.

Tenant Involvement in the M2M Restructuring

The first tenant meeting was held on May 19, 2003, and 8 tenants attended. The PAE was represented by the staff member responsible for the restructuring. The on-site property manager also attended the meeting as did the owner's regional manager. No representatives from HUD or any public officials attended the meeting. Missouri has no OTAG recipient. Both the PAE and the owner said that tenants were well informed, understood the Mark to Market program, and that few had any complaints about the way the meeting was handled. Most of the meeting focused on tenant complaints about the condition of the property, including concerns about security, heating air conditioning, broken windows, and poor maintenance of outdoor spaces.

As stated earlier, no tenants came to the second scheduled tenant meeting in September.

Interviews were conducted with five residents for this case study. Two of them had attended the first tenant meeting. These tenants, as well as those who did not attend the meeting, knew that "something was going on" with the financing of the property. They all seemed to understand that their rents would not change. At the same time that the M2M meetings were taking place, the property management company changed, so most residents were more focused on the possible impact of changes in management, rather than on changes in property finances.

Details of the M2M Restructuring

Rent Levels

The draft plan called for exception rents for this property. At the time of the final restructuring plan, a RAPP must be submitted for properties asking for exception rents. Since the final plan has not been submitted yet for Murphy Blair, no RAPP has been prepared as of mid-November 2003.

The total value of pre-restructure rents was 123 percent of market rents. This ranged from just above market for the five-bedroom units, up to 38 percent above market for the one-bedroom units, and 40 percent above market for two-bedroom units. The proposed post-restructuring rents are uniformly 4.5 percent above market rent, though they are only 75 percent of the local FMR. Table 8 compares rents by bedroom size.

Table 8. Rents Pre- and Post-M2M

Unit Type	HUD-Established FMRs	PAE Market Rents	New Rents		Current Contract Rents	
			Exception Rent	Rent as Percent of FMR	Rent	Rent as Percent of FMR
One-Bedroom	$439	$390	$408	93%	$538	123%
Two-Bedroom	$536	$447	$467	87%	$629	117%
Three-Bedroom	$695	$581	$607	87%	$712	102%
Four-Bedroom	$905	$658	$688	76%	$736	81%
Five-Bedroom	$999	$745	$779	78%	$762	76%

Note: There are multiple types and sizes of each unit type. These numbers reflect weighted averages.

Estimated Savings

Even with the exception rents, following the restructuring, rents will decrease by about 15 percent (an average of $102 per unit per month). This decrease in rents results in an annual savings of $83,460 in Section 8 costs, and a total NPV of savings of $1,059,171 over 20 years. However, because of the large write-off of the current mortgage, the net cost to the government over 20 years amounts to $555,026.

Financing

Prior to the restructuring, the property was unable to make ongoing mortgage payments—adjusted net operating income was on the order of $222,000 while the debt service was about $327,000. (The UPB on the mortgage will be about $2.6 million at the time of restructuring with an interest rate of 10.6 percent). The property was HUD-held. The proposed new mortgages are as follows:

- A 30-year first mortgage for $1,013,000, at 6.75 percent interest.
- A second mortgage for $1,596,455, at 1 percent for 30 years.
- A third mortgage for $1,012,457, also at 1 percent for 30 years.

Renovation Items and Costs

As noted above, the property is in poor condition. The required 12-month rehab is estimated at $244,032 ($3,589 per unit). The main items requiring immediate repair include:

- $110,000 for structural repairs.
- $38,794 for lead paint abatement.
- $7,128 for roof repairs.
- $20,000 for renovation of a down unit.

Over the next 20 years the rehab needs (not inflated) will be $1.25 million ($922 per unit per year). In order to ensure that the property is prepared for these expenses the initial deposit to the reserves for replacement is set at $575,000 ($8,456 per unit), and the annual deposit will increase from the current $14,752 per year to $36,720 per year ($540 per unit).

Outcomes for Tenants

If the restructuring does proceed to closing there will be positive outcomes for the tenants with regard to the condition of the properties. In the short term, the most serious problems will be addressed, such as the foundations and roofs. The interior problems—non-working heating systems, rotted kitchens, thread-bare carpets, old refrigerators and ovens—are scheduled to be addressed over the next five years, with each system taking 3 to 5 years to complete across all units.

Viability of the Project after M2M Restructuring

Following restructuring, income would decrease substantially due to the rent reduction, and expenses would increase slightly. In order for the property to become financially viable, debt service payments would decrease substantially to $83,882 per year. The management would have to reduce tenant turnover, which presumably would happen only after a significant rehabilitation of the property.

Lessons Learned from This Site

Several lessons can be learned from this site.

- This property is an example of a project in very poor condition, for which the M2M program may not be well-suited. If the property does close under M2M, the cost to the government, just in terms of insurance fund write-off, will be over $500,000, and this is before taking into account the fees to the PAE. It is not clear why the government should invest that amount of money to retain this property. The property has high vacancies, and it is located in an area with high vacancies (although the tenants interviewed said that they had few other options because of the scarcity of large units in the vicinity).

- The owner of the property has worked with several HUD Field Offices on M2M deals, handling with a large number of contractors and subcontractors, each of whom had different requirements. The owner found that part of the process very frustrating, as some regions are easier to work with than others. In the case of Murphy Blair, there has been little HUD regional involvement.

- The owner has also worked with a number of PAEs, and felt that they had varying degrees of competence. The owner was very pleased that AIMCO has an agreement under which they only work with two of the large PAEs.

Case Study Eight: Myrtle Manor
Phoenix, Arizona—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

Myrtle Manor is a family apartment complex located on 2.9 acres of land approximately nine miles northwest of downtown Phoenix, Arizona. Phoenix is located in Maricopa County and is the nation's 7th largest city with a population of 1.3 million. Myrtle Manor has 44 units spread throughout one 1-story and four 2-story buildings; it also has a separate 1-story building housing the laundry facilities. The buildings were constructed in 1982, and consist of 34 two-bedroom units with approximately 924 square feet, and 10 three-bedroom units with 1,028 square feet.

The property has been owned since 1992 by Myrtle Manor Associates, an Arizona limited partnership comprised of Raymond Morrison, the general partner, and Jewel Investment Company, the limited partner. It was originally subsidized under the Section 8 New Construction program. As such, it would be considered a newer subsidized property in the Mark-to-Market program. Myrtle Manor is professionally managed by Biltmore Properties, Inc., a company unrelated to the owner. Biltmore Properties currently manages over 2,200 units in 32 HUD-subsidized properties throughout Arizona.

The buildings are constructed of a wood frame exterior over concrete block and wood framing. Each two-bedroom unit contains a living area, dining area, kitchen, two bedrooms, and a bath. Four of the two-bedroom units are handicapped-accessible. Each three-bedroom unit contains a living area, dining area, kitchen, three bedrooms, and one and one-half baths. There is adequate on-site parking, with roughly 69 spaces on a good asphalt parking lot. There is a well-maintained, landscaped common area with lawn and a children's playground.

The building units are in good condition, reflecting the strong maintenance program the management company follows. Deferred maintenance is minimal, since the management company has kept a strict repair and replacement policy to date. Hence, there are minimal immediate repair needs required. REAC inspection scores reflected the high level of maintenance with Myrtle Manor, with scores of 91 in 1999 and 94 in 2002.

According to the 2000 Census, the tract in which Myrtle Manor is located had an 18.4 percent poverty rate, up from 10.3 percent in 1990. The 2000 Census also indicated that the property is located in a tract that is roughly 62 percent white, 5 percent black, 26 percent Hispanic, and 6 percent native American or multiracial.

The current contract administrator for Myrtle Manor, and for the Section 8 program in Phoenix, is the City of Phoenix. A new State organization, the Arizona Public Housing Authority, is scheduled to take over this role as the new performance-based contract administrator (PBCA) for the State of Arizona.

The Neighborhood

Myrtle Manor is located in a neighborhood that is a mixture of multifamily residences, single-family homes, commercial, and vacant land. It is approximately 90 percent developed. The area is predominantly (50 percent) single family homes, with roughly 20 percent multifamily housing, and 20 percent commercial development. Roughly 10 percent of the land is vacant. Most of the properties are maintained to an acceptable level and do not appear to negatively affect Myrtle Manor. The ages of buildings in the area range from 10 to 65 years and include some newer construction.

The property is approximately 2 miles from both the Metro Center Mall and Chris Town Mall, both of which contain many retail stores. North Phoenix Medical Center is approximately two blocks from the property, and nine different Houses of Worship are located in close proximity to the property.

The Housing Market

According to 2000 Census data, the majority (60 percent) of households in the tract in which Myrtle Manor is located are renter occupied and the homeownership rate is 40 percent. This compares to a homeownership rate of roughly 66 percent nationally. The rental vacancy rate in this tract was 4.0 percent, significantly down from the 22.2 percent rate recorded in the 1990 Census. The appraiser stated that the average age of housing in the tract is 32 years.

The appraisal report considered six additional Section 8 properties in addition to five conventional properties used as comparables. The reason was to determine the Section 8 occupancy of Myrtle Manor relative to other properties in the same market area. The appraisal found that all other properties had 100 percent or nearly 100 percent occupancy, with a vacancy rate for subsidized housing in this market ranging between 0 to 2 percent.

Financial History of the Project

The property appears to have had a sound financial history. The unpaid balance on the note was $1.5 million as of April 2003, at an interest rate of 6.95 percent. As noted above, deferred maintenance is minimal, given the strict maintenance schedule followed by the property manager. The HUD FASS scores for Myrtle Manor were 79 in 2000, 75 in 2001, and 74 in 2002. At the time of the site visit, 100 percent of the units were occupied and the on-site manager reported a waiting list of approximately one year. Historically, the vacancy rate of Myrtle Manor has been less than 2 percent. In addition, the property’s bad debt/collection losses have been roughly just 1 percent.

According to the restructure plan, per-unit projected expenses are below the IREM 2001 expenses for garden apartments, but above the expenses estimated for comparable properties. The PAE obtained a Comparable Expense Data report comparing expenses of Myrtle Manor with similar projects with 40 to 65 units. Three of these were used and found that expenses on these three were higher than Myrtle Manor, leading the PAE to conclude that expenses for Myrtle Manor were reasonable. In addition, the PAE examined property payables and confirmed there was no excess obligation to be paid.

The Participating Administrative Entity (PAE): ONTRA, Inc.

HUD referred the restructuring of Myrtle Manor to ONTRA, Inc., a private PAE located in Austin, Texas. ONTRA has been supporting government organizations, primarily as a distressed asset underwriter and manager, for over 20 years. The company's experience includes the Federal Deposit Insurance Corp., Federal Savings and Loan Insurance Corp. (FSLIC), the Resolution Trust Corp. (RTC), and recently the U.S. Department of Housing and Urban Development (HUD) through the M2M program.

To manage their M2M business, the company is divided into three in-house teams: 1) a restructure specialist team; 2) a field specialist team; and, 3) an administrative team. The restructure specialist team develops the plan, handles underwriting, runs underwriting model calculations, handles the second tenant meeting, and deals with the owner. The field specialists develop the market rents, handle comparable assessment, and conduct the first tenant meeting. The administrative team works with vendors, performs closings, manages the collection of documents for submitting to HUD, and handles the post-closing process.

ONTRA, Inc. has completed about 280 M2M restructurings, of which roughly 80 have been Fulls and 200 have been Lites. The organization is currently responsible for about 40 M2M deals in progress, virtually all of which are Fulls. ONTRA has completed only one Lite since July 2001. ONTRA has operated nationwide, with many of their restructurings occurring in the Midwest and West.

The underwriter/restructure specialist working on Myrtle Manor was hired by ONTRA earlier this year. Prior to this position, he had worked for a variety of smaller real estate related companies as a CFO. His formal training is in accounting. At the time of the interview, he had managed (or was managing) about six Full restructurings. Of these, Myrtle Manor appeared to be the least problematic restructuring he had managed.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- OMHAR assigned Myrtle Manor to ONTRA on March 13, 2003. The PAE ordered the third-party appraisal on March 27th and the physical condition assessment (PCA) on March 26th.

- The appraisal was completed on May 22, 2003.

- The Physical Condition Assessment was completed on April 23, 2003. Because Myrtle Manor is in good condition, no critical and just a few immediate repairs were identified and easily documented in the PCA. In addition, there were several properties in the area that proved to be good comparables for appraisal purposes.

- ONTRA conducted the first tenant meeting at Myrtle Manor on May 13th. Prior to the meeting, the PAE sent notices to all residents. Also, as part of the PCA, tenants were provided surveys in which they were asked for their opinions on the condition, maintenance and operations of the property. The tenant meeting took place in the park outside the laundry room, because Myrtle Manor does not have a common interior space. This location may have limited attendance at both this and the subsequent meeting, given the hot temperatures in Phoenix at that time.

  Ten residents were present for the meeting, which was conducted by Eileen Middendorf of ONTRA. In addition, representatives of Biltmore Properties—Cheryl Wirtz as well as Michelle and Hector Rendon, the on-site property managers—were in attendance. The issue that was most important to tenants was the security at Myrtle Manor; specifically mentioned were poor parking lot lighting, and the fact that the fence at the rear of the property was not secure. Handicapped accessibility issues were also raised, as were some apartment-specific issues, such as worn carpeting.

- Due diligence was completed on June 3, 2003.

- The Second Tenant Meeting Was Held on June 20, 2003. This meeting was held at the same location as the first. Prior to the meeting, notice was sent out. A copy of the draft restructuring plan along with additional materials was provided by the PAE to the onsite manager to be available to tenants for inspection. Less than 10 residents attended, fewer than at the first meeting. The only significant issue raised at this meeting was the possibility of installing a community access point for the internet.

- ONTRA, Inc. presented the Full restructuring plan to OMHAR on July 1, 2003.

- The restructuring commitment was executed on July 29, 2003.

- Closing occurred on October 30, 2003.

Tenant Involvement in the M2M Restructuring

Very small numbers of tenants attended the meetings held by the PAE and management, although notices were sent, which included surveys about their satisfaction with management and the condition of their units and the common areas. As stated earlier, the fact that these meetings were held outside in hot weather may have limited attendance. General satisfaction with management may have been another factor in low attendance.

Five tenants were interviewed for this case study. Their views generally reflected those at the tenant meetings, and they also noted how good the current onsite managers were and their responsiveness in resolving any problems or complaints. While one of the on-site managers accompanied the interviewer around the property, the manager remained outside of the apartment during most interviews with the resident.

When asked about the availability of affordable housing in the area, the tenants generally felt that it was difficult to find similar affordable housing in the area. And when asked what they would do if they were offered a Housing Choice Voucher, most all responded that they would stay at the property if the current management remained. (The local HUD contract administrator has reported 100 percent voucher utilization in Phoenix and the Housing Director of Maricopa County stated that 12,000 applicants are on the waiting list for vouchers.)

Details of the M2M Restructuring

Rent Levels

The PAE-recommended rents are consistent with the market rents determined in the appraisal. Table 9 compares the new rent levels proposed in the restructuring plan with the previous rents, and compares all the rents as a percentage of fair market rents. The rents on the two-bedroom apartments are $525/month, and the three-bedroom unit rents are set at $650/month. These new rents are 65 to 70 percent of the pre-restructured rents. Moreover, the proposed rents are substantially lower than the local FMRs for Maricopa County for the same bedroom size. For two-bedroom units, the current FMR is $835/month, whereas the three-bedroom unit FMR is currently at $1,161/month.

Table 9. Rent Levels Pre- and Post-M2M

		New Rents		Previous Rents	
Unit Type	HUD-Established FMRs	Rent	Rent as Percent of FMR	Rent	Rent as Percent of FMR
Two-Bedroom	$835	$525	63%	$810	97%
Three-Bedroom	$1,161	$650	56%	$917	79%

Estimated Savings

This estimated Section 8 savings are $148,000 annually or $1.7 million over 20 years, with total net savings to the government of $800,000 over the 20-year period.

Financing

- 1st mortgage in the amount of $622,100, insured under Section 223(a) (7), and amortized over 30 years at an interest rate of 6.25 percent. This reflects a DSCR of 1.20 at the proposed rents, resulting in an expense cushion of 9.1 percent.

- A 2nd mortgage in the amount of $815,000, at an interest rate of 1.0 percent.

- A contingent repayment note, or 3rd mortgage, in the amount of $376,606 at an interest rate of 1.0 percent.

The plan includes a contribution for the owner's share of transaction and closing costs in the amount of $6,400, which is 20 percent of the total estimated transactions costs.

Renovation Items and Costs

The PAE's plan for immediate rehabilitation needs identifies a modest $14,200 in total costs. This includes the following estimates:

- $6,900 for better security lighting.
- $900 to repair damaged siding.
- $2,500 for modifications to comply with ADA requirements.
- $3,900 for a new cinder block wall at the rear of the property.

Due to the relatively small dollar amount of these needs, and the administrative expenses from establishing an escrow account, the PAE and management agreed that these repairs would be completed prior to closing and funded from the property's reserve account. The reserve would be replenished at closing. No share of immediate rehab items is included in the closing costs since these are being funded from project reserves.

The PAE is also recommending that an initial deposit of $37,950 be made to the Reserve for Replacement account as part of a total $520,000 R4R costs that are estimated to be needed over the next 20 years.

Outcomes for Tenants

Apart from some enhanced security measures, such as the new fence at the back of the property and new security lighting, not much will be different for tenants after the restructuring is in place. The Reserves for Replacement will now have a built-in schedule for replacing, and this tighter timeframe may result in faster repairs or replacement than the timeframe employed by the management company prior to restructuring. Tenant turnover is not expected to occur in response to the restructuring since residents are, for the most part, uninterested in the restructuring and were already very happy with existing management.

Viability of the Project after M2M Restructuring

The long-term outlook for this property appears very good, if current management continues, and the reserves for replacement continue to be adequately funded. The plan incorporated a 5 percent vacancy rate, which is higher than the historical average of 2 to 3 percent for the property. The neighborhood location of the property, the very good condition of the property, and the low vacancy rate for subsidized housing should continue to result in low vacancy rates for Myrtle Manor.

Lessons Learned from This Site

Myrtle Manor is a good example of the type of property for which the M2M program was designed. It is a newer assisted property where current contract rents were clearly above local market rents. Under this restructuring, clear savings to the government are anticipated to occur over the next 20 years, and the funding of reserves should be sufficient to cover future rehabilitation and replacement needs in the property.

Moreover, with estimated market rents for this property at roughly 60 percent of the local FMR—the rent standard for determining the subsidy payment under the Housing Choice Voucher program—HUD's subsidy payments for the existing tenants should be minimized relative to providing Housing Choice vouchers to those tenants.

Case Study Nine: Russell Erskine Apartments Huntsville, Alabama—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

The Russell Erskine Apartments is a 74-unit property in downtown Huntsville, Alabama. The structure was formerly a hotel, built in the early part of the twentieth century. The structure was remodeled in the early 1980s and became a Section 8 "elderly" property. The structure has been designated as an historic building in what is the "old" downtown of Huntsville.

Russell Erskine had traditionally had a low vacancy rate. The building, at least superficially, looks well maintained. Many of the tenants have been living at the property for a number of years and have positive comments about the on-site management.

Although the building does look well-maintained, the Physical Condition Assessment (PCA) associated with the M2M process did identify some needed, major structural repairs. They are not uncommon for a property of this age, but they are usually beyond the scope of a M2M restructuring. These major repairs include such items as plumbing and electrical systems.

In addition to the needed major repairs, this restructuring has been complicated by the building's designation as an historic structure. This designation meant that any M2M rehabilitation would have to pass a review by the Historic Trust Board. The lead underwriters for this restructuring, from the beginning of the process, have been unsure how much freedom they would have in developing a Full restructuring plan given the situation. However, this complication also presented an opportunity. The economic development agency in Huntsville does have funds that could be applied to any rehabilitation of the project. Since the opening stages of the M2M process the underwriters have been in negotiations with the economic development agency to develop a joint rehabilitation plan.

The Huntsville, Alabama census tract that contained the property had a relatively high poverty rate of 36.6 percent, according to 2000 census data. The city is approximately 75 percent non-Hispanic white and 25 percent non-Hispanic black. Huntsville has a long history associated with the development of the Tennessee Valley Authority (it sits close to the Muscle Shoals dam), and has several large military installations. It also has several manufacturing plants.

The Neighborhood

The Russell Erskine apartments sit in the middle of the “old” downtown of Huntsville. Like many downtowns, this is an economically mixed area. Some portions of the downtown appear semi-deserted, while other blocks have a variety of new, small retail outlets including restaurants and cafes. As mentioned above, the Huntsville city government has made a major commitment to promoting development and rehabilitation in this area.

The area immediately surrounding the complex is characterized by a variety of small retail outlets. The several blocks around the hotel are about 50 percent revitalized and 50 percent semi-deserted. Despite the deserted portions of the area, the tenants stated that they felt secure in the neighborhood.

The Housing Market

According to the 2000 Census Report for the tract, the level of home ownership in this part of Huntsville is a moderate 46.5 percent. The downtown area, in particular, does have a large number of private sector multifamily units. The rental vacancy rate in the immediate area is a modest 8.6 percent.

The tenants interviewed for this report indicated that they would be able to locate a unit with a Housing Choice voucher. However, most of the tenants believed that the available units, which would be in downtown Huntsville, would be significantly lower in quality than those at Russell Erskine. Tenants did believe that there were affordable units in the suburbs of Huntsville, but were reluctant to move there because of the lack of public transportation and need for a car.

Financial History of the Project

The Russell Erskine is owned by a commercial firm in Memphis that owns fewer than 10 Section 8 properties. The tenants mentioned that there had been considerable turnover in on-site management in the last several years, and it often takes considerable time to get approval from Memphis for needed repairs.

Despite the problems mentioned above, the property has consistently received REAC financial scores in the 80s and 90s.

The Participating Administrative Entity (PAE): Jefferson County Assisted Housing Corporation

The Jefferson County Assisted Housing Corporation is one of the few public PAEs that have consistently maintained a large presence in the M2M program. Most of the underwriting activities of the PAE are performed on a contractual basis by individual underwriters in the Montgomery, Alabama area. However, the underwriting consultants employed by Jefferson County have considerable experience working with the M2M program, and interviews with these underwriters indicated a detailed understanding of the M2M process. They also indicated a good understanding of subsidized housing issues in general.

A single senior staff person at Jefferson County coordinates all the M2M restructuring activities and assigns properties to specific underwriters. This individual is also responsible for conducting all requisite tenant meetings for a M2M restructuring.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- The property was assigned to Jefferson County in January 2003. Within the month the PAE had selected third-party vendors for the Physical Condition Assessment (PCA) and the Rent Comparability Study.

- The single tenant meeting held to date was on March 9, 2003.

- Both the PCA and the Rent Comparability Study were submitted to the PAE in April, 2003.

- The PAE completed its due diligence review of the owner in April 2003. The due diligence review identified the problem of the apartments being designated an "historic structure."

- Beginning in May, after approval from OMHAR, the PAE and owner began negotiations with the local economic development agency to explore the option of combining economic development funds with the M2M refinancing. In OMHAR's terminology, this would be an "additional funds" refinancing. These negotiations continued all through the summer of 2003.

- In October of 2003, the PAE, owner, and economic development agency reached a tentative agreement on a strategy to include economic development funds in the M2M financing.

- In November 2003 the PAE received OMHAR approval to proceed with the proposed "additional funds" restructuring.

- As of the end of data collection period for this study, the PAE was developing a draft restructuring plan that would incorporate the economic development funds.

Tenant Involvement in the M2M Restructuring

There were 11 attendees at the March tenant meeting. All of these tenants expressed general satisfaction with the current management. A number of the tenants did express a desire for certain unit-specific repairs.

Because of the complicated nature of the negotiations, the owner has kept the tenants informed about the discussions with the economic development agency. Some tenants interviewed for this study expressed concern about the time it was taking to clarify issues with the economic development agency, but all maintained that they were provided with updates on a regular basis.

Details of the M2M Restructuring

Rent Levels

No plan developed yet.

Estimated Savings

No plan developed yet.

Financing

No plan developed yet.

Renovation Items and Costs

No plan developed yet.

Outcomes for Tenants

Assuming that a restructuring plan is implemented, this plan will provide a major benefit to the tenants. Not only will the structure be retained as affordable, but it will also have a very comprehensive physical upgrade, larger than can be normally obtained through the M2M process.

Viability of the Project after M2M Restructuring

No plan is developed as yet. However, the underwriters indicated that with the "additional funds" a viable financial plan could almost certainly be developed.

Lessons Learned from This Site

The lesson learned at this site was the value of external partners to a property restructuring, particularly for an older building with high rehabilitation expenses. This is a strategy that has not been employed for many M2M properties, and probably should be pursued more often. In this case, the underwriters took the initiative to begin negotiations with city agencies. However, they are probably not always the best-suited persons to assume this role. Perhaps greater coordination with local HUD Housing staff would be a good way to identify and act on opportunities for external partners. Certainly, a private

PAE may well not have wanted to deal with the delays to the M2M process that is necessary for an outcome like this one. Consideration should be given to allowing extensions to the time requirements when working on complicated deals like this.

Case Study Ten: Six Chimneys Apartments Cleveland, Ohio—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

The Six Chimneys Apartments project is located on Prospect Ave, one of the principal arteries of the "old" downtown of Cleveland, Ohio. The property is a four-story, brick elevator building that was originally constructed by the Rockefeller family in 1920. The property was substantially renovated in 1982 when the property was given as a charitable donation to the Help Foundation, Inc. The Help Foundation renovated the property so as to provide affordable housing and necessary support services to a tenant population identified as "wholly developmentally disabled." In 1983, after renovation of the physical structure, the foundation began operating Six Chimneys as a Section 8 property.

The unit mix of the structure includes 36 efficiencies, and 10 one-bedroom, one-bath units. The average unit size is 428 square feet for the efficiencies, and 517 square feet for the one-bedroom units. Unit amenities include a window air conditioning unit, electric range, frost-free refrigerator, carpet and vinyl flooring, vertical blinds, pull cords to obtain emergency services, and grab bars. Site amenities include an elevator, a wheel chair lift, secured entry, buzzer/intercom, laundry facility, and a community meeting room with a kitchen, which is used for crafts and recreation. There is also a TV and game room, an exercise room, a nurse's office, a small lounge on the first floor as well as corridor sitting areas on floors 2 through 4. In addition, there is a counseling center, an on-site management office and a gated parking lot.

The building has on-site staffing 24-hours every day. There are pull cords in each unit and an in-house security system. Each unit has an emergency call system that, if activated, will alert the manager's office and a 24-hour call service. Additional services at Six Chimneys include educational opportunities to teach the residents skills that allow them to eventually become independent. These services include, but are not limited to, cooking, shopping, money management, self-hygiene, cleaning and other self-help skills. There is an on-site nurse's office that provides general health maintenance services. The staff also provides aid and intervention with the various government programs that residents must deal with, including Medicaid, SSI, VA, and Medicare.

Although the tenant population is identified as "wholly developmentally disabled," the majority of Six Chimney residents are employed outside the property. Residents pay their portion of the monthly rent according to Section 8 regulations. The facility is locked at all times (tenants do have keys), but visitors are allowed to come in as long as they are screened at the front security post, which has an attendant 24 hours per day. Based on staff assessments, tenants are allowed to leave the premises for errands as well as work requirements. Tenants are encouraged to conduct errands such as grocery shopping or check cashing in groups in order to minimize opportunities for theft or other untoward advances by strangers. Tenants indicated that, on the whole, they felt secure both in the property and in the immediate environment of the property.

The service components of the Six Chimneys are funded through a series of grants with State and local health agencies. Referrals for openings normally come from local agencies such as the Cuyahoga County Board of Mental Retardation and Developmental Disabilities. The property has maintained nearly full occupancy over its operating history based on its referral network with local health agencies. A high proportion of the current tenants have been at the property for more than 10 years.

As noted, the owner of record of the Six Chimneys property is a foundation which operates as a non-profit, Board-operated entity with an IRS designation of 501-c3. The sole purpose of the organization is to provide housing to individuals with mental retardation and developmental disabilities. Six Chimneys is one of three not-for-profit entities managed by the foundation. The foundation itself serves as the management agent for Six Chimneys, so there is an identity of interest between the ownership and management entities.

The foundation's other operations include a number of small residential houses where the residents receive fewer services and have a greater degree of freedom. Periodically, based on staff assessments, some Six Chimneys residents are relocated to one of these facilities.

The foundation has separate Boards of Trustees for each of their corporations. The organization has a separate business department, a building maintenance team, and a large staff of licensed mental health professionals.

The Neighborhood

The area on Prospect Avenue where the property is located is part of the designated historic district of downtown Cleveland. Prospect Avenue itself is a major four-lane traffic artery. The area immediately surrounding the property is characterized by large retail businesses (e.g., a tire dealership), smaller commercial businesses, including grocery stores and banks, and restored "historic" structures. The latter structures generally are maintained by non-profit organizations such as clubs or foundations. The Six Chimneys property is easily accessible to public transportation with a bus stop located directly in front of the building.

The Housing Market

The inner city part of Cleveland where Six Chimneys is located is not a prime rental or residential area. The home ownership rate in the census tract was only 2.1 percent, according to the 2000 Census. The rental vacancy rate in the census data was 17.6 percent. However, these housing market indicators have little general applicability to the population that is resident at Six Chimneys, or their ability to find alternative housing.

Financial History of the Project

The foundation managing Six Chimneys has consistently had high REAC financial ratings. In addition, the property has always received high REAC scores (the latest being a 95) for maintenance of the property.

The Participating Administrative Entity (PAE): Credit Vest

Credit Vest is a private PAE that is a large real estate company with a great deal of experience handling the due diligence process. It was one of the first companies to become a PAE for the M2M program and has completed hundreds of M2M restructurings. The underwriter who handled the Six Chimneys property had extensive underwriting experience both for M2M and in the private sector.

Credit Vest is a “full-service” PAE. Staff of the organization conducts all the essential functions of the M2M process including facilitation of the tenant meetings, development of the Restructuring Plan, and negotiations leading to a closing of the restructuring agreement. Credit Vest staff also have responsibility for selection of third-party vendors for rent comparability studies, appraisals, and Physical Condition Assessments (PCAs).

In the case of Six Chimneys, the Credit Vest staff showed considerable diligence and originality in conducting the tenant meetings. As mentioned above, all of the tenants at Six Chimneys have severe learning disabilities. As required, two tenant meetings were advertised in the building and were comparatively well attended. The Credit Vest facilitator did have to depend on program staff both to “translate” questions and to facilitate responses. However, interviews with tenants indicated that there was a general understanding of the purposes of the restructuring, particularly the opportunity to address immediate rehab or property upgrade requirements. As an indication of their understanding of the process, a number of tenants made requests to include a cable connection in the 12-month rehab package.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- The property was referred to Credit Vest in December, 2002. By January 2003, Credit Vest had selected vendors for the Physical Condition Assessment and the Rent Comparability study. On-site data collection for each of these studies was conducted in January 2003.

- The first tenant meeting for Six Chimneys was held on January 29, 2003. (See the Tenant Involvement discussion below for details.)

- The rent comparability study was submitted to Credit Vest on January 31, 2003. The rent comparability study concluded that the existing HAP rents were considerably above market rents for the vicinity.

- The complete Physical Condition Assessment (PCA) was submitted to Credit Vest on January 31, 2003. The PCA found the property to be in good to satisfactory condition with virtually no "critical requirements" to be funded in the initial 12-month rehab package.

- The normal next step would have been completion of the owner's due diligence and development of a draft plan. At the time, the timetable seemed to indicate a projected date for submission of a plan about July 1, 2003. However, the lead underwriter noted several issues which required attention before a plan was submitted to OMHAR. The first issue was the discovery that the initial rehab of the structure in 1982-83 was partially funded with MAHRA-exempt bonds. After contacts with the issuing agency it was determined that the bonds would be redeemable as of July 1, 2003. OMHAR's decision was that once the bonds were redeemed on July 1, 2003, the property was eligible to proceed with a M2M restructuring.

- During the same timeframe (May 2003) the lead underwriter made a decision to put a "hold" on completion of due diligence until completion of the Help Foundation's annual financial statement. The foundation's fiscal year concluded on June 30. Based on past experience, the underwriter assumed that OMHAR would not be satisfied with a financial statement that concluded June 30, 2002. Thus, she "held" plan development until the Foundation could provide 2003 financial data. These data were submitted to Credit Vest on August 16, 2003.

- The second tenant meeting was held on two days, September 16, 2003, and September 17, 2003. (See Tenant Involvement section below.)

- A draft restructuring plan was submitted to OMHAR on September 29, 2003.

- OMHAR approved the plan on October 21, 2003.

- At the conclusion of the data collection period for this study, the PAE and the owner were in negotiations to finalize the refinancing agreement prior to a formal restructuring commitment.

Tenant Involvement in the M2M Restructuring

The first tenant meeting was held at the property. In order to accommodate the residents, two sessions were held, one at 11:30 a.m. and one at 4:00 p.m. In addition to PAE staff and facility caseworkers, several staff of the Cleveland Tenants Organization attended the sessions. Twelve residents attended the morning session, and eighteen tenants attended the afternoon session. The caseworkers and the CTO staff assisted the PAE representative in facilitating the discussions with the residents. This was felt necessary in order to accurately note comments from the developmentally disabled residents, and to foster an open discussion. (Facility caseworkers also assisted with tenant interviews during this study's on-site visit.)

Nineteen tenant feedback forms were completed. In general, the residents appeared to be satisfied with the management and the overall property maintenance of Six Chimneys. In particular, the residents stressed that they felt secure at Six Chimneys. A couple of concerns or issues were noted on the forms. A number of tenants wanted to know if the restructuring was an opportunity to install cable in the facility. In addition, several wheelchair-bound residents expressed a desire to obtain adaptive equipment to make it easier to open windows and adjust thermostats. Owner representatives indicated that they would take these concerns under advisement.

Facility caseworkers and CTO staff assisted in facilitating the discussions. The residents expressed general satisfaction with the data presented from the draft plan. Eleven residents attended the first session, and 13 attended the second session. A number of tenants expressed concerns about items in their individual units. The PAE and the owners both concluded that these did not need to be addressed as "critical requirements." It was noted that several of these items were scheduled for replacement in Year 1 of the replacement schedule.

Details of the M2M Restructuring

Rent Levels

Table 10 provides the rent levels pre- and post-M2M restructuring.

Table 10. Rent Levels Pre- and Post-M2M

Unit Type	HUD-Established FMRs	PAE Market Rents	New Contract Rents		Previous Contract Rents	
			Rent	Rent as Percent of FMR	Rent	Rent as Percent of FMR
Studio	$483	$519	$519	107%	$820	170%
One-Bedroom	$606	$599	$489	81%	$898	148%

Estimated Savings

The projected savings to HUD over 20 years for the proposed restructuring is $581,071.00. This represents an estimated savings of $12,360.00 per unit over a 20-year timeframe.

Financing

On this restructuring, OMHAR has approved what is an unconventional M2M financing strategy. The proposed strategy is to essentially put nearly all the outstanding debt on the HUD-issued second and third mortgages. In particular, placing a comparatively large amount of the financing on the third mortgage may be an effective strategy for a nonprofit owner/operator.

The details of the approved financing are as follows:

- The proposed first mortgage note is to be in the amount of $117,100.00. Anticipated rate is 6.75 percent with a 30-year term. (The nonprofit owner indicated that they may be able to self-finance the new first mortgage.)

- A second mortgage for $578,000.00 at 1.0 percent and a 30-year term.

- A third mortgage for $1,213,245.00 at 1.0 percent and a 30-year term.

This refinancing strategy would result in a partial claim payment of $1,501,527.00 on the existing note.

Renovation Items and Costs

Only two items were proposed as immediate rehab requirements. These were:

- Installation of Braille elevator instructions at 4 locations: $1,200.00.
- Replacement of one heating boiler: $27,500.00.

Total 12-month rehab costs were $28,700.00 or $624.00 per-unit.

Outcomes for Tenants

The successful conclusion of a restructuring plan for Six Chimneys represented a major benefit for the tenants. In development of the plan, the underwriter employed extremely conservative estimates to ensure an adequate “cushion” to continue operations. On standard measures, the DSCR ratio for this refinancing approximates 1.6.

Given the limited housing options for this tenant population, it appears to be an appropriate programmatic goal to structure the agreement to ensure maintenance of this property. In particular, this is a population where the use of vouchers would appear to be inappropriate.

Viability of the Project after M2M Restructuring

As mentioned above, the financing strategy for this property appears designed to ensure the continuing operation of the program. The only caveat is any uncertainty concerning the ongoing funding of service provision by the State and local health agencies.

Lessons Learned from This Site

Lessons learned from this site include:

- The M2M process has enough flexibility to design a refinancing strategy for properties with unique requirements. Such strategies may be particularly appropriate when dealing with nonprofit owner entities.

- In the case of the restructuring, the focus of negotiations may have been too narrow. All of the negotiations were carried out efficiently, following OMHAR guidelines. However, all the data collection efforts focused on mortgage-related issues. The service component of the property's operations was not really addressed in the restructuring process. This may have been a case where "partnering" arrangements could have been discussed. This might represent a missed opportunity to provide even greater benefits to this tenant population.

Case Study Eleven:
Sneedville Garden Apartments
Sneedville, Tennessee—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

The Sneedville Garden Apartments are located in Sneedville, Tennessee. The property is comprised of 10 one- and two-story structures with a total of 40 apartment units. Twenty-four units are one-bedroom, and sixteen units are two-bedroom. The complex was constructed in 1979 under the Section 8 New Construction program, and has the garden-style appearance of many of the Section 8 properties constructed in the 1970s and 1980s. There is a leasing office in a separate building.

Sneedville, Tennessee is an isolated, small rural township approximately 80 miles northeast of Knoxville. Only two two-lane roads that rise over several large mountain passes access the community. The town is a service center for the immediately surrounding agricultural community where livestock (cattle and horses) are raised and grains are grown commercially. Tobacco production also remains an important part of the local economy.

There is a limited amount of industry in Sneedville. Surprisingly, for this portion of the Blue Ridge Mountains, there is little tourist or commercial recreational activity in the immediate area. The low level of economic activity in Sneedville is in stark contrast to towns such as Morristown that are only 30 miles away, but adjacent to a major interstate highway.

The Sneedville tract that contained the property had a high poverty rate of 43.6 percent in the 2000 Census. The population for the tract was 96 percent non-Hispanic white.

The Sneedville property has been under the same ownership and identity-of-interest management group since its construction in 1978. The same property manager has been in her position since the property was opened. Vacancy rates have been consistently low, and the property was 100 percent occupied at the time of the site visit for this study. A high proportion of the tenants appear to be long-time residents. Two of the tenants interviewed had been resident at the property for over 10 years. There is normally a 2- to 4-month waiting list to obtain a unit at Sneedville Gardens.

The Sneedville property appears to have been well maintained since its construction. The Physical Condition Assessment noted only a few minor repair needs. At the time of closing, the OMHAR restructuring agreement provided no funding for any critical repair needs in the first 12 months of the restructuring agreement.

The Neighborhood

The Sneedville property is located on a hilltop overlooking the town center. Many of the second story units have dramatic views of the several river valleys that lead into Sneedville, and the next ridge of mountains. Most of the structures immediately adjacent to the Sneedville property are old (pre-1940), but well-maintained single-family residences. One side of the Sneedville property does abut a Public Housing multifamily property. Another side of the property is at the base of a small, undeveloped hill.

The Housing Market

As is common in small communities, the home ownership rate in Sneedville is high, listed in the 2000 Census at 70.8 percent. The rental vacancy rate is listed in the census data as a low 5.2 percent. By all indications the private sector rental market within Sneedville is extremely limited. For such a small community, Sneedville has a relatively large number (6) of subsidized multifamily properties. The majority of tenants in all of these properties appear to be drawn from the immediately surrounding rural areas. Many of these tenants had lived in sub-standard rural housing prior to obtaining a unit in one of these properties.

Financial History of the Project

As noted above, the property is still owned and managed by the company that developed it in 1978. All indicators showed that the past financial performance of this property had been highly satisfactory.

The Participating Administrative Entity (PAE): Foley and Judell

The PAE selected for this restructuring transaction was Foley and Judell, a law firm located in New Orleans. As a law firm, Foley and Judell is unique among the PAEs working in the M2M program. However, Foley and Judell had considerable experience working in the housing market, both public and private. In particular, the firm had a long history of providing legal advice on bonds issued for public sector properties, both commercial and residential.

When the M2M program began operation in 1998, the senior partners of the firm recognized a market opportunity to use their considerable underwriting experience in the program. A separate unit was created at the law firm devoted solely to M2M restructurings. This unit of the firm provides all services required for a M2M restructuring, including underwriting, selection of third-party vendors, and the facilitation of tenant meetings. There was no “farming out” of any restructuring functions.

At the time of the project data collection, Foley and Judell had completed over 50 M2M restructurings. At that time they were averaging four to five active cases in a given month.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- The Sneedville property was first referred to OMHAR in May of 2002.

- In June of 2002 the property was referred to Foley and Judell, the PAE.

- A Physical Condition Assessment was submitted to Foley and Judell on July 16, 2002. While the PCA indicated that the property was in good to excellent condition, an August 23, 2002 communication to the owner indicated some environmental concerns identified by the engineers. These included:

    - No certification that the electric transformers were PCB-free.
    - No certification that the property was free of lead-based paints.
    - There was some indication that the property could have asbestos containing materials.

  The owner was required to develop an Operations and Maintenance Plan that detailed how these concerns were addressed. The owner was notified that a restructuring agreement would not be developed until these concerns were satisfactorily addressed.

- A rent comparability study was submitted on August 9, 2002.

- The first tenant meeting was held on July 17, 2002. (See the Tenant Involvement section below for details.)

- The above-listed concerns were satisfactorily addressed by January 2003.

- A draft restructuring plan was submitted to OMHAR for review in February, 2003.

- The draft restructuring commitment was submitted to the owner for review in April, 2003.

- The second tenant meeting was held on May 6, 2003.

- The final restructuring commitment was submitted to the owner on June 27, 2003, with an anticipated closing date of July 30, 2003.

- Final negotiations on details of the restructuring pushed the closing date back to September 13, 2003.

Tenant Involvement in the M2M Restructuring

Eight tenants attended the first tenant meeting on July 17, 2002. The tenants indicated general satisfaction with the property management. Several tenants indicated a desire to obtain new appliances or new fixtures for their apartments.

Six tenants attended the second tenant meeting in May 2003. The tenants were informed that the draft restructuring agreement included no immediate enhancements to the property. No dissatisfaction was expressed with this result.

Details of the M2M Restructuring

Rent Levels

Table 11 provides rent levels pre- and post-M2M restructuring.

Table 11. Rent Levels Pre- and Post-M2M

Unit Type	HUD-Established FMRS	PAE Market Rents	New Contract Rents		Previous Contract Rents	
			Rent	Rent as Percent of FMR	Rent	Rent as Percent of FMR
One-Bedroom	$297	$350	$354	119%	$474	150%
Two-Bedroom	$375	$489	$438	117%	$555	148%
Three-Bedroom	$491	$525	$438	89%	$681	138%

Estimated Savings

The approved Exception Rents result in a net loss to HUD of $44,441 at Net Present Value. This represented a per-unit loss of $871.39.

Financing

The refinancing package set up was a standard M2M arrangement. The package provided for a partial payment of claim on the existing mortgage of $1,110,568.38. This was on an Unpaid Balance of $1,281,312.38. Total transaction costs for the restructuring were $98,947.00.

The new mortgages are:

- A new first mortgage with a balance of $250,000.00, a rate of 6.0 percent and a term of 30 years.
- A second mortgage of $675,000.00, with a rate of 1.0 percent and a term of 30 years.
- A third mortgage of $435,568.38 set at a rate of 1.0 percent and a term of 30 years.

The restructuring agreement required an annual Reserve for Rehabilitation deposit of $30,000.00.

Renovation Items and Costs

A 12-month rehabilitation package was not developed for this property.

Outcomes for Tenants

The major outcome for the tenants at this property is retaining the property in the Section 8 program. This appears to have been an extremely well-managed property. In addition, there is a definite, continuing need for good-quality affordable housing in the Sneedville area.

Viability of the Project after M2M Restructuring

There is an extremely high probability that this property will be financially sound for the foreseeable future.

Lessons Learned from This Site

The primary lessons learned at this site include the following:

- The presence of Section 8 housing in small isolated rural communities does appear to meet a genuine housing need for a low-income population. A high proportion of the tenant population had come from isolated areas in the mountains adjacent to Sneedville. For some of these tenants, particularly the elderly tenants, the Section 8 housing represented a significant upgrade in the quality of their housing.

- A M2M refinancing arrangement still provides major incentives for an owner who has made a reasonable investment over time in the project. In the case of Sneedville, the restructuring was an improvement over the existing debt servicing of the owner. In addition, the restructuring enabled the owner to pay off a significant amount of short-term payables.

Case Study Twelve: Winthrop Apartments
Tacoma, Washington—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

Winthrop Apartments is located in the downtown commercial core of the central business district of Tacoma, Washington, a medium-size city in the Pacific Northwest approximately 35 miles south of Seattle. Tacoma, a former timber mill town and transportation hub, has undergone a downtown revival over the past 10 years. Winthrop is a 12-story, 194-unit apartment building that was originally constructed in 1924 as a hotel. As such, it would be considered an older subsidized property in the M2M program. The building is constructed of steel and cast-in-place concrete, with a combination of brick and terra cotta tile veneer, giving it a classical appearance.

The building was rehabilitated in 1972 by a previous owner under the Section 8 program. The property has been owned by Conifer 116, a limited partnership, for the past 10 years. There are three General Partners in Conifer 116: Conifer Developments, Inc., P&R Investment Services, and Paul Pfleger. Conifer Development, Inc. is the Managing General Partner. Conifer Management, Inc. is the property manager for Winthrop Apartments. Both Conifer Development and Conifer Management are owned by Mr. Allen Hanson, who is one of the three General Partners.

The property consists of 194 residential units—72 studios, and 122 one-bedroom units—as well as ground level common space and retail space. Of the total residential units, 174 are assisted with Section 8 subsidies. All except six units were rented and occupied at the time of the site visit. Those six units were undergoing replacement of plumbing and so were not in service. The property had 67 people on the waiting list. The current contract administrator for the Section 8 program is the Bremerton Housing Authority. The property currently houses small families as well as elderly and disabled tenants.

The units are very small on average and are categorized as small and large studio apartments, and small and large one-bedroom units. The small studios average only 233 square feet, with large studios averaging about 338 square feet. Small one-bedroom apartments are 408 square feet, with the larger one-bedrooms averaging 611 square feet. The Physical Condition Assessment described the property as being in good-to-fair condition with respect to the major structural and mechanical systems, but did note some significant deferred maintenance. These items primarily included plumbing and elevator machinery that require replacement or upgrade. REAC inspection scores were 44 in 1999, 89 in 2000, and 77 in 2002.

In addition to the residential space, there is substantial commercial and community space on the ground floor. The commercial space generates income to the property and includes roughly 16,000 square feet of retail space, and a 4,200-square-foot ballroom that is rented for events. In addition, there are roughly 10,000 square feet of common and circulation space including front offices, laundry facilities, a small chapel, a small tenant-run store, and a kitchen area that is used for regular coffee socials. A major limitation to the building is its lack of on-site parking. However, the opening of the new light rail line should help alleviate some of the transportation problems related to the limited parking.

According to the 2000 Census, the property is located in a very low-income census tract, with a poverty rate of 47 percent. The 2000 Census also indicated that Winthrop is located in a tract that is roughly 60 percent white, 16 percent black, 10 percent Asian or Pacific Islander, 8 percent native American or multiracial, and 6 percent Hispanic.

The Neighborhood

The central business district in which the project is located has been undergoing revitalization efforts for the past several years. The building is located at the west terminus of a new light rail line, which runs through downtown, and connects to both a branch campus of the University of Washington, Tacoma, and to a heavy rail system that runs to other cities to which residents commute. This light rail line is just one aspect of the significant public and private investment in the business district in the past ten years.

Several residential housing projects have been built in this area, encouraged by both the city government and the State's property tax exemption program for multifamily housing development. Several new museums, renovated theatres, the Convention Center, and a revitalized industrial district have enhanced the desirability of the downtown as a location for living and working.

Winthrop Apartments is located near a variety of small retail stores and restaurants. The surrounding area appears well maintained, and the streets and sidewalks are in good condition. Only one small building was boarded up; otherwise, the surrounding commercial spaces were all occupied. Winthrop is also located near an area called Antique Row, which includes many small antique shops. As noted above, the neighborhood also boasts of several desirable features within several blocks of Winthrop that should have a positive impact on rents, including the light rail line, museums, University of Washington (Tacoma campus), and theaters.

The Housing Market

According to Depre and Scott Apartment Advisors, Inc., Winthrop Apartments is located within the north-Tacoma market area, but a significant portion of greater downtown is located within the mid-Tacoma market area. Analysis of these two market areas shows that vacancy rates rose between 1990 and 1996, at which point they reached a high averaging more than 7 percent. This was followed by a general decline, reaching a low in 2000 of less than 2 percent.

In comparison, the 2000 Census for the property's tract recorded a rental vacancy rate of 9 percent, down from a rate of nearly 17 percent in the 1990 Census. One explanation for the low vacancy rate in 2000 was the dot.com boom and the related establishment of many start-up firms in downtown Tacoma. With the recent bust of this industry, rates have started rising again. However, continuing efforts by city planners to establish the downtown as a destination for employment, an economic center and an entertainment district should positively impact vacancy rates.

Financial History of the Project

The project was converted to FHA-insured housing under the 221d (3) program in 1972 when it was rehabilitated. At that time it also received Section 8 subsidies under the Loan Management Set Aside program. Of the total 194 residential units, 175 are assisted with Section 8 subsidies. The other 19 units are rented at market rates.

The financial history of Winthrop Apartments would probably be considered rather typical for an older subsidized property. The unpaid balance on the note was $1.3 million as of April 2003, at an interest rate of 7 percent. Debt service coverage ratio for the last three audits has averaged just below 1.0. Expenses have risen significantly over the past three years, while rental income increased more modestly. One reason for the increase in expenses is a large rise in insurance premiums, which have generally increased throughout the country since the events of September 11, 2001. Deferred maintenance has continued to accrue on the property during this period.

The Participating Administrative Entity (PAE): Kitsap County Consolidated Housing Authority

HUD referred the restructuring of Winthrop Apartments to the Kitsap County Consolidated Housing Authority, a public PAE and county housing authority located in neighboring Silverdale, Washington. Kitsap County has been one of the more active public PAE's in the M2M program. In addition to being a public PAE for the State, the housing authority also has a contract with HUD to be a private PAE to handle restructurings outside of the State. The authority has performed restructurings in California, Oregon, and Arizona, and is currently managing restructurings in Nevada and Idaho.

As of fall 2003, the PAE had completed about 30 M2M restructurings, of which roughly half have been Fulls, and half Lites. Many of the restructurings reportedly came in as Fulls, but were completed as Tier II Lites. In fall 2003, the organization was currently responsible for about 21 M2M deals in progress, all of which were Fulls. The PAE has a small, internal staff (four to five people) that performs the restructuring work with the exception of closings. The authority has entered into an agreement with Heskin-Signet, a private PAE, to handle all closing work, and with Resnik Fedder to handle overflow of projects. At the time of the site visit, the latter was managing the restructuring of 10 properties in two other States that were referred by this PAE.

The housing authority is managed by a six-member Board of Commissioners, and has a very active Executive Director. The Authority's activities primarily involve administration of various Federal housing programs, including low-rent Public Housing and the Section 8 Housing Assistance Payments Program. The Authority also administers the federally-funded Self-Help Housing Program of the Rural Housing and Community Development Services (RHCDS), and operates several other programs designed to expand affordable housing opportunities. On August 1, Kitsap County was scheduled to become the contract administrator for all M2M properties in Washington State.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- OMHAR assigned Winthrop Apartments to the Housing Authority in January 2003, and the PAE accepted shortly thereafter.

- The PAE ordered the third-party appraisal and physical condition assessment (PCA) on January 28, 2003.

- The appraisal was completed on April 1, 2003.

- The physical condition assessment was completed on March 7, 2003. (See Renovation Items and Costs below for details.)

- The PAE provided comments on the appraisal and PCA. At the time of the site visit in June they were working to determine how much plumbing rehab was necessary and what it would cost. The PAE was also grappling with the need for and possible expense of abating lead paint and asbestos-wrapped pipes. At the same time they were working on developing rent comps and developing OMHAR's rent matrix.

- The PAE conducted the first tenant meeting in the Ballroom at the project on March 19, 2003. (See the Tenant Involvement Section below for details.)

- A second tenant meeting was held on August 12th.

- The draft restructuring plan was submitted to OMHAR on August 21, 2003, after refinement of data about repair work to be done at Winthrop Apartments.

- All of the above issues resulted in delays to the timetable for submitting a plan to OMHAR in a timely fashion. As of mid-October, 2003, the plan had still not been approved by OMHAR.

- The PAE was working on addressing several concerns expressed by OMHAR during its review. The key issues of concern to OMHAR included the following: 1) non-compliance with lead-based paint mitigation; 2) the vacancy factor and why Winthrop held six units vacant for so long while, at the same time, arguing that there were 54 people on the waiting list; 3) estimated cost of the plumbing repairs and a request for greater detail on the nature of those repairs; and 4) questions about whether the rent levels proposed by the PAE may be too high, as they are above comparable rents. In addition, the OMHAR reviewer wanted to review copies of the commercial leases.

Tenant Involvement in the M2M Restructuring

Prior to the first tenant meeting on March 19, 2003, the PAE sent notice to all residents, which included a survey to solicit resident opinions regarding the condition of their apartments and of the building. About 21 residents were present for the meeting, which was led by a staff member of the PAE. In addition, a second PAE staff person as well as the project's on-site manager was present for the meeting. Issues raised by tenants at the meeting included the plumbing problems, problems with the elevators, and security concerns.

Tenants also indicated concerns regarding the type of disruptions that could occur during the renovations and whether relocation, especially outside of the building, would be necessary during rehab of the plumbing. Questions and concerns were also raised regarding the possibility that the building might be converted to condominiums.

At the second tenant meeting, held on August 12th, there were 15 tenants in attendance, along with the on-site resident manager. As at the first meeting, tenants expressed concerns about having to move out of their units during the time rehab work was being performed. They also wanted to know what the worst-case scenario might be if HUD did not approve the restructure plan. A handicapped tenant asked about handicap ramps at stairways for access out of the building in case of fire. Other tenants wanted to know if rents were going to be affected, and when the Housing Authority would know whether the restructure plan was approved.

Details of the M2M Restructuring

Rent levels

The PAE is recommending exception rents for Winthrop that are roughly 109 percent higher than the market-determined rents, and 106 to 114 percent above current contract rents, depending on unit size. (These exception rents, however, are 91 to 95 percent of HUD's FY 2004 Fair Market Rents for the County). This would result in an estimated $78,000 of higher annual Section 8 expenses relative to pre-restructure rents, or $900,000 of higher expenses in estimated net present value terms over 20 years.

Table 12 provides rent levels pre- and post-M2M restructuring.

Table 12. Rent Levels Pre- and Post-M2M

Unit Type	HUD-Established FMRS	PAE Market Rents	New Rents		Previous Contract Rents	
			Exception Rent	Exception Rent as Percent of FMR	Rent	Rent as Percent of FMR
Zero-Bedroom	$463	$385	$419	91%	$367	79%
One-Bedroom	$553	$480	$523	95%	$494	89%

Estimated Savings

The current structure would result in an estimated loss to government of $1.2 million as a result of the restructuring. One reason for the high anticipated loss is higher rents. Kitsap County presented its Full restructuring plan to OMHAR on August 21, 2003. It is currently under review by OMHAR and is likely to undergo substantial scrutiny during this process, given these projected losses.

Financing

The terms of the debt restructuring include the following proposed mortgage terms:

- A first mortgage in the amount of $1,258,000 insured under Section 223(a)(7) and amortized over 30 years at an interest rate of 6.5 percent plus 0.5 percent MIP. This reflects a DSCR of 1.68 at the proposed rents.
- A second mortgage in the amount of $1,257,927 at an interest rate of 4.3 percent and amortized over 30 years.
- No third mortgage is recommended.

The PAE has reportedly been in contact with GMAC Commercial Mortgage Corporation regarding the financing of the new first mortgage.

Renovation Items and Costs

The PAE's initial plan for rehabilitation identifies nearly $900,000 in short-term repair needs. Three significant rehabilitation items included in the plan by the PAE are the following:

- Major plumbing repairs: $365,000.
- Elevator upgrades: $279,000.
- 450 fire-rated corridor doors and hardware: $100,000.

The initial plan includes a contribution from the owner of 20 percent of the costs of rehabilitation as well as closing costs. As a result, the owner will have to put nearly $228,000 into the project.

The PAE is also recommending an initial deposit of $393,567 to the reserve for replacement account in order to reduce ongoing annual contributions and provide a better reserve balance for replacing items during the first 10 years when it is needed.

Outcomes for Tenants

If HUD agrees to the proposed improvements, the quality of living for tenants should be significantly improved. Long-term plumbing problems will be resolved, increasing the reliability of water provision in the building. Also, enhancements to elevators will reduce the frequency of breakdowns and improved reliability. Lastly, fireproof corridor doors should improve safety for residents, should a fire break out in the building. Potential dislocation may result from improvements in the plumbing, since repairs may require demolition of existing walls to address the problem.

Viability of the Project after M2M Restructuring

The long-term outlook for this property appears good, if the required repairs and reserve for replacement are adequately funded. This is especially true given the high 1.68 DSCR. The good location of the property will support a strong demand for affordable housing in the area, especially given the convenient location to the light rail line. The major limitation of the building—on-site parking—will continue to limit its ability to convert to alternative use.

Lessons Learned from This Site

Perhaps one of the most important lessons from this site is that although it has rents at or below market rents, the property still requires a restructuring of its mortgage in order to fund substantial rehabilitation needs and assure adequate funding for its Replacement Reserves. While the M2M program was meant to address FHA projects whose rents are above market, there appears to be a need for HUD to examine and address the problems of older projects like this one. At this property, the PAE is using exception rents to make the project financially viable and to address the backlog of much-needed major repairs and replacements.

Despite the high rental vacancy rate for the area, it may still be cost effective to retain this property as affordable housing, since the proposed exception rents are below the most recent FY 2004 Fair Market Rents for the area, making vouchering-out a more expensive alternative than restructuring.

A second lesson relates to the fact that the owner, the PAE, and HUD want to maintain this property as affordable housing, despite the apparent desire of city economic development planners to have a different use for the building. In conversations with the analyst for this study, staff of the City Economic Development Department indicated that the city would prefer to have a different and higher end use for the property, either as market rate rental, a mixed-income rental, or some alternative use. However, the current M2M process does not seem to allow for an opportunity for local government to have input into the restructuring plan or the decisions on the future use of the property. Exceptions to this can occur when a unit of the local government administers the HAP, or if the PAE is a public PAE connected with the locality.

A third lesson that may be drawn from this site is an indication that public PAEs are more likely to “go the extra mile” to preserve subsidized housing than private PAEs. This particular restructuring has required more time than the average restructuring to resolve some thorny rehab and rent issues. However, the PAE has taken the time needed to help resolve those issues. A private PAE may have cut its involvement and simply completed this as a Watch List project.

Case Study Thirteen: Valley Heights Apartments Quincy, California—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

Valley Heights Apartments is a 48-unit property located in the city of Quincy (population 1,879) in Plumas County (population 20,824) California. Quincy is located in the American Valley against the western slope of the Sierra Nevada range. It is the largest community in, and county seat for Plumas County. Quincy is located approximately 110 miles northwest of Reno, Nevada, and about 80 miles directly north of the Lake Tahoe basin.

The property was constructed in 1982 under the Section 8 New Construction program. It consists of nine two-story wood frame buildings. There are 24 one-bedroom, one-bath units, with 597 square feet; 20 two-bedroom one-bath units with 752 square feet; and 4 three-bedroom, one- and one-half-bathroom units with 1,010 square feet. One of the three-bedroom units is occupied by the manager and is not included in the Section 8 contract. One building contains an office, laundry facility, and maintenance shed.

Since its construction the property has been owned by a California for-profit partnership. This partnership was developed with the expressed purpose of acquiring real property in Quincy, California. The General Partner holds a limited interest (5 percent) while the seven Limited Partners have greater share holding (10-20 percent). A northern California property management firm has managed the property since its construction. An identity of interest exists. The general partner of the ownership entity is a shareholder and a director of the property management firm.

The Physical Condition Assessment (PCA) conducted on the property noted no major structural defects. The PCA did note water damage to some of the bridges between the units. The recommendation was to replace the original wood slats with rot-resistant cedar or redwood slats.

Census data for Quincy lists the poverty rate at a low 10.2 percent. Nearly 90 percent of the local population is classified as non-Hispanic white, with Hispanics being the largest minority at 5.2 percent of the local population.

Plumas County and the American Valley remain relatively isolated parts of the “High Sierra” region. Plumas County shows little of the tourism-driven development that has taken place in other “High Sierra” towns such as Truckee. In and around Quincy the main sources of employment remain logging, ranching, and farming.

The one exception to these traditional industries is Feather River Community College, located in Quincy. Until relatively recently, Feather River was a small California community college that drew students by offering unique courses (e.g., horse training). In the last several years the College has become much more aggressive in recruiting students. A major focus of this marketing strategy has been a heavy emphasis on intercollegiate athletics. The College now has competitive baseball, basketball, and football teams.

It is a relatively recent phenomenon (the last 3 to 5 years) that students are a high proportion of the tenants at Valley Heights. Prior to that time the Village Heights property had a poor reputation in the community. There were reports of high levels of drug use among the tenant population, with police visits to the property not being uncommon. In the last several years the property management has successfully addressed this problem.

The Neighborhood

The Valley Heights property is located on a slight rise above the main commercial road that runs through the town of Quincy. There are no immediately adjacent residential or commercial areas. The backside of the property is at the base of one of the smaller mountain ridges that encompass the American Valley. The front units of the complex, particularly the second-story units, have a spectacular view of the entire American Valley and the next major ridge of the Sierras.

The Housing Market

The Quincy area is characterized by a relatively high rate of home ownership (60 percent). The number of rental properties in the immediate vicinity is limited, and the quality varies significantly. The rental vacancy rate provided by census data is 7.3 percent.

Although there is not a large amount of economic development in Quincy, wage rates are not particularly low. Wages for retail and service jobs run in the range of $8 to $10 per hour. This has an impact on the potential tenant base for Village Heights. In Quincy, individuals with normally low-wage positions often find their income will make them ineligible for Section 8 housing. For the last several years, the majority of residents at Village Heights have been students at Feather River Community College. Many of these students are on one of the school’s athletic teams. The tenant base has kept the property at virtually full occupancy for the last several years. Normally there is a one-to-three month waiting list to obtain a unit. The student/athletes indicated that there is a network among the teams that allows athletes to know when there is an opening at the property.

There are limited opportunities for the tenant population to obtain comparable low-cost housing in the community. Many of the rental units in Quincy proper are old, rural structures, often in poor repair with inadequate heating for the severe winter weather of the High Sierras. Recently, the Community College has been involved in the development and leasing of several multi-unit properties adjacent to the campus. However, the College is attempting to rent these units at rates that are three to four times what eligible students are required to pay at Valley Heights.

Financial History

This property consistently scored highly on financial management. However, REAC scores and evaluations over the last several years expressed concerns about the adequacy of maintenance reserves.

The Participating Administrative Entity (PAE): Heskin-Signet Partners

HUD referred the restructuring of Valley Heights to Heskin-Signet Partners. Heskin-Signet is a private Participating Administrative Entity (PAE), one that has had a major role in M2M restructurings across the country. Heskin-Signet has considerable experience in public/private partnerships dealing with distressed properties, and played a major role in handling distressed properties for the Resolution Trust Corporation (RTC)—the government vehicle for dealing with individual properties formerly handled by failed Savings and Loan institutions. In addition to working with distressed properties, Heskin-Signet provides consulting services to private-sector real estate developers.

The senior staff at Heskin-Signet has experience going back to the 1980s dealing with distressed properties. None of the restructuring functions required by OMHAR, such as facilitation of tenant meetings, is “farmed out” by Heskin-Signet. All functions are performed by Heskin-Signet staff.

At the time of the Valley Heights restructuring, Heskin-Signet had completed over 300 restructuring agreements for OMHAR. This included over 100 Lite restructurings. At the time of the Village Heights process, Heskin-Signet had approximately 80 to 90 M2M properties in various stages of restructuring. Of these, only three were Lites.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- Valley Heights was referred to OMHAR on May 16, 2002, with OMHAR then referring the property to Heskin-Signet on June 13, 2002.

- The Physical Condition Assessment and a Third-Party Rent Study were completed in the fall of 2002. The Draft Restructuring Plan was submitted to OMHAR on December 15, 2002. This Plan remained substantially the same until the final restructuring agreement was reached. However, the Plan involved several layers of OMHAR, including a Loan Committee Review at the Chicago OMHAR Office. This review was due to two factors, namely:

- The Draft Plan proposed exception rents that were above Fair Market Rents and market rents.
- The financial plan projections indicated a total loss of $729,338.00 over the course of the restructured agreement.

- At the conclusion of this review process, OMHAR judged that the property was preservation worthy and a Restructuring Commitment was sent to the Valley Heights Limited Partnership on April 7, 2003.

- The main factor in contributing to OMHAR's approval of the restructuring plan was the strong support of the Plumas County Housing Authority. That authority administers approximately 335 Section 8 vouchers with a waiting list of approximately 200 applicants. The Authority administers 114 HUD low-rent Public Housing units with an overall occupancy rate of 100 percent, and with 45 applicants on the waiting list. There are also two USDA Rural Development multifamily properties (one elderly and one family) in the city of Quincy, both with an overall occupancy rate of 98 percent and with both properties maintaining active waiting lists.

- As required, the Plan's request for Exception Rents was supported by a Rental Assistance Assessment Plan, drafted in November 2002. That Plan focused on two key factors in supporting the request for Exception Rents. One was the relatively high level of poverty in the county, with 13.1 percent of the county's population falling below the poverty line. The second was the static nature of the local economy and, particularly the housing market. As noted above, all subsidized housing in the local area has virtually 100 percent occupancy, with significant waiting lists. Interview data indicated that affordable rental properties in the immediate area were often below acceptable standards. The RAAP noted that maintaining Village Heights as project-based units would be more costly to the government than the issuance of Section 8 vouchers. However, the static nature of the local economy and housing market made it highly unlikely that current residents of Valley Heights could find adequate, comparable, and affordable housing in the community.

- Originally, the closing for Valley Heights was scheduled for June 15, 2003. The actual closing did not occur until August 24, 2003. This final delay in completing the restructuring resulted from a need to obtain clarification on a California code regulation requiring bathroom facilities in the management offices. Once the necessary clearance was obtained, the Restructuring Agreement was implemented.

Tenant Involvement in the M2M Restructuring

The tenant involvement in this process was limited. The initial tenant meeting was held on August 1, 2002, with no attendees. The second tenant meeting was held on January 16, 2003 with a total of 34 attendees. Attendee input at that second meeting indicated general satisfaction with the property management and with the proposed rehab enhancements contained in the Draft Restructuring Plan. Some tenants did make requests for some minor physical enhancements not included in the Draft Plan.

Details of the M2M Restructuring

Rent Levels

Table 13 presents the rent levels pre- and post-M2M restructuring.

Table 13: Rent Levels Pre- and Post-M2M

Unit Type	HUD-Established FMRs	PAE Market Rents	New Contract Rents		Previous Contract Rents	
			Rent	Rent as Percent of FMR	Rent	Rent as Percent of FMR
One-Bedroom	$406	$490	$561	138%	$540	133%
Two-Bedroom	$522	$565	$665	127%	$598	115%
Three-Bedroom	$720	$680	$793	110%	$686	88%

Estimated Savings

Based on this rent schedule and projected costs, the OMHAR model estimates a total loss of ($729,338.00) over 20 years of operation. This equates to a per-unit loss of ($15,194.50) over the same 20-year timeframe.

Financing

- The first mortgage is $451,800.00 and was sized using exception rents with a 5 percent/2 percent vacancy/bad debt factor, a 30-year term, 7.75 percent rate (inclusive of MIP), and a 1.36 DSCR. The UPB on the existing first was $1,441,614.00.
- The second mortgage was sized using exception rents with a combined 3 percent vacancy/bad debt ratio, 30-year term, and 1 percent rate. The cash flow split is 75/25. The remaining balance is $979,605.00.
- No third mortgage was included in the package.

Renovation Items and Costs

A total of $177,733.00 was allocated for the 12-Month Repair package. These funds were allocated as follows:

- Replace Bridge Slats: $400.00.
- Install Ceiling-Mounted Heater in Maintenance Shop: $300.00.
- Route Bath and Hood Fan Ducts to Soffits: $4,800.00.
- Add Attic Ventilation: $4,800.00.
- Replace Marlite Shower Surrounds: $16,000.00.

- Replace Wood Trim: $7,200.00.
- Replace Windows: $59,000.00.
- Repair Parking Lot: $50,000.00.
- Install Basketball Hoop: $2,000.00.
- Erosion Control on Hillside: $15,000.00.
- Insulate, Weather-Strip Attic Hatches: $900.00.
- Handicap Transition Plan Modifications: $13,550.00.
- Installation of Property Signs: $3,783.00.

The owner's contribution to this allocation was $39,101.00. The owner's contribution to the "rehab" escrow was calculated as 20 percent of the total 12-month rehabilitation needs plus a 10 percent contingency fee.

Outcomes for Tenants

The tenants should receive substantial benefits from this process. The 12-month "rehab" package will address problems of deferred maintenance. Many of these maintenance problems are due to the severe High Sierra winter weather. In addition, preserving the property for the Section 8 program is a major asset for the Quincy community, which is likely to have an extremely tight rental market for the foreseeable future.

Viability of the Project after M2M Restructuring

The approval of the Exception Rents augurs well for the long-term viability of the property. The waiting lists at all subsidized housing in the community, and the continuing expansion of the Community College, makes it likely that the property will remain at virtual 100 percent occupancy. In addition, the Plumas County Housing Authority had indicated an interest in acquiring the property following the completion of the restructuring. This interest indicates the authority's judgment that the financial restructuring is viable over the long term.

Lessons Learned from This Site

The obvious lesson to be drawn from this site is that the M2M process can result in the actual raising of rent levels. The justification provided for this was the lack of affordable housing in an isolated community. The RAAP justification was not entirely convincing in demonstrating the continued need for this property. Given the projected cost to the government, this restructuring might have merited some type of special review by OMHAR. This analysis would need to factor in the appropriateness of maintaining the property when the primary beneficiaries are the tenants.

Another lesson to be learned from this site is the factors that can "draw out" the restructuring process. From beginning to closing this restructuring took approximately 15 months. This was somewhat longer than the "average" restructuring at the time of data collection, which was 11 months.

Two factors were primarily responsible for “drawing out” this process. First, right from the initial financial analysis the PAE believed that exception rents were needed to preserve this property. This determination required a considerable amount of research to provide the data that could support an Exception Rent determination. Approximately three months (September to November 2002) were taken up with conducting this research.

The second factor was obtaining needed clarification on the applicable zoning regulations regarding the manager’s residence at the property. This issue came to light after the submission of the Restructuring Commitment to the owner in April 2003. The closing for the property was originally scheduled for June 15, 2003. Because of the zoning issue the property did not close until mid-August, 2003.

An additional lesson from this site concerns the Section 8 tenant populations. A common perception is that the tenants for Section 8 properties are drawn from the immediate community, the Section 8 properties being considered a community asset. At Valley Heights nearly three-quarters of the units were occupied by students attending the local community college. In all likelihood this should not be considered an aberration from the proper Section 8 model. Nearly all of the students at Valley Heights were from outside Plumas County. The interview data indicated that many of them would not have been able to attend the college without the availability of the subsidized housing at Village Heights. Thus the Valley Heights property has been serving the needs of a low-income population, albeit that population may be transient and with expectations of major gains in income. In addition, given the importance of the Community College to the local economy, Valley Heights is a valuable resource for the general community.

Case Study Fourteen: Villa 14 Apartments
Ault, Colorado—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

The Villa 14 Apartments is a four-building, 36-unit complex located in Ault, Colorado. The buildings are garden-style wood frame structures with brick siding. All of the units are single-story and two have handicap accessible features. There is a fifth building on the property which houses the Office, a laundry room, and a community room. There is a considerable amount of open space between the structures, covered by well-maintained lawns and shrubbery.

Ault is located in Weld County Colorado, a primarily rural county with a population of under 250,000. Ault itself is an extremely small agricultural service community (population approximately 1,200), the most noticeable feature being the large grain elevators along the railroad tracks that bisect the town. There are few retail outlets in the town, but the town is the site of county grammar and high schools.

The area immediately surrounding Ault is devoted to large commercial farming and stock raising enterprises. There did not appear to be any large manufacturing or retail entities within a fifteen-mile radius of the town center.

Although Ault itself remains a small rural community, there has been considerable urban sprawl in this part of Colorado. Both Fort Collins (about 30 miles to the west of Ault) and Greeley (about 15 miles to the south of Ault) had large increases in population growth during in the 1990’s. Both of these communities now have the feel of being far outer suburbs of Denver with large numbers of new housing developments, malls, and increasing traffic. In contrast, Ault still retains the feel of a fairly isolated agricultural community.

As in many agricultural communities in the West, the area surrounding Ault has a significant Hispanic population. The latest census figures place the Hispanic population at 22.3 percent of the total population, with virtually all the rest of the population being non-Hispanic whites. The poverty rate for the area is moderate, listed in census data at 18.1 percent.

Since its construction in 1982, Villa 14 has operated as a Section 8 “elderly” facility. Historically, the property has had low vacancy rates, and very low turn-over rates. At the time of the project site visit, the property was 100 percent occupied.

At the time of the project site visit, the Villa 14 property appeared to be in extremely good condition. The lawns and shrubbery were in excellent condition, and the buildings showed only minor indications of aging. This impression was confirmed by a review of the Physical Condition Assessment (PCA). The third party conducting this review recommended only $3,421 worth of improvements for the initial 12-month rehab program.

The Neighborhood

The Villa 14 complex is immediately adjacent to a well-maintained neighborhood of single family residences. Like many small agricultural communities, the “main street” consists of small restaurants and second-hand shops. However, the residential neighborhood adjacent to Villa 14 looks like any reasonably prosperous middle-class neighborhood, with single-family residences. One side of the Villa 14 property faces some agricultural property that has not yet been developed.

Residents must go to Greeley or Fort Collins for retail outlets. There are an elementary school and a middle school in Ault.

The Housing Market

The home ownership rate for Ault is moderately high, listed in the 2000 Census at 62.2 percent. As might be expected in a small agricultural community, the rental vacancy rate is low, the most recent figure being 6.4 percent.

In the rural area immediately surrounding Ault, the rental opportunities are extremely restricted, especially for the small one-bedroom units preferred by most elderly tenants. To obtain units comparable to those at Villa 14, the tenants would have to look at properties in Greeley or Fort Collins. This is an option most of the elderly residents here would not like to face, given the urban character of both areas and distance from friends and family. Tenant interviewee for this study were unanimous in stating that the use of vouchers would force them to accept a living environment they consider significantly inferior to the one at Villa 14.

Financial History of the Project

The Villa 14 Apartments are owned by a limited partnership that was formed just before construction of the property began in 1982. The property is managed by a full-service property management firm that manages a wide variety of private-sector residential and commercial properties. There is an identity of interest between the ownership of Villa 14 and the management company.

Over its history this property was consistently rated in the 90s in terms of financial management. This rating was confirmed by the Physical Condition Assessment which confirmed that the maintenance of the property had been highly satisfactory.

The Participating Administrative Entity (PAE): Heskin-Signet

HUD referred the restructuring of Villa 14 to Heskin-Signet, a private Participating Administrative Entity (PAE), one that has had a major role in M2M restructurings across the country. Heskin-Signet has considerable experience in public/private partnerships dealing with distressed properties. Heskin-Signet played a major role in handling distressed properties for the Resolution Trust Corporation (RTC), the government vehicle for dealing with individual properties formerly handled by failed Savings and Loan institutions. In addition to working with distressed properties, Heskin-Signet provides consulting services to private-sector real estate developers.

The senior staff at Heskin-Signet has experience going back to the 1980s dealing with distressed properties. None of the restructuring functions required by OMHAR, such as facilitation of tenant meetings, is "farmed out" by Heskin-Signet. All functions are performed by Heskin-Signet staff.

At the time of the Villa 14 restructuring, Heskin-Signet had completed over 300 restructuring agreements for OMHAR. This included over 100 Lite restructurings. At the time of the Villa 14 process, Heskin-Signet had approximately 80 to 90 M2M properties in the process of restructuring. Of these, only three were Lites.
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Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- The Villa 14 property was originally referred to Heskin-Signet on June 25, 2002.

- Notification of the owner was made on July 12, 2002. In the original response to OMHAR, the owner requested that this restructuring be processed as a "Lite," thus accepting any markdowns in the HAP contract rents without any accompanying changes in the debt structure of the property.

- After a review of several rent comparability studies in the fall of 2002, Heskin-Signet indicated that the restructuring could not be processed as a "Lite." The main reason was an insufficiency in the Debt Service Coverage Ratio (DSCR) based on the property's past expenses. Using the owner's past expenses, the owner's rent study, and a $500.00 per-unit benchmark annual deposit for the replacement account, Heskin-Signet concluded that the resulting DCSR would only be 0.71. Under OMHAR's underwriting principles this made the property ineligible for "Lite" restructuring. The owner was requested to elect processing the property as a Full restructuring. The owner approval for the Full restructuring was received in the first week of March, 2002.

  As part of the initial Lite restructuring effort, the owner had conducted his own rent comparability study. This study noted that there were only two other multifamily rental complexes in Ault. However, both of these properties were subsidized. Thus there were no truly comparable units in Ault. In addition, there were no comparable units in Eaton, the closest community. The appraiser thus used units located in Greeley. This analysis resulted in a conclusion of a comparable market rent level of $595.00. As indicated above, the use of Greeley as a comparable market could be considered highly suspect. In particular, the PAE noted that the owner's appraiser had used data that were nearly two years old. The PAE noted that in this part of Colorado rents had been falling for nearly two years.

- After the owner accepted the Full restructuring, Heskin-Signet requested the required Physical Condition Assessment of the property.

- The Physical Condition Assessment report was submitted to Heskin-Signet on April 23, 2003. This report found No Critical Repair Items and recommended only $3,421.00 in repairs during the initial 12-month rehab period. The report predicted a Capital Needs of $568.00 per unit per year for the 20-year estimation period.

  Heskin-Signet's own rent comparability study had come in with an estimate of comparable rents, considerably lower than that of the owner's study. The Heskin-Signet figure was $450.00, submitted in March 2003. Looking at its own rent appraisal, Heskin-Signet recognized the same comparability problems that had affected the owner's rent study. The PAE, using its own staff, chose to look at comparable units in Greeley, but adjusted for the current rental market. After this analysis, the PAE estimated a market rent figure of $540.00. This figure represented approximately 77 percent of the pre-restructuring HAP contract rents of $648.00.

- The $540.00 market rent estimate was incorporated into the draft underwriting model that was submitted to OMHAR on May 9, 2003. The formula proposed for the restructuring was the now normal partial pay-down of the existing first mortgage, with HUD providing additional financing through second and third mortgages. The PAE chose to include a major market upgrade in its plan submission: the installation of air conditioning. This was considered necessary to make the property truly market comparable. The $34,000.00 installation cost was the only amount included in the 12-month rehab package.

Tenant Involvement in the M2M Restructuring

At this site, tenant involvement in the restructuring has been minimal. The first tenant meeting was held on April 28, 2003 with five participants. The participants expressed general satisfaction with the management of the property. However, two tenants did express concern about the health and capacity of the current on-site manager.

The second tenant meeting was held on June 24, 2003, with seven participants. The tenants expressed general satisfaction with the proposed restructuring agreement.

Details Regarding the M2M Restructuring

Rent Levels

Table 14 provides the rent levels pre- and post-M2M restructuring.

Table 14. Rent Levels Pre- and Post-M2M

Unit Type	HUD-Established FMRS	PAE Market Rents	New Contract Rents		Previous Contract Rents	
			Rent	Rent as Percent of FMR	Rent	Rent as Percent of FMR
One-Bedroom	$581	$540	$540	93%	$648	112%

Estimated Savings

This rent restructuring is estimated to provide HUD a savings of $431,383.00 over 20 years. This equates to an estimated per-unit savings of $11,972.00 over the same 20-year timeframe.

Financing

The restructuring called for a pay-down of the initial mortgage of $373,236.54. The M2M refinancing included:

- A new first mortgage was issued for $701,500.00. This was a conventional mortgage issued at 6.75 percent with a 30-year term.
- A HUD-issued second mortgage at $51,886.00, at 3 percent for 30 years.
- A HUD-issued third mortgage at $195,163.00, at 3 percent for 30 years.

Renovation Items and Costs

As noted above, the only item included in the 12-month rehab package was installation of the central air conditioning ($34,000). In addition, the replacement plan for the property envisaged installation of major capital items only after 10 years. In short, the present condition of the property was not a major factor necessitating a financial restructuring.

Outcomes for Tenants

The major positive outcome for tenants is the retention of this property for the Section 8 program over the long term. This property has been maintained in good to excellent condition. A high proportion of the retired, elderly tenant population is highly satisfied with a high-quality, affordable housing option that is outside the fast-growing Fort Collins and Greeley metropolitan areas. If this property had been restructured as a Lite, it is quite possible that the owner may have looked to move the property into the private sector after the requisite 5-year programmatic commitment.

Viability of the Project after M2M Restructuring

Given the owner's past performance, and the PAE's care in establishing truly comparable market rents, this property should be financially viable. This probability is increased by the virtual 0 percent vacancy rate at the property, and the tendency for the tenants to remain at the property for many years.

Lessons Learned at This Site

There were two primary lessons learned at this site:

- An owner's decision regarding restructuring may be heavily influenced by short-term developments in the rental market. In this area of northern Colorado there was a significant expansion of the private-sector market in the 1990s. This was primarily in the Fort Collins and Greeley metropolitan areas. The economic downturn that began in 2000-2001 had a significant impact on this market. Properties that had been profitable in the 1990s now often became marginal, at best. This short-term, economic decline may have been a significant factor in the owner's decision to enter the M2M program, and to attempt a Lite restructuring. Due to its very good physical condition and location, the owner of the Villa 14 property could have seriously considered moving the property to the private sector. The choice of a Lite restructuring may have been an attempt to "ride out" the short term economic downturn and wait to see what conditions would be in 5 years. The PAE's analysis demonstrated that this option would likely have resulted in a decline in services and maintenance at the property. The financial viability of the property may also have been endangered. Thus, the timing of the restructuring, and the PAE analysis, resulted in keeping this property in the Section 8 portfolio.

- The quality of life provided to tenants often needs to be measured by factors other than those measured by systems such as REAC. One of the "draws" of Villa 14 for tenants is its distance from the suburban sprawl of Fort Collins and Greeley. A high proportion of the tenants grew up in this part of Colorado (many returning from other parts of the country). The Villa 14 property environment is for many of these tenants representative of the rural Colorado they have known for most of their lives. This is a distinct "value-added" characteristic of the Villa 14 property. For the near term, this "draw" should ensure that Villa 14 maintains an effective 0 percent vacancy rate.

Case Study Fifteen: Village Green Apartments Red Bay, Alabama—Full Restructuring

The Property, Neighborhood, Housing Market, and Financial History

The Property

The Village Green Apartments is a 57-unit property located in Red Bay, Alabama. The complex consists of nine residential buildings and an additional office building. The units are distributed among four 2-story buildings and six 1-story buildings. The complex was constructed in 1981 under the Section 8 New Construction program, and has the garden apartment style of so many of the Section 8 structures built in the 1970s and 1980s.

Red Bay is a small community of approximately 6,000 located in northern Alabama, almost directly on the Mississippi border. The community serves as a service center for the surrounding agricultural economy. There is virtually no manufacturing industry in Red Bay, and the retail sector is also restricted

Although there is limited economic activity in the immediate region, the local area is not one of severely low incomes. Census data for 2000 show the poverty rate for this area at 9.9 percent. Nearly 85 percent of the population owns homes according to 2000 census data. There is a limited rental market in the area, with a rental vacancy rate at only 4.5 percent. The minority population in the area is extremely small, as 97.7 percent of the population was classified as non-Hispanic white in the census data.

The property was developed by a large company from the west coast that also owned some 100 other Section 8 properties. This same entity had been responsible for the on-site management of the property.

At the time of the visit to the site for this study, there were indications of very poor maintenance. A considerable portion of the external siding appeared warped. A number of the units inspected during the visit showed indications of water leakage. Some doors and windows also showed evidence of damage. The Physical Assessment Report found serious rehab needs at the property, which are discussed in the M2M Milestones section of this report.

Interviews with PAE staff and on-site management made it clear that this property has consistently had a problem attracting and retaining tenants. At the time of the site visit, the vacancy rate was 25 percent. The historic turnover rate has been much the same, at 24 percent.

The Neighborhood

The Village Green property is approximately one-half mile from one of the major commercial thoroughfares in Red Bay, and is set back from a residential road. Because the property is set well back from the residential road, it appears almost self-contained, with few if any structures in view from the units. The closest structures to the Village Green property are several single-family residences that appear to be well maintained. In addition, there is another subsidized multifamily property on the same road. The property is a relatively short walk (about one-half mile) to retail outlets on the main thoroughfare.

The Housing Market

There is a limited rental market in the immediate area, with nearly 85 percent of the population owning homes according to 2000 census data. The vacancy rate for the rental market was only 4.5 percent in that same census data.

Tenants indicated that there were virtually no multifamily rental properties, except for subsidized housing, in the immediate area. Tenants perceived limited opportunities for the use of vouchers. A number of the tenants indicated that their first option, after subsidized housing, was isolated rural rental units. Some of the tenants indicated that these units were often significantly inferior in quality to subsidized units.

Financial History of the Project

As noted earlier, at the time this property came into M2M it was owned and managed by the same large west coast firm that had built it in 1981. During the initial stages of the M2M process, more than 40 of the Section 8 properties owned by this firm were transferred to the company that owns Village Green now. This entity owns and manages more than 200 Section 8 properties.

Under the original owner, the Village Green property was consistently rated poorly on its REAC financial scores. Immediately prior to the M2M processing, there was particular concern regarding the extremely low (approximately $5,000) cash reserves maintained for the property.

The Participating Administrative Entity (PAE): Jefferson County Assisted Housing Corporation

The Jefferson County Assisted Housing Corporation is one of the few public PAEs that had consistently maintained a large presence in the M2M program. Most of the underwriting activities of the PAE are performed on a contractual basis, by individual underwriters in the Montgomery, Alabama vicinity. However, the underwriting consultants employed by Jefferson County have considerable experience working with the M2M program, and interviews with the underwriters indicated a detailed understanding of the M2M process and of subsidized housing issues in general.

One senior staff person at Jefferson County coordinates all the M2M restructuring activities and assigns properties to specific underwriters. This individual is also responsible for conducting all requisite tenant meetings for the M2M restructuring.

Milestones in the M2M Restructuring Process

The following are key milestones in the M2M restructuring process:

- This property was referred to OMHAR in December 2002.

- OMHAR referred the property to the PAE, Jefferson County Housing Corporation, in January 2003.

- The first Physical Condition Assessment (PCA) report was submitted to Jefferson County on February 5, 2003. This report provided the first indication that there were serious rehab requirements at the property. The first estimate for critical repair requirements was slightly over $308,000.00. This was more than $6,000.00 per unit. This was within the range of possible M2M commitments, but still a major expense item. Once the possible size of the rehab requirements for the property was identified, the lead underwriter began to question the advisability of proceeding with the M2M restructuring for the property. A key issue was the historic vacancy rate at the property. Based on usual criteria for doing such a restructuring, the historic vacancy rate at Red Bay would exclude it from consideration. However, the lack of large numbers of rental properties in the Red Bay area led the underwriter to continue with recommendations for the M2M restructuring plan.

- In the spring of 2002, the plan development was put on hold when it became known that the large portfolio holder was negotiating to transfer the property to another owner entity. This transfer was completed in July when over 40 Section 8 properties of the original were transferred to another major holder of Section 8 properties. This entity owned and managed more than 200 Section 8 properties. Plan development was put on hold while the PAE waited for the new management entity to assess the requirements, and be able to respond to specifics of any plan.

- The first tenant meeting was held on June 22, 2003.

- During the period that the ownership changed, the PAE underwriter continued to obtain background information regarding the suitability of the Village Green property for a restructuring. As part of this process the underwriter requested input from the local Housing Agency. The local agency staff noted that the Village Green complex had been the first subsidized housing in Red Bay. Since that time the local housing agency had been able to open more than 150 multifamily units in Red Bay. Local agency staff indicated that the Red Bay complex had a historic reputation for not screening tenants well. This had led to the complex having a bad reputation, and for many prospective tenants was considered the last option of available subsidized housing in Red Bay. This viewpoint was confirmed by interviews conducted during the site visit. Several respondents indicated that the property was noted for fairly frequent visits by law enforcement officers to address a variety of problems.

- Staff from the new owner entity conducted a series of assessment visits to the property in August and September 2002. Based on these assessments, the new ownership entity indicated that it had confidence that it could address the problems identified at the complex, including a marketing strategy to reduce the historic vacancy rate at the property.

- Based on the property assessment, in October 2003, the PAE began development of a draft restructuring plan. The underwriters were still maintaining that the general census information showed a definite need to maintain or even expand the amount of subsidized housing in the locale. However, they anticipated that OMHAR would have serious questions about a property with the traditionally high vacancy rate as at Village Green.

Tenant Involvement in the M2M Restructuring

The initial tenant meeting at Red Bay was held on June 22, 2003. There were five attendees at the meeting. At this meeting no concerns about property management were expressed.

Details of the M2M Restructuring

Rent Levels

No plan developed as yet.

Estimated Savings

No plan developed as yet.

Financing

No plan developed as yet.

Renovation Items and Costs

No plan developed as yet.

Outcomes for Tenants

This is a case where it is unclear whether a successful M2M restructuring will be of real benefit to the tenants. This property has not been well maintained, and it is not certain that the new ownership group can “turn it around.” This is a case where the PAE and the local Housing staff should seriously consider alternatives to the restructuring. Tenants expressed skepticism about using vouchers, but a study by Office of Housing staff would seem advisable.

Viability of the Project after M2M Restructuring

It is unclear if a successful plan can be developed for this property. The key factor is the historic vacancy rate. Unless there is radical improvement on that score, it would seem that the property cannot be made viable. A short-term option might be to give the new management six months to a year to show significant improvement in the vacancy rate.

Lessons Learned from This Site

The principal lessons learned at this site include:

- The importance of subsidized multifamily housing in small and rural communities. In the case of Red Bay, all the performance indicators pointed to the lack of suitability of this property for a restructuring. In short, based on its condition and historic vacancy rate, this property was a poor investment for the government. However, those with the best knowledge of the local housing market, including the public PAE, felt that they should push this effort as far as possible. Perhaps, this type of demographic area should get special consideration in the review process.

- This was obviously a case where the process would have benefited from a RAAP type of analysis early on. If a review of this type had been conducted, it may have been possible to reach a decision relatively quickly, possibly saving HUD considerable administrative costs. In addition, if such a determination was made in the initial stages of the process, it would provide tenants, owners, and local officials a longer timeframe to review options for the future of the property and the tenants.

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