

October 26, 2015

TO: State Directors  
Rural Development

ATTN: Program Directors and Coordinators  
Multi-Family Housing

FROM: Tony Hernandez /s/ *Tony Hernandez*  
Administrator  
Housing and Community Facilities Programs

SUBJECT: Underwriting Guidance for Transfer and MPR Transactions for Fiscal Year 2016

**Purpose:** This Unnumbered Letter (UL) supersedes the September 30, 2013, Unnumbered Letter entitled “Underwriting Guidance for Transfer and MPR Multi-Family Housing (MFH) Transaction”, and supplements the UL of April 24, 2015, entitled “Underwriting Update for Multi-Family Housing (MFH) Transfer and Multi-Family Preservation and Revitalization Demonstration Program (MPR) Transactions” with clarification of key underwriting principles and guidelines for underwriting MFH Transfers and MPR Transactions. The core program underwriting standards have not been significantly adjusted since the initial publication of the respective program handbooks and the implementation of the MPR Demonstration program in 2005. The clarifications contained in this guidance are in response to changes in the real estate and finance markets, and to requests from both Agency staff and stakeholders. This will provide more flexibility in the internal underwriting process and streamline the Agency approval process by allowing borrowers and applicants to respond in a more timely fashion to the available financing opportunities being presented in today’s competitive financial markets.

These clarifications address many concerns raised by customers and clients who have provided comments and suggestions on the business processes used to determine the long-term feasibility and viability of aging projects within the Rural Housing Service (RHS) portfolio. The areas addressed are all functions of the respective program Handbooks, Regulations, and previously published RHS guidance and do not require further regulatory waivers or statutory changes upon incorporation into the formal program policies and guidance. These changes will be published in the Handbooks later this year.

EXPIRATION DATE:  
October 31, 2016

FILING INSTRUCTIONS:  
Housing Programs

**Objectives:** The current key objective of the Rural Development (RD) revitalization effort is to ensure RD MFH projects continue to meet the ongoing long-term program purposes by maintaining the affordability of needed rental housing in rural areas and to ensure the transaction meets the best interests of the Government and the tenants by:

1. Improving and maintaining the long-term physical and financial viability of the property;
2. Improving or maintaining the affordability of the property for RD eligible tenants and applicants; and
3. Completing the transaction in a timely and efficient manner.

“Underwriting” refers to the process of determining the financial feasibility of a proposed transaction based on the requirements specified in the Agency Handbooks and/or applicable Notice of Funding Availability (NOFA) and Notice of Solicitation of Applications (NOSA). This UL strives to provide the framework for the timely and consistent review of the applicant’s submission subject to the applicable program and statutory requirements. The specific aspects of the transaction process such as determining applicant eligibility, assessing environmental compliance, or evaluating fair housing compliance are fully addressed in the current Handbooks and Regulations.

**Tools:** Agency underwriters will use the most current underwriting tools (UWT) available at the RD intranet (SharePoint) <https://mfh.usda.net/ProgTracking/default.aspx> to document their MFH transfer and MPR decisions. Applicants and borrowers may access these forms through the appropriate RD public websites (<http://www.rd.usda.gov/programs-services/multi-family-housing-direct-loans> or <http://www.rd.usda.gov/programs-services/housing-preservation-revitalization-demonstration-loans-grants> ). Refer to the April 24, 2015, UL entitled “Underwriting Update for Multi-Family (MFH) Transfer and Multi-Family Preservation and Revitalization Demonstration Program (MPR) Transactions” for additional information.

The RD Preliminary Assessment Tool (PAT) contains general instructions, basic underwriting thresholds and pertinent tips for RD customers and staff to assist in preparing and evaluating proposals. The tool supplements the more detailed instructions found in the applicable RD handbooks and regulations and the Code of Federal Regulations (CFR). Additional instructions and suggestions are available internally for agency underwriters through the Agency SharePoint by drilling down to their specific needs.

**Responsibilities:** This UL relies on the underwriter’s and loan originator’s ability to complete the basic eligibility determinations concerning both the applicant/borrower and the project to ensure the transaction complies with the respective MFH program authorities described in current RD Handbooks, CFR, and statutory authorities. All transfers and MPR Transactions must be in the best interests of the Government and tenants. These transactions must

demonstrate the extended viability/sustainability of the project, the likelihood of full repayment under the terms being offered, and the potential to succeed in providing and maintaining quality housing over the long-term. It is **not** the Agency's role to assume any responsibility for the individual business decisions of the borrower or applicant in ultimately determining the course of action they propose.

Every component in every transaction will be evaluated and analyzed on their individual merits. Common sense, consideration of pertinent present and historical conditions, as well as recognition of justifiable future impacts must all be used to judge the project's potential to succeed over the term of financing being proposed.

Key considerations may include questions such as:

- Is the project needed?
- Is the applicant eligible?
- Is the project eligible? Is there a present and continuing need for the project in its market area?
- Is the project economically feasible? Does the transaction cash flow use a reasonable operating budget comparable to other similar affordable properties in the market area?
- Will the project be and remain affordable upon completion of the transaction?
- Are the RD-eligible project construction and operating costs reasonable?
- Are the Agency's interests secure?
- Is the transaction in the best interests of the Government and the tenants?
- Does the proposal offer adequate property and asset management to meet RD requirements into the future based on the information presented?

The terms and conditions of the transaction presented by the applicant must reasonably address the issues that determine the potential for success. This includes substantiating any future tenant subsidies that may be necessary to ensure success of planned operations. All parties need to recognize that the transactional costs and fees being proposed may adversely limit the amount of funds needed for repairs, replacements, and improvements and become detrimental to the Agency transfer requirements and thresholds. Ultimately, any allowable costs will pass to the tenants through rent increases but tenant subsidies such as Rental Assistance (RA) are not guaranteed beyond their current expiration. Tenants who do not receive RA will be impacted directly by any rent increase, which they may not be able to afford.

MFH Transfer and MPR underwriting is used to authorize the respective transaction and the future servicing requirements upon closing. An ongoing RD team effort involving both the servicing and underwriting staff is required to deliver a project that will be sustainable for eligible tenants over the life of the RD loan. It relies on the expertise of the RD staff currently servicing the loan and the invaluable input and insights they each can offer on the project, the market, the borrower and the applicant. Responsibility for successfully completing any MFH underwriting relies on the ongoing coordination of loan making and loan servicing efforts.

**Organization:** This UL organizes and suggests broad solutions to common underwriting issues based on past Agency reviews in three broad categories of MFH underwriting.

- “Attachment A” outlines the general underwriting principles applicable to all MFH transactions.
- “Attachment B” outlines the most important underwriting factors in transfer transactions.
- “Attachment C” outlines the most important underwriting factors for MPR Transactions.

The points of contact for this UL are the Preservation and Direct Loan Division (PDL) staff. A PDL staff member is assigned to assist State Office and field office staff with Transfers and MPR Transactions to help address questions and concerns raised by the respective underwriter with these transactions. If there are questions regarding the content of this UL, please contact your assigned MFH PDL staff member.

## General Underwriting Concepts and Principles

### Key Agency Underwriting Concepts

- A. **Major MFH Goal:** The major goal for the Rural Development (RD) Multi-Family Housing (MFH) portfolio is to preserve needed properties and extend their useful lives through cost effective revitalization that is in the Government's best interests and provides eligible families, seniors and individuals with affordable, decent, safe and sanitary places to live. A revitalized property is sustainable for the long-term considering its current rent and financing structure, often with no or limited rent increases or new Agency loans, and has long-term affordability protection under a Restrictive-Use Provisions (RUP) or a Restrictive-Use Covenant (RUC). This goal may be accomplished through ownership changes (transfers) which may include the infusion of additional funds from eligible sources as defined in the Handbooks and the MPR NOFA/NOSA.
- B. **Guiding Principles:** Using the information provided by the applicant, Loan Servicers should assess whether the transfer request is consistent with the following general principles and the respective program regulations or NOFA/NOSA requirements for the proposed transaction:
- There is a continuing need for the property in the community. This must be considered in lieu of prepayment for any existing RD properties.
  - When the transaction is complete, the property will be in the hands of eligible owners.
  - The transaction will address the immediate and long-term physical needs and all of the accessibility needs of the property.
  - Any increased post transaction rents will not displace existing tenants otherwise meeting the RD eligibility requirements for continued occupancy.
  - Post transaction basic rents will not exceed the lesser of Conventional Rents for Comparable Units (CRCU) or the restricted rents as defined in current RD regulations, unless an exception is allowed by the Agency. Low Income Housing Tax Credits (LIHTC) rents are differentiated from CRCU and other restricted rents that may be imposed by the applicant's participation in other funding sources such as HOME or individual State Housing Assistance programs.
  - Any loan requiring an appraisal will include a market value appraisal that complies with RD appraisal requirements.

- RD encourages the use of third-party resources to secure adequate funding to successfully complete transfers and associated revitalization efforts.

C. **Sustainability:** A sustainable rent and financing structure is needed to meet the property's long-term capital and operational needs without further additional Agency direct funding, or with third-party funding at minimal cost to the Agency and the tenants. RD will consider any available Rental Assistance (RA) for which the project may be eligible at the time of underwriting in evaluating the total long and short-term costs to the tenants and the Government associated with each individual project's efforts to meet this goal.

A long-term RUP and/or RUC is used to ensure the project will remain available to eligible tenants at sustainable affordable rents within the financing structures available through the MFH programs.

D. **Budget Pressure, Particularly on RA:** The limited funding for direct loans and rising RA outlays to maintain the project's cash flows necessary for viable operations have not kept pace within the tenants' ability to support the cost of project operations and increased the demand for additional assistance from both borrowers and tenants. This budget pressure to minimize RA costs requires that rent increases be considered only as a last resort. The most cost effective method of revitalizing properties to date has been through the infusion of equity and soft debt in conjunction with debt deferral and reamortization of existing debt. Based on common economic principles, needed rent increases generally should not exceed the annual inflation rate unless explicitly justified based on circumstances beyond the control of the property owner and project management.

E. **MPR Demonstration Program:** The MPR Demonstration program for eligible RD MFH property owners is available based on the annual appropriation from Congress to develop, evaluate and implement a demonstration using debt deferral, zero percent loans, soft second loans and grants as some of the financial tools. Selection of properties is made available through the NOFA/NOSA process. If a transfer is part of a MPR Transaction, the transfer must first be underwritten to meet the requirements of 7 CFR 3560.406 and HB-3-3560, Chapter 7. With PDLDC concurrence, a transfer selected for the MPR may be underwritten, and if appropriate, MPR tools may be applied on a case-by-case basis to enhance the affordability to eligible tenants but may not be used to increase any other condition included in the RD Headquarters transfer authorization (see "Attachment B" and "Attachment C").

- F. **Working with LIHTC Resources:** The primary source of third-party funding in RD MFH preservation efforts has been provided through the LIHTC program. The RD State Offices should develop an understanding and/or written agreement with the appropriate State LIHTC Agency to promote subsidy layering review, and inspection responsibilities to assure the most effective use of public resources while minimizing duplicative review and underwriting processes. Examples of understandings/agreements may include agreeing that sales prices for transfers cannot exceed appraised values, establishing appropriate amounts of Return to Owner (RTO), and agreeing upon property reserve levels based on an analysis of the repairs mandated by the respective State and Federal programs participating in the transaction.
- G. **Working with Other Third-Party Funders:** Many of the RD MFH transactions also involve other third-party funding sources willing to participate in project revitalization efforts. Similar to the understandings reached with various State LIHTC Agencies, some projects may also be able to secure additional funding from various public and conventional sources including recognized lenders as described in more detail in the RD Handbooks and applicable NOFA/NOSA. However, these funding sources must provide rates and terms that comply with the respective RD MFH direct loan program requirements.
- H. **Clauses that Survive Closing:** RD requires some clauses or phrases in the Conditional Commitment (MPR Transactions) or the concurrence/authorization memorandum (transfer transactions) that must survive the transaction closing to comply with the statutory authorizing requirements governing the respective MFH program. Those conditions or commitments must be entered into the Multi-Family Information System (MFIS) to document that the commitments will be met during the term of the loan or until a new RD servicing action occurs that may require modification of the original approval.
- I. **Restrictive Use Agreements:** As a general rule, a new RUP or RUC is required of any significant Agency or non-Agency investment in a property to meet the Congressionally mandated restrictions governing any prepayment of the loan prior to the final due date of the RD financing. LIHTC required covenants and use restrictions cannot be used to replace the mandatory RD required language. Participating third-party funding sources should be advised of these mandatory RD restrictions early in the underwriting process.

- J. **Modest and Affordable Rents:** MFH transactions must demonstrate sustainable rents that are as low as possible to be affordable for eligible tenants in the market area without relying on continuous RA support. Usually, these rents are at or below CRCU for the market area and may frequently be limited to the maximum rents limited by LIHTC, HOME, bond or other participating funding sources. Rents should be established based on the cash flow of the project's typical year operating budget, affordable debt service requirements, and required reserve requirements. The Agency's underwriting allows for a planned operating cash carryover in the property's annual budget (Form 3560-7, Part I, Line 30) so that normal year-to-year variations in revenues and expenses can be absorbed from operations, rather than the capital reserve account. Sustainability factors include the assumption that inflationary factors will occur during the life of the proposed transaction, and underwriters must consider the net impact when evaluating each individual transfer or MPR.
- K. **Minimum Annual Reserve Balance Benchmark:** The Agency requires the project reserve account to be resized during underwriting to show funds will be available to meet the physical (capital) needs of the property over the 20-year approved Capital Needs Assessment (CNA) cycle. The underwriter will size the annual deposit to require a positive ending balance in each year of the 20-year capital needs cycle. In all transactions, the reserve should be sized to show that 100 percent of the CNA's capital needs can be met from the reserve account in the year the need is projected to occur. These must be met without additional funding from the Agency or without supplemental rent increases for specific items only occurring within a single operating year. Annual reserve deposits may be periodically adjusted by amendment to the loan agreement or resolution during the term of the 20-year cycle to reflect at 5 or 10-year intervals, either through an updated CNA or as part of the original life cycle cost analysis (see 7 CFR 3560, §3560.65).
- L. **Capital Operating Budget:** Although many routine repairs may be typically addressed in the annual operating budget, they must be incorporated into the project's management and maintenances plan for the approved transaction. A reasonable amount may also be allowed in the RD budget underwriting to address tenant turnover costs so long as these costs are not reflected in other budget lines nor duplicated in the CNA underwriting analysis tables. The budgeted amount for tenant turnovers must be supported by the project's management plan and related documents.

- M. **Adequate Funding for 20-Year Capital Needs:** The ongoing reserve balance in any transfer or MPR Transaction must be sufficient to meet at least the fully funded inflated value of the identified capital needs of the property over the next 20 years in accordance with the CNA accepted by RD. This amount will be determined by RD through the underwriting tool used by RD to document the transaction. The CNA must be provided as part of the approval documentation for the transaction after being found acceptable by the Agency.
- N. **Transition to the Underwriting Phase:** The integrity of the CNA is critical to the underwriting conclusions. Financial planning adjustments may only be done during the underwriting phase and collaboration among the technical and financial perspectives are key to a well maintained, viable property.
- O. **Rents:** All RD underwriting will establish the minimum acceptable level of rents to be implemented upon completion of the transaction being proposed. Such rents will be sufficient to fully meet the project's projected total annual operating expenses (including agreed upon vacancy and rent loss), reserve deposits, allowable debt service and authorized return to owner. Appropriate documentation of an agreed upon method of funding any shortfalls in such items that will be funded by the project owner from non-debt sources must be executed prior to closing, and shall run for the term of the RD loan unless full rental assistance is subsequently received.
- P. **Rent Changes:** The rents should be the minimum needed for the property to cash flow at the RD approved rents at all times, and may only be changed using the processes described in 7 CFR §3560.205; HB-2-3560, Chapter 7, Section 4 and the specific transaction approval conditions authorized by the approval official. The maximum rents described in paragraph O [above], may only be reached upon final completion of the repairs and rehabilitation as underwritten at the time of approval. In some transfer or MPR cases, additional permanent debt service for an equity loan or immediate upfront repairs/rehabilitation may be authorized in the transaction approval in lieu of using temporary interim financing and may require a rent change to pay only those additional debt service amounts specifically authorized by the approval official on a case-by-case basis.

**Q. RD Interdivisional (PDL/PMD/GLD) Coordination:** MFH Transfer and MPR underwriting is used to authorize the transaction and approve the terms leading to approval. Often underwriting transactions become intertwined among the aspects and requirements crossing multiple interdisciplinary divisions within the Rural Housing Service (RHS). To minimize potential confusion for borrowers and applicants, and to insure consistent application of pertinent RHS requirements, underwriters must coordinate loan making (direct and guaranteed when applicable) and servicing expectations when evaluating the proposed MFH transaction. Responsibility for successfully completing any MFH underwriting requires ongoing coordination of PDL loan making, Guaranteed Loan Division (GLD) guaranteed loan participation, and Portfolio Management Division (PMD) loan servicing efforts.

**R. Loan Closing:** PDL staff is responsible for providing underwriting guidance and assisting the State Office throughout the underwriting, obligation and closing process for each of the transfer and MPR Transactions authorized. The State Office and delegated field staff are responsible for ongoing servicing of the account and assume responsibility for servicing the completed transfer or MPR immediately after the authorized transaction is closed. They should request any needed and appropriate account servicing guidance and assistance through PMD. In both cases the respective knowledge, experience and cooperation from both is necessary to successfully implement the transfer or MPR approval because of the invaluable input and insights each can offer about the project, the market, the borrower, the applicant, project management, etc. Ultimately, this is an ongoing team effort involving both the servicing and underwriting staff to deliver a project that will have the long-lasting future benefits intended for the eligible tenants over the life of the RD loan.

## Transfer Underwriting Principles

This Attachment discusses supplemental underwriting principles for MFH transfer transactions in addition to the requirements shown in “Attachment A” of this UL. For transfers participating in the MPR Demonstration program refer to “Attachment C” for supplemental MPR underwriting guidance.

- A. **Overview:** All transfers of ownership are defined in and will be completed pursuant to HB-3-3560, Chapter 7. All transferees must meet the eligibility requirements found in HB-1-3560 for the respective loan program type (Rural Rental Housing or Farm Labor Housing). After a transfer is authorized and revitalized, the properties should be financially and operational sustainable for the remaining term of the RD funding.
- B. **Key Parties to a Transfer:** Key parties are the Seller, the Purchaser, the Agency (on behalf of the tenants and as mortgagor) and any third-party funders (other lenders, tax credit agencies, syndicators/investors, etc.). Each party may have competing or conflicting requirements, needs and/or objectives and goals that must be recognized and addressed early in the transfer process. It is not RD’s responsibility to negotiate on the buyer or seller’s behalf to reconcile such conflicts, but rather to demonstrate reasonable flexibility in the application of program requirements as appropriate within the allowable RD authorities and interests. RD offers the PAT to assist applicants, borrowers, lenders, and other involved parties in gaining an insight into the potential feasibility of a proposed transfer and encourages all interested parties to contact the RD servicing office as early as possible to discuss program requirements and conditions.
- C. **Funding Resources:** RD encourages the use of third-party resources to secure adequate funding to successfully complete transfers and associated revitalization efforts. Such resources include Low Income Housing Tax Credits (LIHTC), grants, and participating lenders adhering to RD MFH policies and programs, including Section 538, Guaranteed Rural Rental Housing (GRRH) loans. Lenders include Federally regulated and insured institutions; State regulated, chartered and insured institutions; and other national, State, regional or local governmental agencies specifically authorized to make loans and or grants for multifamily housing purposes authorized under the authorities accorded to the U.S. Department of Agriculture (USDA).
- D. **Working with Third-Party Funders:** Non-RD direct funds may be provided through tax credits, tax-exempt bonds in association with 4 percent tax credits, and/or other third-party funds. In such cases, the Agency’s representative must be involved during the negotiation stage between the potential purchaser and the seller to protect the interests of the Agency. Even though tax credits are provided through State Housing Finance or LIHTC Agencies and there may not be any additional USDA debt service, the credits

could not be obtained without utilizing the existing RD-financed property and the benefits available through interest credit and RA. It is important for the Agency's representative to ensure the Agency's regulatory requirements are met throughout the life of the planned transaction to efficiently enhance the viability of the transaction. Third-party funders must be provided the Agency's requirements at the earliest possible time [generally at the initial transfer discussions] and reminded as necessary of applicable requirements and limitations.

E. **Preliminary Transfer Thresholds:** To satisfy the objectives and principles identified in current program authorities, RD adopted the following thresholds and policies for evaluating MFH transfer feasibility. These thresholds promote consistency in RD underwriting for MFH transfer transactions, and balance the needs of the Agency, customers and the project to maintain affordability for eligible tenants under the RD programs. A preliminary assessment using these standards should be completed early in the transfer process by the transferee and discussed with the RD office responsible for servicing the account. Applicants may use the PAT available on the USDA RHS public website to assist them in preparing for the transfer application submission. Careful analysis by all parties involved can identify the general issues that will need to be resolved as the transfer application is completed and submitted for formal review. Not meeting the preliminary thresholds does not mean the application will be rejected. However, any preliminary thresholds not fully met during the preliminary assessment review will require further analysis with appropriate justification and documentation provided to RD before processing continues. Acceptance of the preliminary analysis by RD does not constitute final approval by RD of a transfer proposal . Key policies to be considered include:

1. **Post-Transfer Rents** - Post transfer rents should not exceed the restricted rents of the LIHTC, HOME program (if applicable) or CRCU (as defined in existing RD regulations) whichever is less. The term "Restricted Rents" for the purpose of this review will be the rent restrictions of LIHTC, HOME or other Rent Restricting Program(s) that will be placed on the property upon completion of the transfer. Post-transfer rents on properties with 100 percent project-based Section 8, will not exceed the maximum rents authorized under the HAP contract. No rent increase beyond the current basic rents is authorized prior to completion of the planned rehabilitation except as provided in Attachment A, paragraphs O and P.

2. **Rents Cash Flow in Proposed Operations** - Proposed rents must be sufficient to meet all projected expenses including a reasonable allowance for operations and incidentals and is typically included in the estimated individual operating expense line items. The allowance may be expressed as a percentage of total operating expenses and the planned amount is shown as net cash on the RD operating budget, Form 3560-7, Part I, Line 30. The **minimum** combined

allowance for operating expenses and vacancy/bad debt loss must not fall below the equivalent industry standard of 5 percent vacancy loss or the applicable amount specified in #3 below. Net operating income (NOI) must also be sufficient to meet the general industry minimum standard of 1.15 debt service coverage ratio (DSCR) for all amortizing debt being placed on the property in the initial underwriting review. If third-party lenders specifically require DSCR in excess of the minimum, such rate should be used (see #9 below).

3. **Vacancy/Bad Debt Loss** - The **maximum** allowance for vacancy and bad debt is 10 percent (for 16 or more units) and 15 percent (for less than 16 units) unless otherwise specified by terms of any NOFA/NOSA for which the transaction has been submitted. The **minimum** allowance is the lesser of the historical average of collected rents for the most recent three years plus 2 percent, or the Restricted Rent Program/Lender requirement when specified. In rare instances, an allowance that is less than the historical average plus 2 percent may be considered and approved at RD's sole discretion, if there are properly documented extenuating circumstances.
4. **Operating Expenses** - The **minimum** amount of operating expenses required per unit is the greater of any specified by either the Restricted Rent Program (LIHTC, HOME, etc.) or the third-party Lender (if applicable). No more than a 10 percent change or variance in total project post-transfer closing operating expenses based on historical actual averages will be accepted for underwriting without adequate justification acceptable to RD satisfaction.
5. **General Operating Account Minimum Requirement** - The project General Operating Account (GOA) must be equal to 20 percent of the total operating expense as underwritten at the time of transfer (excluding the required prorated tax and insurance escrow) and have no outstanding accounts payable exceeding 30 days. If this cannot be achieved through the normal project

operations as projected in the underwritten typical year budget, the transfer development budget must include an additional cash deposit to the GOA. Any additional required deposit (not from normal operations) made by the applicant must be documented to the agency at the time of transfer. The applicant may recoup the additional required cash deposit to the GOA between the second and seventh year of operation in accordance with HB-2-3560, Chapter 4, Section 4.10.

6. **Tenant Protection** - RD does not permit the intentional displacement of any existing RD eligible tenant as a result of the planned transfer so long as the tenant remains eligible under RD regulations and the terms of the RD approved lease. For projects not having full RA, for all revenue units where the transfer results in a rent increase, the applicant must agree to protect currently eligible tenants affected by the rent increase for a full 2 years after the later of the closing of the permanent loan **or** the full completion of the approved rehabilitation as required by 7 CFR 3560.406(b) and HB-3-3560, Paragraph 7.27B. All tenant protection costs must be included in the “Sources and Uses” analysis used in RD underwriting for the full amount needed to fund the specified 2-year minimum. The applicant will establish a specific cash escrow set aside for this purpose at the time of closing, and is responsible for providing from non-project resources any future tenant subsidy or protections necessary to maintain cash flows if the project does not have or fails to secure 100 percent RA or other tenant subsidy necessary to meet LIHTC or other third-party tenant rent restrictions.
7. **Capital Needs Assessment (CNA) Funding & Reserve Deposit** - The minimum requirement per unit is the greater of either any Restricted Rent Program (LIHTC, HOME, etc.), or third-party Lender (if applicable) that will be placed on the property upon completion of the transfer. The Reserve Account ending balance forecast **must be** positive for all 20 years of CNA.
8. **New Loans for Section 515 Eligible Purposes** - Any new loans being placed on the property must be for Section 515 RRH eligible loan purposes only as defined in 7 CFR 3560.53. Prohibited uses of loan funds as defined in 7 CFR 3560.54 must be paid from non-debt sources. However, projects using a RD Section 538 GRRH loan may allow additional debt for purposes eligible under the GRRH regulations.

9. **Debt Service Coverage Ratio (DSCR)** - RD underwriting will include annual trending increases of revenue of 2 percent and allowable project operating expenses increases of 3 percent for each of the first 15 years. For RD transfer underwriting and analysis, the project must, at a minimum, meet an initial DSCR of 1.15 through year 3, and may project subsequent DSCRs of 1.1 in years 4 and 5, and 1.0 for the remaining years solely for the purposes of the RD initial transfer analysis. (Note: meeting this condition, replaces in part the concept of the operating “cushion” amounts previously required in the RD underwriting budgets.) Third-party lenders may require higher DSCR for their individual underwriting approval requirements; however, such amounts will not be used to establish the RD rents due to the adverse impact on tenant rents and RA costs at the Government’s expense.
  
  10. **Loan to Value** - Upon completion of all planned rehabilitation/repairs and approved development, all Debts must be secured within the **Prospective As-Improved Security Value** as defined by RD in 7 CFR 3560, §3560.63. RD determines security value and includes the intangible benefits afforded by the interest credit subsidy of the RD loans, benefits of other favorable financing resulting from other Federal direct or Federal intermediary lending programs such as HOME, PRLF, and Section 538 GRRH loans being made at below market rates and terms, as permitted by RD regulations. Security value does not include any non-amortizing or deferred loans or grants regardless of the source; or any federal, state or local LIHTC and Historic tax credits or the investment value thereof.
  
  11. **Loan Terms of Third-Party Debt** - No balloon payment of any third-party debt is allowed prior to the expiration of the minimum RD Loan Term (30 years for RRH transfers and 33 years for FLH); unless the Lender provides a written agreement, acceptable to the Agency, to extend the scheduled maturity on terms that do not require rents above CRCU through the term of the RD loan.
- F. **Adequate Sources & Uses:** Sufficient funds must be available and adequate for all proposed rehab, acquisition costs and uses to meet the terms of the proposed transaction. Funds must be adequate to address repairs needed immediately, including all health and safety, fair housing and accessibility issues. These may be included as part of the up-front rehabilitation that is being paid by third-party funds. Applicants must be able to fund any projected shortfalls from resources other than the project or project income.

**G. Adequate Rents and O&M Expenses:** The rents and O&M expenses underwritten for the transfer must be adequate to operate the project in a typical subsequent operating year and should generally be at or above historical levels. However, projects requiring major rehabilitation may reflect changes in the maintenance cost whenever: (a) historical expenses have been elevated because of the properties' previously poor physical condition and (b) the proposed reduced cost will still be adequate on a long-term basis and will be within an acceptable cost range when compared with other RD projects of similar size and characteristics in the same cost areas. Underwriters may also utilize the Hyperion report information available internally to compare similar and same-market area property expenses. Underwriters should also compare the operating income and expense data used by other funding sources (LIHTC, syndicator, other lenders, etc.) involved with the proposed transfer and discuss any differences early in the process to avoid conflicting underwriting standards that may jeopardize the potential success of the project. If the third-party funders have rent restrictions lower than CRCU, the transaction must be underwritten using the lesser of CRCU or the rent restrictions imposed by any third-party funder, including LIHTC awards. **Note:** If the transaction includes a Section 538 GRRH loan as a funding source, the annual guarantee fee may be itemized in the O&M expense budget in Form RD 3560-7, Part II, Line 32. In all cases, the Owner must pay any recurring or annual bond fees not included as part of their debt service from non-project sources such as earned RTO.

- H. **Appraisal Requirements:** A market value appraisal acceptable to RD is required whenever an equity payout is proposed or additional debt is being incurred as part of the transfer. Either RD staff or other licensed commercial appraisers may perform the appraisal, but in all cases must meet minimum RD standards and is accepted by the designated RD appraiser serving the respective State Office. The market value appraisal subject to unexpired use restrictions presented in the appraisal assists the underwriter in determining the maximum equity payment or exit incentive described in this UL that the seller might receive. For more information regarding appraisals see HB-1-3560, Chapter 7, Section 2. A market value appraisal does not establish the RD security value required to justify RD financing.
- I. **Sales Price:** The sales price for the project is the amount negotiated by the buyer and seller under the terms of a valid current sales contract, agreement, or option. It is not restricted by RD in transactions that do not affect the basic rents and are funded solely with LIHTC equity, the purchaser's own funds or other "soft dollars", and are not otherwise dependent on project income for repayment. The sales price is often described as the total amount being paid and may be the sum of the following:
1. **Real Estate:** The recognized sales price for the real estate is the lower of the appraised value or the amount of assumed debt plus the third-party equity loan that fits within CRCU and the present market value determination of the RD accepted appraisal. Underwriters should carefully review the sales contract to understand fully the terms and conditions to which the buyer and seller have agreed. If third-party funding sources are being considered as part of the transaction, care should be taken to ensure all parties to the transaction (including any third-party funding sources) are using the same conditions, assets being conveyed and any other terms before underwriting the transaction. If anything is not clearly understood, the buyer/seller should provide appropriate clarification to allow accurate data input into the UWT. This may include modification or amendment to the purchase contract or other agreements.
  2. **Other Assets:** This may include the non-real estate assets of the project including personal property, equipment and associated chattel property transferred to the new owner by bill of sale or transfer of title under State law.
  3. **Reserve Balance:** Under the terms of the seller's RD loan agreement, the project reserve account is pledged as additional security for the RD loan after having been accumulated from rent collections. However, the Agency allows the seller to "sell" the reserve balance to the purchaser but requires the reserve account funds themselves to pass to the purchaser as part of the transaction.

As a practical matter, the purchaser must provide cash or other soft funds to pay the seller for the reserve balance. Generally, the sales contract must note if the reserves are included (state law may restrict what is included in a real estate contract) in the total sales price (purchase of the reserve account may be over and above the sales price for the real estate.) The transfer of the existing required project reserve account balance is not equity eligible for RTO nor is it part of the required purchaser down payment or contribution that may be required by any third-party lender providing financing for the transaction.

**J. Transfer and Assumption of the Reserve Account:** When a project transferee assumes the full amount of the present reserve account determined to have “excess reserves” (see below), such excess reserves may be incorporated into underwriting the project’s rehabilitation needs under the following conditions:

1. **Under-Funded or Delinquent Reserves:** When the reserve balance is below the required amount, the seller or purchaser must restore the required balance as of the closing date of transfer. For additional information: 7 CFR 3560.406 (c) 2.
2. **Excess Reserves:** Generally, all reserve funds must pass intact to the purchaser. However, RD may grant an exception for reserve balances that exceed the RD required reserve balance and permit the release of the “excess reserves” as of the date of closing directly from the reserve account to the seller as part of an equity pay-out at closing only when any health and safety items neglected by the seller and identified in the CNA are satisfied through other funding sources not having any impact on the transaction in any other manner. (See also HB-2-3560, Chapter 4, 4.16 and 4.18 and Inadequate Reserves below.)
3. **Inadequate Reserves:** Typically in MFH transfers, the reserve is at or above the RD-required amount (required deposits less authorized withdrawals) but does not have sufficient funds to meet any immediate needs and provide an appropriate starting balance for meeting the 20-year CNA. In this situation, the transfer transaction must include sufficient sources of non-Agency funds, grant funds or non-amortizing loan funds to supplement the inadequate reserve balance. When determining the needed additional reserve deposit at the time of transfer (the IDRR), the underwriter must also consider the following:

- a. **Gap Account:** If some of the reserve funding is earmarked for an insurance deductible, subtract that amount from the reserve for underwriting purposes.
  - b. **Authorized Reserve Requests:** If the seller has been authorized to withdraw funds from the reserve account, the underwriter must determine if those purposes are part of the needs identified in the CNA and adjust the amount as appropriate.
- K. **Equity Loans:** Any equity loan amount will be supported by a market value appraisal meeting RD appraisal acceptability requirements.
- L. **Maximum Equity Loan Debt Service:** The maximum equity loan amount is based on RD's analysis of project cash flows based on the current as-is present market value appraisal as described in RD HB-1-3560, and the maximum or the allowable monthly debt service payment (using the lower of the restricted rents or CRCU rents). It is determined during the RD underwriting analysis and can be estimated using the PAT after:
1. Subtracting a reasonable allowance for rent loss,
  2. Adding a reasonable estimate for other income (e.g., laundry),
  3. Subtracting adequate O&M expenses,
  4. Subtracting an adequate Reserve deposit,
  5. Subtracting debt service on pre-transfer debt, and
  6. Subtracting the current owner's RTO.
- M. **Seller Equity:** All Seller's Equity will be calculated based upon the Market Value reflected in the RD accepted appraisal, less the unpaid balance of the outstanding RD Loans on the Property and any other amortizing debt outstanding at the time of transfer. If no new loans will be placed on the property at the time of transfer, an exception can be made for payment of a seller's equity on a case-by-case with RD Headquarters PDL D approval. If any equity is available, a seller cannot receive an Exit Incentive (EI) offer (see items N and O below).
- N. **Exit Incentive (EI):** An EI can be paid to the seller if all of the following tests are met and the RD approval official has specifically approved such payment for the specific property:

1. The present RD accepted market value appraisal *indicates no equity exists* in the property as-is,
2. All threshold items listed in 7.2 C of the handbook are met,
3. The total amount paid as Exit Incentive (EI) is available from tax credits or other soft dollars,
4. All new loans are used for Section 515 eligible purposes, and,
5. The total of all loans post-transfer will be less than the Security Value determined by RD.

O. **Equity/Incentive Considerations:** Sellers **cannot** receive both seller's equity and EI on any individual property even though the specific property may be included in a portfolio transaction or is being consolidated as part of the transfer process. Other individual properties in the transaction may be independently eligible for an EI if no equity is available based on the RD accepted appraisal. When any EI is proposed, the RD Headquarters must review the Preliminary Transfer Assessment tool before the agency issues a letter of support for the buyer to obtain tax credits. The settlement statement pre and post-closing must also be reviewed by the agency to verify the amounts that may ultimately be released at closing and confirm no more than the amount authorized has been paid.

P. **Accounts Payable:** the seller must pay any accounts payable for the project being transferred prior to closing. This may reduce the amount of any expected net cash the seller may receive.

Q. **Return to Owner (RTO):** Each transfer will result in computation of a new RTO for the new owner if all the following conditions are met at closing. This maximum potential RTO will remain the same for the entire term of the loan unless subsequently adjusted by other initiated RD servicing actions, and is documented in the buyer's Loan Agreement/Resolution. Currently the RD RRH program allows the project owner to earn potentially up to an 8 percent RTO as described in HB-3-3560, Chapter 7. For transfers, the following conditions are considered in determining when any tax credit investor receipts and/or projected deferred developer fees will be used to establish the new return to owner at 8 percent:

1. Rehabilitation costs eligible for Section 515 program purposes less all outstanding and new Loans must not exceed the RD determined Security Value.
2. The new maximum projected RTO will be afforded at the time of transfer approval based on the Agency underwriting analysis of Net Operating Income (NOI) less debt service for all loans (without agency debt deferral),
3. The NOI for payment of RTO should provide at a minimum for the DSCR of 1.15 (when RD recognized new equity has been provided), and will be based upon the projected post-rehabilitation operating budget with rents not exceeding the lessor of CRCU, or if applicable the LIHTC rents required by the tax credit application process or any other restricted rents as approved during RD underwriting,
4. The budget must reflect the lesser of the Agency's factored combined project cash flow allowance (as described in E2 and E3 above) of 5 percent of O&M and **3-year** historical vacancy plus 2 percent (not to exceed maximum of 10 percent for 16 or more units, or 15 percent for less than 16 units), or the industry standard of 5 percent vacancy, and
5. There must be a demonstrated ability to repay any deferred developer's fee from the NOI/RTO proposed by the applicant without anticipating any subsequent or additional increase in projected rental rates rental income except as presented in the Underwriting Tool and analysis used in the RD approval over the remaining term of the RD loan. The initial rents for this calculation uses the rents approved for the transaction in the RD analysis.
6. RD considers a Limited Partnership (LP) or Limited Liability Company (LLC) as a for-profit entity eligible to earn a RTO. A non-profit entity serving as a General Partner does not preclude the partnership from earning a RTO. However, the non-profit entity serving as the general partner or managing partner is not eligible for the asset management fee.

- R. **Transfers Selected Under the MPR NOFA/NOSA.** If either an equity payout or increased RTO is being proposed as part of the transfer transaction, no new Agency direct funds may be proposed as part of the transfer underwriting portion of the transaction. If the project being transferred has also been selected under the MPR NOFA/NOSA for preservation, the transfer underwriting may assume the project will be allowing the deferral of all eligible Section 515 loans (loans obligated prior to October 1, 1991) which are being assumed, there is no increase in the project RTO beyond the amount that could be earned under paragraph Q above without any debt deferral, no additional increase in the total required hard debt service unless authorized by the RD Headquarters on a case-by-case basis to complete all immediate rehabilitation required in the approved CNA, and all equity is being paid from sources not requiring repayment such as LIHTC investor receipts. Also, see “Attachment C” for specific processing principles that may be available to transferring projects only after the transfer has been authorized under the transfer principles of this Attachment and those described in HB-3-3560, Chapter 7. No MPR tools (including loan deferral) will be used to support or establish equity payout or increased RTO for the buyer in any transfer transaction.
- S. **Restrictive Use Requirements:** For all Transfer transactions, applicable restrictive use provisions and extensions must be inserted in the legal documents required for the specific transaction (mortgage or deed of trust, warranty deed, release documents, etc.). These provisions may include a separate RUC approved by your Regional Office of General Counsel (OGC) that is outside the loan documents that has been designed to survive foreclosure or prepayment. Refer to 7 CFR 3560, 3560.72 (a) (2), 7 CFR §3560.406 (g) and 3560.662, and HB-3-3560, Chapter 7, Paragraph 7-31 D.
- T. **RD Headquarters Concurrence:** The PDL D must concur with equity loan amounts or increased RTO being authorized, and coordinates the approval of all waivers of transactions that fall outside of the normal transaction principles, RD Headquarters approvals, or revitalization related policy issues.
- U. **For More Information:** HB-3-3560, Chapter 7 addresses the Agency’s requirements for transfer transactions.

## **Underwriting Principles for Multifamily Housing Preservation and Revitalization Demonstration (MPR) Transactions**

This section discusses underwriting principles for MPR Transactions. MPR tools are only available for transfer transactions involving RRH and FLH transfers, which have been selected under the then outstanding NOFA/NOSA. Such transfers may be underwritten using the projected loan deferral to establish feasibility. However, such transfers will be underwritten to first satisfy all of the transfer principles discussed in “Attachment B” including establishing the maximum RTO, determining the maximum equity payment, and sizing of the reserve account to include the repairs and rehabilitation planned with the MPR Underwriting MPR Transactions with stay-in owners or transfers providing **NO** equity payout to the seller and **NO** increase in the RTO will also adhere to the following principles and any other supplemental conditions specified in the respective NOFA/NOSA.

Transfers selected into the MPR may assume the eligible Agency loans will be deferred in the transfer underwriting. If a transfer is part of a MPR Transaction, the transfer must first be underwritten to meet the requirements of 7 CFR 3560.406 and HB-3-3560, Chapter 7. After the transfer has been underwritten and concurred with by the PDL, the MPR Transaction may be underwritten and if appropriate additional MPR tools may be applied on a case-by-case basis to enhance the affordability to eligible tenants, but may not be used to increase any other condition included in the RD Headquarters transfer authorization.

A. **Key Underwriting Determinations.** The key financial feasibility determinations for MPR Transactions include the following:

1. **Combined Vacancy/Rent Loss Factor.** Budget an appropriate allowance for vacancy/rent loss. This combined percentage should be set at a level the property should not reasonably exceed. The appropriate factor is one that will be adequate to absorb normal year-to-year fluctuations in occupancy and in local market conditions. Generally, the combined vacancy and rent loss factor should be the greater of (a) 5.0 percent or (b) 2.0 percent above recent actual rent loss. However, in no case should the combined vacancy and rent loss exceed the limit stated in HB-2-3560, Chapter 4 Section 4.26 B.
  - a) **Consider the Impact of any Rent Increase.** Changes in the project’s basic rents will affect the marketability of the property to eligible tenants.
  - b) **Consider Relationship to CRCU.** If the proposed basic rents are well below CRCU, typically this borrower should be able to market the property to eligible applicants with low or minimal rent loss. Marketing the property to eligible applicants without a subsidy will be difficult whenever the proposed basic rents approach CRCU levels.

- c) **Temporary Rent Loss during Rehabilitation and Lease-Up.** If the MPR Transaction includes significant repairs, relocation of residents may be necessary. Additional sources of funds may be included under the MPR Demonstration program to cover temporary loss of revenue during the repair and lease-up period. Insufficient funds to meet normal operating expenses during the rehabilitation period must be addressed in the underwriting template and projected sources and uses. Required tenant relocation costs during the rehabilitation period may be included in the MPR funding. The applicant must provide a plan to document the proposed relocation costs documented in the MPR narrative and the ODE tab included in the RD underwriting tool used for Stay-in Owner MPRs.
2. **Sustainable O&M Expenses.** Underwritten O&M expenses must be adequate to meet project needs while absorbing normal variations in expense levels without being excessive. The planned expenses must be reasonable to meet all necessary operating costs and documented in the project narrative. Underwriters need to be cognizant of the timeframes involved; underwriting, closing and rehabilitation completion all contribute to a delay in a timely budget implementation. Realistic budgets should reflect these impacts and will generally be limited by the greatest of one of the following considerations:
    - a) **Consider Recent Actual Expenses and Budgeted Expenses.** Normally the underwritten amount for each subtotal for any operating expense category O&M line item (Form 3560-7, Part II) should be the greater of (a) the current approved budget, (b) the most recent or actual results adjusted for inflation, or (c) the prior year actual results adjusted for inflation. Subtotal amounts exceeding the acceptable thresholds set forth in HB-2-3560, Chapter 4 require adequate documentation.
    - b) **Consider Effects of the MPR Transaction.** When recent actual expenses include high repair costs and the MPR Transaction includes replacement of those components, the underwriter may reduce operating costs for the component to a typical level. Similarly, if the MPR Transaction involves adding, e.g., air conditioning, the underwritten amount for the Heating Ventilation and Air Conditioning repair costs should be higher than historical levels. Agency underwriters can use the Hyperion operating budget analysis tool to compare expense items among all Agency properties to determine if the operating costs are reasonable in comparison to other RD transactions.

- c) **Consider Similar Properties.** If proposed O&M expenses are materially lower than those of similar properties, there is a risk that the property might not be viable or if a change in management is required. Materially higher proposed O&M expenses can be compared to those of similar properties. This analysis should indicate the efficiency of the proposed project management in evaluating the MPR Transaction's overall ability to meet the demonstration requirements. Consider requiring replacement of ineffective or inefficient management as appropriate.
  - d) **Consider the CNA.** Form 3560-7, Part II Line 9 (annual capital budget Operating) will normally be zero or a minimal amount in an MPR Transaction because the items normally included in this line will be included in the CNA (and funded from the reserve post MPR).
3. **MPR Operating Cushion.** An allowance, built into the basic rents over and above the allowed RTO should allow the property to absorb normal income and expense fluctuations without needing to dip into the reserve.
- a) **Greater than Normal Cushion.** Increase the cushion when the project is especially vulnerable to revenue and expense fluctuations.
  - b) **Lower than Normal Cushion.** Decrease the cushion when the property has an especially strong history of operational stability, low vacancy and a strong operating cash balance.
  - c) **Cushions and RD Form 3560-7.** In the post MPR proposed operating budget, the cushion should appear on Part I, Line 30. Underwriters should consider budgeting a cushion only if the property is not generating surplus cash taking into consideration a and b above.
  - d) **MPR Cash Flow.** The Agency underwrites all MPR Transactions to allow for a positive cash balance on line 30 of the Operating Budget. The maximum cash balance on line 30 is 10 percent of the proposed O&M expenses. In determining what reasonable cash balance is for the property, the underwriter will consider the balance in the GOA. When the GOA is between 15 percent - 20 percent of the O&M expenses, the cash balance should not exceed 5 percent. If the GOA has a balance of 10 percent or less of O&M, 10 percent may be reasonable.

4. **Accounts Payable**, if the property has outstanding accounts payable (over 30 days old), the underwriter should include a solution in the proposed transaction narrative page. If any tax escrow or insurance escrow accounts are under-funded, the underwriter should consider the under-funding because under-funded escrows are additional accounts payables. Solutions could include payment of the excess payables by the borrower.
5. **Sustainable Funding for Capital Needs**. The reserve account is a key factor to ensure the physical viability of the property. Determine the appropriate mix of funding to address long-term capital needs identified in the CNA. After MPR, the property should be able to meet 100 percent of its expected long-term capital needs from the reserve, without needing operational resources such as rent increases above the rate of inflation and without needing new funding such as supplemental loans.
  - a) **Agency Review of CNA**. Agency review and acceptance of the CNA must be completed prior to beginning the capital needs portion of the underwriting process. The Agency instruction for CNA reviews is found at: <http://www.rd.usda.gov/programs-services/housing-preservation-revitalization-demonstration-loans-grants>. Adjustments to the CNA tables during underwriting are documented in the underwriting tool. Underwriters do not make any changes to the accepted CNA, which remains in the Agency's files. Underwriters should recognize that the CNA (and the Agency's CNA review) and any agreed upon scope of rehabilitation may call for changes in the O&M expenses and will be documented in the UWT narrative.
  - b) **Sources of Funding**. Reserve funding sources include the existing Reserve balance, any upfront IDRR being required to be made at the MPR closing, future Reserve deposits and interest earnings.
  - c) **Inflation Assumptions**. The NOFA/NOSA assumes there will be increased costs over the term of the MPR at pre-determined percentage rates each year. The most current rates are set out in the most current UWT that is posted to the Agency websites. Refer to the latest tool's instructions, thresholds and CNA sheet for additional guidance.
  - d) **Mix of IDRR and ADRR** - A property's 20-year capital needs can be met through many different combinations of an upfront IDRR and ADRR. Underwriters should select a combination that is appropriate given the particular transaction's characteristics, including:

- 1) **Impact on Rents and RA.** Use the combination that results in the lowest level of basic rents and minimizes RA costs.
  - 2) **Likely Future Needs.** Generally, the ADRR should reflect the most likely long-term level of capital needs, so the property will be adequately positioned for sustainability following the 20-year analysis period.
  - 3) **Availability of Funds.** A strategy that requires a significant IDRR can be adopted only if sources of funds are available to make the IDRR and if it is more cost effective to utilize those funds than to utilize an alternative strategy that does not require an IDRR. Generally, this strategy is preferred when significant equity is involved.
  - 4) **Annual Reserve Balances.** The annual projected reserve balances will be projected in sufficient amounts to reflect a positive year-end cash balance each year in the underwriting reserve analysis 20-year cycle at the time of approval. If the amount that would cause the required project rents to exceed the greater of the current LIHTC rents or CRCU, the IDRR should be increased and the ADRR should be decreased.
  - 5) **Third-Party Reserve Requirements:** For any transaction that includes third-party funding, the underwriter should discuss RD reserve funding requirements as well as reserve uses early in the process to avoid misunderstandings and assure RD program requirements are being followed throughout the term of the loan.
- e) **Impact on Rents and RA.** In approving MPR Transactions, the Agency carefully considers the impact on RA costs and prefers approaches that minimize RA cost. Some MPR Transactions require significant increases in basic rents to ensure the property is financially stable. Basic rents shall not increase by more than 10 percent in any single year. A rent increase may be phased in over a period not to exceed three years and the total rent increase needed should not exceed 30 percent. Any rent increase should be the minimum required for the property to cash flow. Rent increases for transfers selected for the MPR will be considered on a case-by-case basis.
- f) **Viable Rents.** Basic rents must be set at the rate to support the property's long-term viability but low enough to be affordable to tenants and to be competitive in the local rental market.

- g) **Rent Decreases.** Generally, rent decreases are implemented immediately and are not phased in.
6. **Mix of MPR tools.** The MPR Demonstration program includes a variety of financial tools for making properties sustainable. *The underwriter should propose the best mix of tools for the specific property taking into account the factors discussed below.*
7. **List of MPR Tools.** The following is a brief description of the MPR tools that have been authorized by Congress for the MPR Demonstration program (FY 2005 through FY 2014).
- a) **Debt Deferral.** Generally, MPR Transactions should utilize a debt deferral to reduce debt service of any MFH loan obligated prior to October 1, 1991 under the terms of the respective MPR NOFA/NOSA under which the project was selected. Debt deferral allows basic rents that previously funded debt service to be used for increased reserve deposits, a reduction in rents or other purpose as may be authorized in the applicable NOFA/NOSA
  - b) **Supplemental Section 515 Loans.** MPR Transactions may include supplemental Section 515 funding. This funding is typically used to meet capital needs whenever doing so will result in a debt service that keeps basic rents at or below CRCU and are otherwise affordable.
  - c) **Grant.** A small amount of grant funding is available to non-profit owners and may only be used to fund immediate health and safety issues identified in the CNA. *Generally, underwriters should propose this funding for eligible transactions when funds are available and for those transactions that cannot afford additional debt service without raising rents over CRCU or that would cause a greater negative impact on current tenants.*
  - d) **Soft Second Loan.** A loan with a 1 percent interest rate, with all debt service deferred for the remaining term of the longest currently existing Agency loan. See the discussion in B.8 below for situations in which this MPR tool may be appropriate.
  - e) **Zero Percent Loan.** A loan having a 0 percent interest rate, a 30-year term and is amortized over the maximum term provided in the NOFA/NOSA for the specific MFH program type. This funding maybe used when the debt service of a Supplemental Section 515 loan will require an increase in basic rents to or above CRCU.

## 8. Other MPR Considerations.

- a. **Use of the Soft Second Loans.** Less frequently, transactions with up-front cash needs (that cannot be covered from available third-party funding) will use the soft second loan tool to meet some or all of the project's needs. This MPR tool is appropriate for use when there is an especially strong reason to minimize the post-MPR basic rents. Underwriters should not propose this MPR tool unless (a) the project has a significant number of non-assisted tenants that are currently rent overburdened and (b) there is an especially strong reason to minimize basic rents.
- b. **Maturing Mortgages.** The Agency recognizes that a number of Section 515 and Sections 514/516 properties are financed through mortgages scheduled to mature through calendar year 2018. The Agency will make an MPR debt deferral available to properties with all Agency mortgages maturing on or before December 31, 2018, in order to extend the affordable use of the housing and continue its eligibility for Section 521 Rental Assistance. Notwithstanding any other provisions of this Notice, applicants applying for a deferral of their eligible mortgage debt will be required to meet the eligibility requirements in either 7 CFR 3560.55 or 3560.555, as determined applicable by the Agency.

### B. MPR and Transfers:

1. MPR tools must not be used in transfers selected for the MPR program to size the allowable RTO, determine maximum debt service coverage for eligible RD direct loan program purposes, or compute maximum allowable equity.
2. MPR transfers selected under the NOFA/NOSA without additional debt, **NO** change to RTO or equity payout authorization may be processed as a single combined transfer/ MPR Transaction.
3. MPR transfers primarily benefit from use of the MPR debt deferral tool. When determined necessary and appropriate by the MPR Loan Review Committee, additional tools may be offered on a case-by-case basis when permitted under the MPR NOFA/NOSA to further benefit the tenants and promote the long-term viability of the revitalization efforts.

4. For MPR Transactions, a separate, stand-alone RUC is required and is generally recorded ahead of any other liens or restrictions approved for the transaction. The term of the RUC is set out in the MPR's NOFA/*NO SA*. States need to use as directed, the MPR documents available on the RD intranet (SharePoint) site <https://mfhdemoteam.sc.egov.usda.gov/MPR2009/default.aspx>. MPR applicants and borrowers may contact their respective RD State Office for more information.