

Section 8 Mark Up to Market Transfer (MUM-T): A useful tool for non-profits buying at-risk properties

(Notice H 2000-21 as updated by the Section 8 Renewal Guide)

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Summary

With the publication of Notice H 2000-21 and updates in the Section 8 Renewal Guide, HUD has defined a variation of Mark Up to Market (MUM, as it has become known in the lexicon) by modifying MUM for transfers *specifically to non-profits* (MUM-T). Because eligibility criteria for MUM-T are significantly more liberal than for MUM-profit, owners seeking to realize value may be encouraged to sell to non-profits and non-profits may be more able to buy.

Background on Mark Up to Market (MUM)

Originally introduced in HUD Notice 99-36, MUM Transfer has been further clarified and improved in HUD Notice 2000-21 and the Section 8 Renewal Guide. The positive changes incorporated in the new guidance clearly reflect HUD's MUM experience to date, where few MUM sales were occurring, and show thoughtful consideration of concerns and suggestions by preservation-oriented industry members. MUM-T enables non-profit owners to fund acquisition, capital improvements, and an equity return by offering increased Section 8 rent levels to *post-rehab* market rents upon transfer.

Eligibility

HUD considers properties with the following characteristics as eligible for participation in the MUM Transfer Program:

- Expiring property-based Section 8 (other than Section 8 Moderate Rehab Contracts administered by PIH or Section 8 Moderate Rehab SRO Contracts administered by CPD).
- Acceptable non-profit owner (as defined by HUD; for this purpose, an LIHTC limited partnership with a non-profit as controlling general partner is considered a non-profit).
- Current rents below market as determined by a HUD-reviewed Rent Comparability Study (and post-MUB rents at or below market).
- Unaffiliated current and prospective owners.
- Any existing use restrictions are unrelated to ELIHPA or LIHPRA Recapitalization.

MUM-T for non-profits is similar to MUM for-profit *except* that many more properties will be eligible. For-profit owners seeking MUM must demonstrate that:

- Comparable market rents are at least 100% of FMR
- The property's current REAC score is 60+, *and*
- The owner has the legal ability to go market (e.g. no LIHPRHA Use Agreements).

None of these conditions are required under MUM-Transfer.

While the MUM program for profit-motivated owners will prevent owner opt-out in the short term (generally five years), MUM-T provides HUD and the residents with a much better result – affordability for at least *twenty* years, and if one presumes the non-profit has an affordability-oriented mission, the possibility of affordability in perpetuity.

Why MUM?

Unlike the more time-consuming Mark Up to Budget rent increase process for non-profit owners, non-profit purchasers can:

- Obtain Section 8 rents at *post-rehab* market rent levels upon transfer. In effect, the property can better operations by borrowing to fund rehab, supported by a MUM rent increase that is in turn achievable because rehab improves the property.
- Complete major capital improvements and recapitalize replacement reserves *without* submission of a PCNA and HUD approval of the rehab scope;
- Possibly improve its Section 8 renewal prospects by electing a 5-year or 20-year contract. (Of course, both contracts are subject to annual congressional appropriations, so the reliability of the longer term is at least questionable. Nevertheless, lenders seem to take comfort in the longer-term contracts so they may well be easier to finance against.)
- Have a chance to raise future rents beyond the OCAF by submitting a new Rent Comparability Study (RCS) if market rents have risen.
- Generate *and distribute* a cash flow distribution equal to 6% of defined equity where the HUD-insured mortgage is kept in place. If the HUD-insured mortgage is prepaid as a result of the transfer, then the distribution limitation is governed by the new financing or the existing Section 8 contract.

How to MUM-T

To apply for a MUM-T the non-profit purchaser (or the owner) must submit:

- Evidence of site control (a purchase and sale or equivalent)¹;
- Rent Comparability Study (RCS);
- A letter of intent from the current owner to sell the property to an eligible non-profit; and
- A TPA Application if the HUD mortgage remains in place.

¹ Not specifically required by the guidance, but seems implicit in determining property eligibility.

Section 8 Rent Increases

As for profit-motivated owners, the MUM-T rents are capped in several ways:

- *Local market.* HUD must find that the post-MUM rents are at or below market. To do this, HUD will commission its own RCS and will reconcile HUD's RCS with the owner's RCS. HUD's decision is final.
- *150% of FMR.* Post-MUM rents are generally capped at 150% of FMR (but HUD can waive that ceiling in some cases, although we find it hard to imagine this will arise often.)
- *MUM rents reduced by current debt service savings.* To prevent properties from being effectively over-subsidized, market rents will be reduced by any debt service savings attributable to the HUD mortgage, that is either (i) the Section 236 IRP payments or, (ii) in a 221d3 BMIR, an imputed debt service subsidy calculated by HUD based on the difference between the current constant (at 3%) and a market-rate constant.
- *Future rents set by OCAF.* In later years, post-MUM rents will rise generally at OCAF (although, as noted above, owners can submit new RCS's to recoup lost ground).

Since this is a new *option*, not an entitlement, HUD's final determinations of local rents and supportable MUM-T rents may not be appealed.

Rents will become effective immediately upon sale to the non-profit.

Rent in Unassisted Apartments

Meanwhile, if the property has partial Section 8, there are restrictions on rent increases for households that benefit from HUD-subsidized mortgages. While those paying the so-called Section 236/221d3 'market' rents² have no cap on their rent increases, those paying basic or excess but less than 'market' can *not* be assessed a rent increase; HUD can waive this 10% increase ceiling for good cause.

Owner Distributions

Unlike profit-motivated owners, non-profit owners will be limited to a 6% equity distribution each year if the HUD-insured mortgage remains in place or if the Section 8 contract imposes a dividend restriction. To obtain it, however, the owner must ask for a Headquarters waiver, which HUD will grant for 'good cause'. As examples of good cause, the notice suggests:

- Non-project uses related to the entity's non-profit purposes. (Fairly broad, should be satisfiable for any multi-activity mission-driven non-profit.)
- Repayment of surplus cash or residual receipts notes from secondary financing.

² Not in any sense a true market rent, rather a construct based on adding back debt service savings to the established budget-based rents. By definition, 236/221d3 'market' residents will currently be paying less than 30% of their income for rent.

We expect HUD will be receptive to other good causes proposed by reputable non-profits. As noted above however, distributions will be *unlimited* if (i.) the terms of the mortgage do not prohibit distributions and (ii.) the Section 8 contract is silent regarding distributions.

Use Agreement

To secure the MUM, however, the new non-profit buyer must accept a new³ 20-year recorded use agreement designed to assure mutual affordability and viability:

- Subject to owner compliance, and to availability of appropriations, HUD pledges to provide ongoing Section 8. (Presumably, if HUD fails, then the use agreement lapses and the owner could seek other alternatives.)
- The owner must accept Section 8 assistance "in accordance with its terms⁴."

While the owner's commitment to accept Section 8 renewal is not terribly limiting, any form of 20-year use agreement will have some constraining effect, some of whose consequences may be impossible to foresee. Before closing a MUM, even mission-oriented owners who have no plans whatsoever to go market should give careful consideration and satisfy themselves that a MUM-based rent structure will address the property's long-term needs.

Conclusion

With this Notice, HUD dedication to preserving affordable housing through non-profit ownership is made clear. Though not perfect, the new MUM Non-profit Transfer Program provides increased incentives for both purchasers and sellers and so will undoubtedly spur increased preservation-oriented sale transactions. Now that HUD has better guidance and some experience in processing these MUM requests, the time is right to take action.

³ Properties that already have use agreements must extend them for 20 more years.

⁴ This last phrase is troubling, since the terms of the MUM rent increase are not specifically grafted into the Use Agreement, instead requiring the owner to accept any type of Section 8 renewals offered. The new Section 236 IRP use agreement includes a similar provision requiring continued Section 8 renewals but helpfully specifies that such renewals shall be on the same terms and conditions of the existing HAP contract. We recommend owners pursue clarification along those lines, designed to assure property viability and HUD continuing fulfillment of the MUM rent structure.