



# HB3-3560, Chapter 7 Overview

**CHAPTER 7: TRANSFER OF  
OWNERSHIP**

**7 CFR 3560.406**

**Industry Interface Call**

**April 19, 2017**

# Goal

Streamline process to support the Transfer Improvement Project, update policies to more closely adopt industry standards, eliminate redundancies, clarify program requirements, and correct oversights and omissions.

# Accomplishments

- Shortened timeframe for RD reviews
- Clarified minimum acceptable submission
- Implements use of Preliminary Assessment Template (PAT)
- Uses industry standards when appropriate
- Recognizes allowable industry practices
- Promotes loan making and servicing cooperation

- Eliminated redundant forms and information submissions
- Clarified responsibilities for RD and Applicant
- Expanded opportunities to access available RD servicing tools
- Emphasized Agency preservation goals
- Considered internal and external customer comments and limitations

# General

- Applies to all RRH and FLH Transfers
- Provides Guidelines and Direction to Staff
- Requires Eligibility and other determinations
- Relies on HB1-3560, Chapters 4 and 5
- Requires Underwriter & Servicer Cooperation
- Clarifies Objectives and Responsibilities
- Establishes Goals and Timelines
- Establishes use of PAT for documentation
- Requires Agency Prior Consent and Approval

# Authority

- Loan Agreement/Resolution

- Regulatory Covenants

- So long as the Loan Obligations remain unsatisfied, the Borrower shall comply with all appropriate regulations of the Government and .....
    - Unless the Government gives prior consent:
    - 1) Not use the Housing for any purpose other than as rental housing and related facilities for eligible occupants.
    - 2) Not enter into any contract or agreement for improvements or extensions to the Housing or other property securing the loan obligations.
    - 3) Not cause or permit any transfer or encumbrance of title to the Housing or any part thereof or interest therein, by sale, mortgage, lease, or otherwise.
    - 4) Not borrow any money, nor incur any liability which would have detrimental effect on the Housing.

# Regulation

- §3560.406 MFH ownership transfers or sales
  - applies to ownership transfers or sales (e.g., title transfers) involving an Agency financed housing project. The provisions cover situations where Agency loans are being assumed as a part of a housing project transfer or sale.
- §3560.407 Sales or other disposition of security property
  - must obtain Agency approval prior to selling or exchanging all or a part of, or an interest in, property serving as security for Agency loans

# Resources

- Website
  - <https://www.rd.usda.gov/programs-services/multi-family-housing-direct-loans>
- CFR
  - <https://www.ecfr.gov/cgi-bin/text-idx?SID=5e8f4ad77dd162fd10ae34935ea54a83&node=pt7.15.3560&rgn=div5>



# Objectives

- Must be in best interests of Gov't & Tenants
  - ✓ Improve & maintain physical & financial viability within reason
  - ✓ Improve & maintain affordability for RD eligible Tenants
  - ✓ Improve & maintain consistency in application processing and review
  - ✓ Provides consistent framework for working with transaction funding partners throughout the process (state agencies, third party funders, investors, etc.)

# Definitions

- Transfer – Any change in ownership that:
  - Places title in a new owner's hands
  - A new owner assumes liability for the debt,
  - There is a change in the ownership entity that is commonly considered to create a distinct and separate entity from the original borrower including a new IRS tax number or resulting in 100% of the ownership interests being transferred within 12 consecutive months,
  - Is not excluded by the limited servicing exceptions in HB3-3560, Chap. 5,
  - or is required by loan documents

# Conditions for Transfers

- Revitalization
- Remove Hardship
  - Serious Illness or Death
  - Financial difficulties beyond borrower's control
  - Maintain affordable rents
- Court Order
- Alternative to Prepayment
- Best interests of Government & Tenant
- Preservation

# Other Conditions

- Unauthorized transfers constitute defaults
- If a project has a RD-Approved workout agreement and an IOI transfer is proposed, the transferee must be in compliance with the agreement.
- Transferees must be in compliance with RD requirement, including any outstanding work out agreements they may have on any other RD properties.

# What is Underwriting?

- It is a process used to determine the operational and financial feasibility of the transaction using the principles, standards and guidelines established by RD.
- It includes applicant eligibility, program compliance (including environmental, fair housing, etc.) specified in all applicable statutory, regulatory, handbook and guidance publications.

# CRCU

- Set using RD – approved appraisal
- Area Market Rent Survey (AMRS)
- When no appraisal is required and transfer is at same rates and terms, no additional senior debt is added, no subordination, no change in authorized RTO, and there is no ARMS alternative methods may be used as described in HB3-3560, 7.7 B 3.
- N/O HQ PDL D approval required for any transfer in which Post-Transfer rents exceed CRCU

# Policy Considerations 7.7 Rents

- Budget/ Reasonable Rents
  - Transferee provides info on market if rent increase is proposed
  - Basic rents not be higher than the lesser of CRCU or restricted rents
  - If higher, transferee must fund cash escrow for any amount above basic rent from non-project & non-amortizing sources (Initially for first 2 years and indefinitely as needed for life of RD loan)
  - No increase in RTO or Equity financing
  - Approved by NO on case-by-case
  - Eligible uses defined in HB1-3560 and CFR
  - Effective date = completion of approved repairs/rehab

# LIHTC and Basic Rents

- Rents are set in Chapter 7, HB2-3560
- Basic rents are set at a level necessary to provide for the physical and financial viability of the project.
- Basic rents may be higher or lower than maximum LIHTC
- Borrowers must cover any amount of shortfalls when LIHTC rents charged that exceed the basic rents from RTO or other non-project resources



# RTO - General

- Maximum Potential RTO based on net cash flow using PAT
- Considers amount of LIHTC equity used for eligible hard costs of construction
- Considers any additional owner contribution for hard construction costs
- Set for term of loan
- May not exceed amount remaining from NOI less RD debt service without debt deferral.

# Setting RTO

- Formula driven in PAT to establish a maximum potential \$ but it may not be achievable based on underwriting standards and thresholds, allowable rents, etc.
  - 515 eligible rehab costs less the total debts must not exceed RD security value
  - Uses Net Operating Income (NOI) less total debt service without deferrals
  - NOI must cover 1.15 Debt Service Coverage Ratio (DSCR) when RD recognizes equity
  - Used project post-rehabilitation budget (expenses and rents)
  - Must be achievable based on the information provided and analyzed and limitations established for the project
  - RTO does not set the rents being allowed

# RTO and LIHTC

- Based on Cash (not loan proceeds) invested in hard costs of construction
- Calculated using PAT
- RTO for transfers differs from RTO calculations for RD Prepayment transactions under Chapter 15, HB3-3560
- RTO is not the same as ROI for new construction in original initial development
- RTO language inserted in RD Loan Agreement/Resolution

# Sales Price

- No limitation on sales price paid solely with assumption of debt plus any non-RD funds that do not affect basic rents
- All others consider lesser of:
  - Present Market value of real estate plus balance of RD reserve account, or
  - The sales price that can be supported with in CRCU

# Equity Payout

- Equity payout averts prepayment and removal of needed affordable units
- Equity Sources not affecting basic rents generally have no limitation
- Equity Debt only on PREPAYMENT processed under Chapter 15, HB3-3560
- Equity from 3<sup>rd</sup> Party debt paid with rents
  - Limited by appraisal or CRCU
  - Restrictive use has not expired and new period

- Buyer/seller/cash flow notes
  - Not paid from rents
  - No lien on project, rents, etc.
  - No present or future interest or claim in the property income or assets being sold or relinquished
  - No reversionary interest during term RD loans remain outstanding

- Use of Equity Loan Proceeds not permitted if:
  - RD debt not assumed
  - Prior non-agency liens not paid in full
  - Required project accounts not properly funded
  - Management, operation and/or maintenance deficiencies not being corrected.
  - Borrower entity cited for violations of Fair Housing or Equal Opportunity requirements without HQ consent.
- If repairs are required must have Repair Agreement

# Equity Payout during Unexpired RUP

- No equity paid from USDA loan funds
- May use other 3<sup>rd</sup> party funds if transfer meets program requirements
- RD cannot consider prospective value of conversion to market rents with 10 or more years remaining on RUP
- Appraiser uses discounted cash flow to reflect regulated use thru the end of the RUP



# Non-Equity Compensation

- If there is no equity in project
- Buyer chooses to pay more thru mutual agreement with seller
- RD concurs under 7.29 F
- Is first applied to satisfy non-RD claims

# Developer Fees

- Payment of developer fees not RD eligible use of loan funds except in GRRH 538 loans
- May recognize up to 15% of total development cost for rehabilitation authorized for LIHTC
- Limited to 8% of the acquisition costs authorized
- Developer fees not included in RD maximum debt limits or loan amount calculations
- Deferred Developer Fees cannot be paid from operations but may be paid from authorized RTO
- Deferred Developer Fees are not loan payments and cannot be paid from operations.

# Other Important Definitions

- Debt Deferral – Only available with MPR
- Exit Incentive – Incentive compensation paid to a seller to facilitate a transfer to an eligible owner when there is no equity and it is in the best interests of the Government & Tenants
- Identity of interest - 7 CFR3560.102(g)
- Key Principle – the party involved in the organization decision-making and operational control

# Road Stops Along the Way

Stop 1 – Applicant contemplates sale

Stop 2 – Contacts RD

Stop 3 – Preliminary Meeting

Stop 4 – Applicant delivers complete application

Stop 5 – Servicer & Underwriter Cooperate

Stop 6 – Field determines eligibility

Stop 7 – Underwriting is completed

Stop 8 – Authorization & Approval

Stop 9 – Closing & Completion

# RD Responsibilities

## Field/State Office

- Point of Contact and initial preliminary/conceptual meeting
- Eligibility of applicant, project, etc.
- Identify potential problems, issues, and objectives
- Application guidance/collection and managing expectations
- Coordination internally, and with applicant and borrower
- Reviewing to meet program requirements
- Processing
- Underwriting
- Evaluation to meet program thresholds and restrictions
- Recommendations and alternatives
- Closing
- Completion including Construction
- Servicing
- Electronic tracking in the RD systems

## National Office

- Policy, Oversight, training, authorization

# Applicant Responsibilities

- Applicant
  - Complete, timely and accurate information to all the participants
  - Adequate documentation
  - Revisions, clarifications and changes
  - All business decisions
  - Coordination with any third party participants
  - Evaluating, Accepting and Implementing recommendations
  - Update information throughout the process

# Coordination

- Complex issues may require consultation between State Office and National Office HQ
- Simple transfer processing should be handled locally thru communication amongst all the parties to assure speeding processing
- All eligibility determinations and application documentation made at S/O level
- N/O HQ may assist in completion of PAT
- N/O HQ may concur with S/O recommendation, issue justified exceptions and waivers for ultimate approval by State Director as described in HB.

# Guiding Principles

- RD Regs, Handbooks and Guidance
- Document file and underwriting analysis
- Preliminary Assessment Tool (PAT) documents the transaction and aids in the analysis of the proposal: It is part of the underwriting process and triggers information from the applicant, underwriter and servicer that is necessary to complete the transfer process such as:
  - Is there a continuing need for the housing?
  - Will it be owned by an eligible owner?
  - Will Immediate & long-term physical needs met?
  - Will rents displace tenants?



- What type of rent determines the income stream and is it achievable?
- Is equity supported by market value appraisal?
- What is the RD recognized equity?
- What if there is no equity?
- Is there Equity or an Exit Incentive?
- When is National Office concurrence needed?
- Are third party resources being used to benefit the transaction?
- What is the impact of Section 8 rents?
- What will the new RTO be?

# PRELIMINARY TRANSFER THRESHOLDS

- Used to provide guidance and consistency
- Intended to balance needs of the Agency and customers
- Maintain affordability for RD eligible tenants
- Provide discussion points for applicants, underwriters, and servicers
- Identify issues and obstacles early on
- Create a pathway that can be followed to complete the transfer process

# 13 Threshold Keys

- Restrictions on Post-Transfer rents (lesser of CRCU or LIHTC/restricted rents)
- Rents sufficient to cash flow in proposal
- Maximum allowance for vacancy & bad debt
- Minimum operating expenses required
- Minimum General Operating Account (GOA)
- Tenants must be protected for as long as the RD loan remains outstanding
- Minimum CNA funding & reserve amounts
- New loans must be for eligible 515 purposes

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- Debt Service Coverage Ratio analysis for RD
- All debts secured w/in RD prospective improved Security Value
- No 3<sup>rd</sup> Party balloon notes during RD loan term
- All Sources and Uses must balance
- Applicant must be able to fund projected shortfalls from outside resources other than project resources or project

# Analytical Concepts

- Meet RD Objectives
- Gather and review sufficient information provided by applicant AND records
- Underwriting is a process
- Evaluate applicant
  - Financial Capacity & credit worthiness
  - Experience to own & manage property
  - Compliance abilities
  - Decision making abilities

# Eligibility

- Treat every applicant as a new applicant –  
Review HB1-3560 and evaluate:
  - Financial Capacity
  - Credit Worthiness
  - Experience
  - Incidence of ongoing adverse business dealings
  - Document explanations of negative, incomplete and insufficient information
  - Verify Need and Demand for the project

# Evaluating Feasibility

- Use PAT
- Identify & address all compliance issues
- Identify & address all repair issues
- Identify & address all 3<sup>rd</sup> party funding issues
- Understand tenant impacts
- Reasonable rents and budgets
- Sales price and equity payout
- RD loans
- Other issues

# Risk Levels

- Financial
- Operational
- Does the transaction reduce, maintain or improve the degree of risk RD and the tenants will have if the transaction is approved?
- As proposed does it or will it conflict with respective program loan origination and servicing principles.



# Transfer Processing

- Exhibit 7-1 Shows the Key Steps
  1. Applicant completes preliminary analysis & schedules consultation with Loan Servicer
  2. Initial Consultation with all parties
  3. Applicant turns in transfer application & RD begins review w/in 14 days of receipt.  
(Incomplete applications are returned.)
  4. Request Underwriter Review: Provide status update every 30 business day. Maintain program status tracking on SharePoint

5. When complete application has been viewed submit to NO for authorization within 10 business days
6. Communicate Agency Decision within 45 business days for individual property and 75 for multiple properties
7. Approval Conditions letter from SO sent to applicant within 15 business day for acceptance by applicant
8. Coordinate Closing Instructions and OGC Document approval
9. Schedule and Close Transaction
10. Complete post-closing review and verification

# Topics for Initial Consultation

- Entity and principles
- Eligibility Requirements
- Site Control
- Appraisal Requirements
- Capital Needs Assessment
- Scope of Work
- Applicant's Feasibility Analysis
- Letter of Support

# Application provided by Applicant

- A transfer triggers a servicing action.
- Servicer updates agency records including MFIS.
- Upon receipt of the transfer package, the servicer WILL establish the transferee as a new account in AMAS.
- Servicer/underwriter established and updates MFH Transfer Tracking System
- Servicer/underwriter checks MFH Main Index to find current links to tools and resources
- Goal = full evaluation of complete applications
  - 45 business days for one property
  - 75 business days for 2 or more properties

# Impact of New Debt Service

- Basic rents should not increase until rehab completed and accepted by RD
- Debt service on new interim or bridge loans will not included in Basic rents
- Interim rent increases may be considered for that portion of permanent debt used to pay acquisition equity only if not funded with interim or bridge construction funding

# Other Policy Considerations

- Principal and Interest during construction may not be paid from project operations
- Transactions with multiple sources of funds are subject subsidy layering requirements
- Transferee applications for other funding sources must be disclosed
- Final cost certifications and audits should be provided to RD

- Know all the timetables involves
- Know terms of other funders transaction (rates, terms, conditions, requirements, etc.)
- Other reserve requirements placed on transferee by funders
- Understand purposes and disbursement requirements
- Deal with conflicting requirements up front

