

Chapter Fifteen

NONPROFIT SECTION 8 PRESERVATION EFFORT

15-1. Overview.

One of HUD's primary goals is the long-term preservation of affordable housing. This Chapter gives guidance on preservation efforts to save affordable housing by encouraging the repair/rehabilitation of Section 8 projects controlled by nonprofit entities and/or the sale of multifamily Section 8 projects to nonprofit entities. Throughout this Chapter, the two will be referred to as the Capital Repair Program and the Transfer Program respectively. This Chapter has been broken into four parts. Part One addresses the definition of Nonprofit Owner, Part Two addresses the general criteria for both programs, Part Three addresses the Capital Repairs Program and Part Four addresses the Transfer Program.

PART ONE: DEFINITION OF NONPROFIT OWNER

15-2. Nonprofit Owner.

- A. An acceptable nonprofit owner must:
1. Be financially solvent with no open or unresolved audit findings or findings from analyses of the audited annual financial statements.
 2. Have a tax exemption ruling from the Internal Revenue Service under Section 501(c) of the Internal Revenue Code of 1986.
 - a. If the nonprofit is applying for the tax exemption ruling, the entity is eligible. However, increased rents will be withheld until the entity provides HUD with evidence that the tax exempt ruling has been issued.

b. Exceptions:

- 1) Any project where the nonprofit owner was not previously required to have a 501(c)(3) rating from the IRS to participate in HUD programs.
 - 2) Limited-Equity Cooperative entities that are not 501(c)(3) eligible.
3. Have a resolution from the organization's Board of Directors that authorizes the additional debt to be incurred to purchase and/or rehabilitate the project.

B. An unacceptable nonprofit owner includes:

1. A public body or instrumentality of a public body, or,
2. An entity whose organizational documents permit any part of its net earnings to inure to the benefit of any private shareholder, contributor, or individual.

15-3. Nonprofit Controlled For-Profit Entity.

A nonprofit may form a for-profit entity for a specific project. For example, the nonprofit may want to obtain low income housing tax credits and raise capital through the sale of the tax credits.

A. For this Guide, the term nonprofit owner includes:

1. A limited partnership with a sole general partner that is wholly owned and controlled by a nonprofit entity; or
2. A limited liability company where the managing member of the LLC is wholly owned and controlled by a nonprofit entity.

B. The nonprofit must meet the requirements of section 15-2.A. above.

PART TWO: GENERAL CRITERIA FOR BOTH CAPITAL REPAIRS AND TRANSFER PROGRAMS

15-4. APPLICABILITY.

- A. This section applies to most multifamily housing projects with either:
 - 1. A non-MAHRA Section 8 contract, with rents below comparable market rents, that ends in HUD's current fiscal year; or
 - 2. A 524(a) or (b) MAHRA Section 8 contract with rents below comparable market rents.
- B. Owners with the following Section 8 contracts cannot apply:
 - 1. Section 8 Moderate Rehabilitation projects administered by the Office of Public and Indian Housing.
 - 2. Section 8 Moderate Rehabilitation Single Room Occupancy Projects administered by the Office of Community Planning and Development.
 - 3. Section 8 contracts administered by OAHP.
 - 4. A non-MAHRA Section 8 contract that either:
 - a. Is not eligible to renew in HUD's current fiscal year; or
 - b. Is eligible to renew in the current fiscal year but has rents at or above comparable market rents
 - 5. A 524(a) or (b) MAHRA Section 8 contract with rents at or above comparable market rents.

15-5 Basic Requirements.

- A. The owner/purchaser must agree to accept:
 - 1. A twenty-year recorded Use Agreement. If currently under a Use Agreement, the term must be extended for an additional 20 years. For example, if the current Use Agreement ends in 2010 the term will be extended to 2030.

Note: There are various conditions imposed by the use agreement, therefore the existing Use Agreement may have to be modified to include the conditions imposed by the sample Use Agreement found in Appendix 15-1.

2. A twenty year Section 8 contract, subject to annual appropriations.
- B. Terminating an existing Section 8 contract.
1. HUD and the owner may terminate by mutual agreement most existing Section 524 MAHRA Contract(s) to take advantage of these programs.
 2. The following contracts cannot be terminated early to take advantage of these programs:
 - Non-MAHRA contract
 - Section 514 MAHRA contract
 - Section 524(b) MAHRA Contract with rents above comparable market rents
 - Section 524 (e)(1) MAHRA Demo Contract
 - Section 524(e)(2) MAHRA Preservation Contract
- C. Combine Multiple Contracts or Stages.
1. Owners **must** combine multiple contracts or stages.
 2. The only exception to combining contracts is in cases where a project has both pre- and post-October 1, 1981 contracts. Due to conflicting income eligibility requirements for these two categories of contracts, it is not practical at this time to allow owners to combine a pre-October 1981 contract or stage with a post-October 1981 contract or stage.
- D. Renewal Options.
1. The owner/purchaser renews under Option 2, Contract Renewals for Other Projects with Current Rents At or Below Comparable Market Rents.
 2. A nonprofit controlled for-profit entity, if eligible, may renew under Option 1, Mark-Up-To-Market. In this situation, the rent setting mechanisms of Option 1 override the rent setting mechanisms contained in Section 15-6.

15-6. BUDGET BASED RENT INCREASE.

- A. If the owner/purchaser intends to renew the Section 8 contract under Option 2 then they must submit a proposed budget-based rent increase not to exceed comparable market rents to pay for costs associated with the transaction including new debt. The budget-based rent

increase request is prepared in accordance with paragraph 16-1.A. of this Guide.

In addition, the owner/purchaser must provide:

1. A rent comparability study.
 - a. If applicable, the comparable market rents assume all repairs and/or rehabilitation work was completed as of the date of the rent comparability study. The concept of prospective rents, forecasting rents into the future is not acceptable.
 - b. If the owner/purchaser contemplates the use of tax credits then the RCS must reflect the tax credit restricted rents.
 2. A detailed description of the proposed transaction including but not limited to:
 - a. For the Transfer Program:
 - 1) A letter of intent to sell the project to an eligible nonprofit; and
 - 2) Cost of recapitalizing the replacement account.
 - b. For the Capital Repairs Program the cost of:
 - 1) Capital repairs and rehabilitation (e.g., lead-based paint, energy efficient equipment, repairs, etc.) and recapitalizing the replacement reserve escrow; or
 - 2) Substantial rehabilitation.
 3. A Project Capital Needs Assessment (PCNA) or Comprehensive Needs Assessment (CNA) as discussed in Section 15-9.
 4. A detailed sources and uses funding statement.
- B. Upon receiving the owner/purchaser's submission, the PM/CA checks the owner/purchaser's RCS for completeness and timeliness.
- C. Effective Date of the New Rents.

The PM/CA will notify the owner/purchaser of the maximum new rent levels.

1. For the Capital Repairs Program involving:
 - a. Modest repairs or rehabilitation, the finalized new rents will not be available until the PCNA is completed, financing is approved and, if applicable, the critical repairs are complete.
 - b. Substantial rehabilitation with a construction loan, the final rents will not be available until all the work is completed and accepted. (See Appendix 15-2, PROJECT-BASED SECTION 8 HOUSING ASSISTANCE PAYMENTS - Addendum to RENEWAL CONTRACT.)
2. For the Transfer Program, the final new rents will be effective once the transfer is approved and completed.
3. In the case of a blended transaction, involving both a transfer and capital repairs, the rents will be adjusted after the strictest requirement in 1 or 2 above has been met.

15-7. UNASSISTED UNITS IN A HUD PROJECT.

- A. To protect low and moderate income tenants who live in other HUD subsidized units, including Rent Supplement, RAP, BMIR, and Section 236 properties (refer to Handbook 4350.3 REV-1, Occupancy Requirements of Subsidized Multifamily Housing Programs) rents may be increased by no more than 10 percent as a result of the transaction.
- B. Owners who raise these rents are reminded that they must comply with the notification requirements in 24 CFR 245.

15-8. CAP ON MARKET RENTS.

If applicable, the PM/CA must lower the comparable market rents in the RCS to reflect any use restriction on the level of rents that can be charged; for example tax credit restricted rents.

This requirement for adjusting the comparable market rents will apply during the life of the Section 8 contract.

15-9. PROJECT NEEDS ASSESSMENT AND INCREASED DEPOSITS TO THE REPLACEMENT RESERVE ACCOUNT.

- A. The owner/purchaser's mortgagee must submit a PCNA prepared in accordance with Appendix 15-3. The PCNA includes:
1. A Physical Inspection Report (PIR) containing detailed information about:
 - a. The condition of the Project.
 - b. Identification of the Project's immediate repair needs and expected repair, replacement, and major maintenance needs over various time periods:
 - The "near-term" from the transaction through the tenth year;
 - The "long-term" from the eleventh through the twentieth year of the transaction; and
 - The "remainder" from the twenty-first year until some future point in time. For example: two years beyond the maturity date of a note and mortgage.
 - c. An estimated cost, adjusted for inflation, to complete the needs identified.
 2. A Statement of Resources and Needs, which discusses:
 - a. The Mortgagee's review of and possible adjustment to the PIR.
 - b. All critical repairs must be completed before final loan closing. Any associated cost of doing the work must be paid no later than the closing.
 - c. If applicable, non-critical repairs may be completed after final loan closing if the associated costs are escrowed at the closing.
 - d. Recommendations to HUD regarding:
 - 1) The amount of the initial and monthly deposits to the replacement reserve.
 - 2) How the monthly deposit to the replacement reserve will be funded and its impact on the long-term viability of the project. This should detail the level monthly payment and a monthly payment that increases over time.

- B. If the transaction does not include new debt, the owner/purchaser assumes the role of the mortgagee discussed in Section A above.
- C. PM/CA should review the additional application exhibits. If the material and recommendations are found acceptable, HUD may incorporate them, in part or whole, into HUD's underwriting determinations for a rent increase.
- D. Those projects that are legally required to submit CNA may submit a current CNA in lieu of a PCNA. The CNA must have been updated or resubmitted within the previous 12 months.

15-10. HUD Mortgage Insurance Programs.

- A. An owner/purchaser may use the Department's mortgage insurance programs with the Capital Repairs and Transfer Programs.
- B. The application for mortgage insurance will be processed as a for-profit transaction if the proposed mortgagor is a nonprofit-controlled for-profit entity as defined in Section 15-4.

Note: Form HUD-3433, Request for Preliminary Determination of Eligibility as Nonprofit Sponsor and/or Mortgagor, is not required.

- C. Davis-Bacon prevailing wage rate requirements are applicable under certain HUD mortgage insurance programs.

Note: Performance of rehabilitation under Appendix 15-2, PROJECT-BASED SECTION 8 HOUSING ASSISTANCE PAYMENTS - Addendum to RENEWAL CONTRACT, involving renewal of a Section 8 contract along with conventional financing does not trigger application of Davis-Bacon requirements.

PART THREE: CAPITAL REPAIRS PROGRAM

15-11. General.

The Capital Repairs Program is intended to cover the costs of:

- A. Capital repairs and rehabilitation (e.g., lead-based paint, energy efficient developments, repairs, etc.); and
- B. Recapitalize the replacement reserve escrow; or

- C. Substantial rehabilitation; and
- D. New financing needed to cover the cost of repairs and rehabilitation.

15.12. ADDITIONAL ACCEPTABILITY REQUIREMENTS FOR THE OWNER.

The owner must be:

- A. In good standing and not subject to administrative sanctions (i.e., debarment, suspension, unresolved adverse audit findings or has failed to correct material violations of HUD rules);
- B. In compliance with the terms of the current Regulatory Agreement, Note, and Mortgage; and
- C. Current in debt service and all payments, including the Reserve Fund for Replacement (or current under a workout agreement).

Note: If the current owner is subject to administrative sanctions, they may still participate in the Transfer Program. Such owners may not receive funds from the transaction until all costs associated with bringing the project to an acceptable standard are covered.

15-13. PROJECT Eligibility.

The PM/CA checks that:

- A. The project has a physical inspection performed using the Uniform Physical Condition Standards [24 CFR Part 5] by the Real Estate Assessment Center ("REAC") with a score greater than 30; and
- B. If applicable, a substantial rehabilitation proposal must:
 - 1. Be in compliance with HUD's environmental regulations at 24 CFR Part 50.
 - 2. Have a relocation plan for the residents during the rehabilitation acceptable to HUD.

PART FOUR: TRANSFER PROGRAM

15-14. General.

Under the Transfer Program, HUD will permit a rent increase, provided the new rents do not exceed comparable market rent,

to facilitate a change in ownership from a for-profit owner or limited-dividend owner to a nonprofit owner or a nonprofit controlled entity; or from one nonprofit owner to another nonprofit owner or a nonprofit controlled entity.

15-16. ADDITIONAL ACCEPTABILITY REQUIREMENTS FOR THE PURCHASER.

- A. The purchaser must have managerial experience in owning and/or operating multifamily projects or significant activities related to the provision of decent housing that is affordable to very low-, low-, and/or moderate-income families.
- B. The nonprofit entity must have ties to the community. National or regional nonprofit organizations that are not active in the community may meet this requirement by:
 - 1. Entering into a joint venture with a local nonprofit organization; or
 - 2. Obtaining the support of a majority of the residents living in the project.

15-17. PROJECT ELIGIBILITY.

The Transfer Program without repair or rehabilitation requires that the project have a physical inspection performed using the Uniform Physical Condition Standards [24 CFR Part 5] by the REAC with a score greater than 60 with no uncorrected Exigent Health and Safety (EHS) violations. Additionally, the property must **not** be designated as a "troubled project."

15-18. TRANSFER OF PHYSICAL ASSETS (TPA) FOR HUD INSURED TRANSACTION.

To encourage nonprofit transfers, HUD will waive the transfer fee. Follow outstanding TPA instructions found in HUD Handbook 4350.1, Asset Management and Project Servicing.

15-19. RESIDUAL RECEIPTS AND REPLACEMENT RESERVE ACCOUNTS.

- A. With an old regulation Section 8 contract or a LMSA Section 8 contract, the seller may keep the funds in both the residual receipts and reserve for replacement accounts. Therefore, the purchaser will be required to replenish the reserve for replacement account.
- B. With a new regulation Section 8 Contract, the funds in both the residual receipts and reserve for replacement accounts must stay with the project. Furthermore, the purchaser must establish the adequacy of reserve for replacement account.