U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

AUG 11 2015

MEMORANDUM FOR: All Multifamily Regional Center / Hub Directors
All Multifamily Satellite Office / Program Center Directors
All Multifamily Operations Officers

FROM: Benjamin T. Metcalf, Deputy Assistant Secretary for Multifamily Housing Programs, HT

SUBJECT: Financing HUD Assisted Living Conversion Properties (ALCP) Using Multifamily FHA Mortgage Insurance

Purpose

The purpose of this memorandum is to delegate to the Ft. Worth Multifamily Regional Director commitment and processing responsibility to allow recapitalizing Section 236, 202, and 202/8, Direct Loan senior properties with Assisted Living Conversion Program (ALCP) grants to use FHA Section 223(f) refinancing or Section 221(d) (4) substantial rehabilitation programs.

Background

Since 2000, the Department has provided ALCP grants to over 80 HUD senior facilities allowing low-income seniors to age in place while receiving affordable assisted living services. While many HUD 202 Direct Loan properties have benefited from FHA financing to recapitalize and preserve elderly subsidized properties, multifamily mortgage insurance programs have not been available to those projects with ALCP grants.

Waiver Process

The Multifamily Accelerated Processing (MAP) Guide will be revised to incorporate the provisions of this memorandum. Until the MAP Guide is revised, MAP Lenders may submit loan applications with requests to waive Section 3.4.S. or 3.9.D of the current MAP Guide. Waivers of the prohibition on assisted living services in multifamily properties will only be considered for projects which have received ALCP grants from HUD with less than 75% of the units and residents receiving such services. MAP Lenders should submit applications to the Multifamily Hub or Regional Center Production Office with geographic jurisdiction over the project. The Multifamily Hub or Regional Center Workload Sharing Coordinator should transfer the application to the Ft. Worth HUD Office, attention: Thomas L. Goade.

Points of Contact

The local HUD office will provide for technical support including site visits, environmental review, and Asset Management review. Underwriting guidance is included as a technical attachment.

Please contact Thomas A. Bernaciak at (202) 402-3242 or Mark C. Wiesendanger at (202) 402-6696 if you have any questions about this memorandum.

ATTACHMENT: Underwriting Considerations for Recapitalizing ALCP Properties Using FHA Multifamily Mortgage Insurance Programs

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<u>Underwriting Considerations for Recapitalizing ALCP Properties Using FHA Multifamily Mortgage Insurance Programs</u>

A. General Provisions.

- Transactions which are Section 202 properties with project-based Section 8 rents on a property with ALCP units are exempt from restructuring under MAHRA (for the first re-financing). If the Section 8 contract rents are materially above market, the proposed loan amount needs to be stress tested at market to ensure at least 1.0 Debt Service Coverage.

- Underwriting income and expenses, including the appraisal requirements, should consider all of the units as if independent living and will not be based upon assisted living units.

- Underwriting of either 223(f) or 221(d)(4) sub-rehab loans on properties with ALCP units should be based upon the income and expenses as a multifamily property following the underwriting rules of the multifamily programs, including the Section 202 refinancing programs.

- The presence of ALCP units should be considered an amenity as the property has units that will allow aging residents to remain in the building.

- HUD Section 236 projects with ALCP units should be underwritten under the current HUD Section 223(f) program with the income and expenses based upon rental housing.

- Unassisted units within the project, if applicable, shall be processed at market rent. The processing rents used for the project-based Section 8 assisted units will be the current or to be adjusted Section 8 contract rents for the project, even if the contract rent is in excess of the market rent.

- In the absence of sales of assisted properties with which to draw a comparison, capitalization rates may be derived using a band of investment and the Section 8 contract and any favorable financing specific to the application may be factored into the rate analysis.

- Non-shelter spaces already constructed for projects with current insured mortgages may include formal dining areas with meal services if they are provided to residents.

B. Mitigation to Risk of Assisted Living Services:

- The underwriter's narrative will include an analysis of the operation of the assisted living units, including a limited review of the experience/capacity of the care provider and an evaluation of the funding sources.

- The analysis will address the services that are being provided to tenants in the assisted living units. This analysis will include an examination of the income and expenses attributable to the services. However, the income and expenses will not be included as part of the Appraisal or forms HUD 92013 or HUD 92264. Since the service income and expenses are not part of the property's realty operations, the service income and expenses should be analyzed separately from the realty income and expenses.

- In some circumstances, where the ALCP renovations have recently been completed, there may be no operating history available to provide a meaningful review. In other circumstances, where the service provider may serve multiple properties, an analysis of the income and expenses for services may not be feasible. For these reasons, while the underwriter should address the income and expense to the extent feasible, it should not be a requirement of the Section 223(f) loan.

- The income and expenses attributed to the property and included in the loan underwriting will be based on the annual audited and internal financial statements for the Mortgagor entity, and the Section 8 budget and Section 8 rent schedule. The Appraisal will also be based on the property's income and expenses without including the services.

- The underwriting will include an analysis of the possible impact to the project of the reduction or elimination of the funding for the assisted living services to an extent where providing assisted living services is no longer feasible. The "stress test" analysis will address what operating deficit escrow would be reasonable to fund the costs related to transitioning the assisted living units back to independent living units.

- The PCNA report would include any major moveable equipment associated with the assisted living program in the repair and reserve analysis, and must include a separate analysis of any costs associated with converting the property to full multifamily use. An escrow will be established at closing for any conversion costs (within the replacement reserve fund).

C. A (3) month debt service/operating reserve shall be considered on a case by case basis, designed to mitigate any financial costs associated with the transitioning the existing residents out of the facility and then re-leasing of units to independent elderly, dependent upon the number of assisted living units which are in place. (Example: a recommended operating deficit would likely account for any vacancy loss created during any future transition from assisted living back to independent living. It would also account for the minimal cost of physically modifying the units back to an independent living standard).

D. Mortgagors who provide services must form a separate, entity for the provision of the services.

E. Physical Condition/ REAC scores must exceed 60.

Waivers

The MAP Firm Commitment Application would require the following waivers of the MAP Guide:

- **Section 3.9.D** Elderly developments. Existing projects specifically designed for the elderly, age 62 and over, are eligible under Section 223(f) as long as the property does not contain the features of the Section 232 program described in Section 3.4.S.
- **Section 3.4.S** Elderly Developments. New construction or substantial rehabilitation of apartments specifically designed for the elderly age 62 and over, as defined by the National Housing Act, should be processed under Section 231 which allows a project to restrict its use and occupancy to elderly residents only.

Waiver requests on a HUD-2 may be approved by the Ft. Worth Multifamily Regional Director, and should cite the following language and reference this memorandum:

> The prohibition on services and licensure discussed in this sub-section does not apply to formerly or currently HUD-held or FHA insured multifamily projects which received Assisted Living Conversion Program Grants for less than 75% of the units.