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HUD Section 202 affordable elderly multifamily properties refinancing opportunities

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Rockport Mortgage Corp. (RMC) is one of the largest originators of HUD/FHA insured project loans nationwide, and the largest originator in New England.

During the last 5 years, RMC has refinanced 55 HUD 202 projects in 21 states at a cumulated loan amount of almost $180 million. Section 202 projects have been the federal government's principle vehicle for the production of affordable elderly multifamily housing since 1959. Since its inception, approximately 207,000 units of affordable senior housing have been developed.

During the 1977 to 1990 period, these projects were financed with 40 year direct federal loans at the then prevailing interest rates, with most of them at rates of 9% or higher. Until 2002, there was not an effective way to restructure the original financing on these projects and reduce the burdensome interest rates.

Further, there was no mechanism to address the many capital needs of the projects in regard to funding necessary repairs, replenishing depleted replacement reserve accounts, and funding supportive services for the elderly population aging in place.

There are over 2800 Section 202 properties whose owners may be able to obtain significant benefits by refinancing through the HUD 202 Prepayment Program. These benefits included reduced mortgage payments, increased cash flow, upfront funding for capital improvements and replacement reserves, a developer's fee, and increased supportive services for project residents.

In November 2004, HUD implemented changes to the existing Section 202 prepayment program outlined in Notice 2002-16 to improve the economics of such refinancing transactions. These amendments can be found in HUD Notice 04-21.

The following provides a summary of the key aspects of HUD's newly improved Section 202 Prepayment Program.

For all transactions regardless of how refinanced:

* At least 50% of the savings must be used to benefit the residents;
* A portion of savings may be used to increase supportive services for residents;
* Refinancing proceeds can be used for capital improvements and replacement reserve funding;
* Excess replacement reserve funds can be used to build an addition, assisted living facility, community center, etc.;
* A use agreement must be signed to maintain affordability through the original mortgage maturity;
* The sponsor can now be either a Section 501(c)(3) nonprofit or a non-profit controlled limited partnership formed to obtain tax credits.
* Developers of LIHTC projects can earn a developer's fee equal to the lesser of 15% of eligible basis or the state LIHTC requirement;
* Developers of non-LIHTC projects can earn a developer's fee equal to 15% of rehabilitation costs;

and
* Owners of LIHTC project can earn an annual distribution equal to 6% of tax credit equity.

For projects refinancing with FHA Insurance, the following additional benefits apply;
* Section 202 projects maintain their Mark to Market exemption status - that is, Section 8 rents can be above market comparable rent levels without any risk of mortgage restructuring.
* Existing Section 8 rents can be used in the underwriting - even if they are above market comparable levels;
* Section 223(f) loan terms are revised to allow for loans up to 90% value and 1.1 debt service coverage;
* Appraisers can use a band of investment approach in determining value which will result in lower cap rates and higher values;
* Existing HUD-approved meals programs can continue; and
* When a mortgage is debt service constrained, lenders can finance against tax abatements that run only with the sponsor.

An example of New England 202 project RMC refinanced with HUD
As can be seen, this project required extensive capital improvement and was refinanced under the HUD 221d(4) program, with tax exempt bonds and 4% low income tax credits.
New Canonchet Cliffs
Hopkinton, R.I.
RMC provided financing of $6 million under the HUD 221(d)(4) program for New Canonchet Cliffs Apartments. The FHA/GNMA guarantee provided the credit enhancement in tax exempt bonds issued by the Providence Housing Authority. The project financing also involved 4% low income tax credits. The project previously consisted of two 202 projects. This loan will provide financing for the substantial rehabilitation of the 114 unit project.
Clearly, the refinancing of Section 202 projects, utilizing the HUD/FHA programs, can be a win-win outcome for the projects and the tenants. Further, no rent increases are required, so there is no additional cost to the federal government.
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