



TO:

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FROM:

Linda Couch, VP, Housing Policy, LeadingAge

DATE:

April 3, 2023

SUBJECT:

Issues and Suggestions for Section 202 Supportive Housing for the Elderly Program

Thank you for meeting with representatives from the majority of Fiscal Year 2020 round of Section 202 Supportive Housing for the Elderly awardees on February 9, 2023.

LeadingAge has convened regular calls of this group of Section 202 awardees since February 2022, just after these awards were announced. The group has shared updates, information, challenges, and successes with each other. LeadingAge convened the group to facilitate all those things, but also to make sure the program's renaissance, after a painful several year pause, is successful. Given the severe need for affordable senior housing and the unique qualities of the Section 202 program to meet those needs, it is in all our best interests to work to improve and expand the Section 202 program.

This memo reiterates both the issues and the suggestions the group offered with you at our February 2023 meeting. We hope it helps to continue our shared goal providing homes connected to services and supports to older adults through the Section 202 program as quickly as possible in the highest quality way.

Issue: Communication & Information

Across all the HUD offices and underwriters, a main concern has been communication. Communication from HUD staff varies widely across the awardees. Of course, slow communication delays information sharing, decision making, progress and has resulted in rising costs and interest rates.

Suggestions:

- HUD should require, rather than suggest, certain kinds of check-ins (a project planning conference, pre-closing calls to clarify roles and timelines) with awardees, regular weekly or bi-weekly meetings with awardees, and have standard operating procedures for communication (e.g., constructive replies to phone calls or emails within 1 or 2 business days).
- Further, it was noted that awardees should feel empowered to "go up the chain of command" at the regional office and, as necessary, all the way to headquarters to resolve issues. To accomplish this, awardees need to understand that chain of command and to have access to names and emails should primary contacts be unresponsive or unavailable.

Issue: Firm Commitment Amendments

A main challenge here is HUD's requirement that the numbers must tie exactly to the Firm Commitment throughout the project. The timeline for the Section 202 program is often in conflict with equity investors, housing authorities, and other lenders. Every time an awardee must make a change to its financing model (to adjust a loan amount or account for an interest rate lock, for example) the awardee must submit a request to HUD to amend its Firm Commitment. On mixed finance deals, which HUD has all but required in the current iteration of the Section 202 program, the numbers tend to shift up until closing. Therefore, awardees must request multiple rounds of amendments during the closing process. This is very time consuming, for awardees and for HUD. By the time awardees get an amendment approved, they often need another amendment. One awardee gave an example of needing seven amendments for a project, which makes it very difficult to stick with a closing timeline.

Suggestion:

- HUD should build in a percent variance into the Firm Commitment where no interim amendments would be needed if an awardee is within that variance (10%, or whatever HUD is comfortable with). With a built-in variance, awardees can hold off on amendments until their numbers are final or close to final and submit one omnibus request for amendment. This would mean less processing for HUD and would keep the project moving toward closing table.

Issue: Construction Draw Process

This issue is two-fold. First, since the HUD draw must be processed first, even if it is a zero draw, awardees cannot have draws of other funders reviewed and approved until they get HUD's approval. The HUD approval process has been taking 1 – 4 weeks; this causes delays in paying our contractors. A consistent draw review process and timeline would be very helpful. Second, different HUD offices use different methods to calculate the amount of 202 funds awardees can draw down.

Suggestions:

- HUD should establish a consistent draw review process and expected timeline. A consistent process for how draws are calculated would give awardees something to rely on, so when they submit draws they know they are correct and awardees will be able to draw down construction funds efficiently.

Issue: Lack of Consistency Among Field Offices and Underwriters

Awardees and consultants to awardees across all multifamily regions report a lack of consistency with how Section 202s are processed across field offices and across the various underwriters and HUD counsel that are assigned. Knowledge of, and experience with, the Section 202 program varies widely among HUD underwriters and counsel. Awardees have worked with some highly skilled in mixed finance and many others who are not. This inconsistency and lack of training creates challenges for what appear to be the bulk of the Section 202 deals. Contributing to the uneven support for the Section 202 program is lack of any comprehensive guidance for the Section 202 program as it exists today. There is a variety of guidance available but there is nothing that is comprehensive for the 202 program as it exists today. Because of this, awardees have seen a lot of different pieces of guidance being applied inconsistently. Also, a lot of the forms are out of date and do not contemplate mixed finance transactions in a world ruled by mixed-finance. Addressing the lack of guidance, outdated forms, and consistent staff training are a priority.

Suggestions:

- HUD must develop consolidated guidance and updated forms.

- HUD should manage the Section 202 program nationally from one central office.

Issue: Incompatibility of HUD's Use and Capital Advance Regulatory Agreements

For a current Section 202 program that all but requires mixed finance, HUD's Use Agreement and Capital Advance Regulatory Agreement do not work well with other sources. Because these Agreements do not mesh with tax credit equity and traditional debt, awardees have not been able to get their Firm Commitments. For example, there is language in both Agreements that exclude a senior lender from exerting certain rights in the event of foreclosure or default. For mixed finance lenders, it is very problematic for them not to exercise control.

One common workaround suggested by HUD is conversion under the Rental Assistance Demonstration. However, language in HUD's Agreements run counter to a lot of RAD use agreements. The challenge for awardees is that they cannot take any Section 202 capital advance dollars without entering into those agreements. So, awardees must do a capital advance upon completion. For one awardee this meant a \$7.5M capital advance that it now must get through conventional debt and must pay interest on. The awardee must bridge this cost because its senior lender is not comfortable with the Section 202 Capital Advance Regulatory and Use Agreements so it must wait to take the capital advance dollars, convert to RAD, and then get those capital advance funds.

HUD must quickly develop agreements to clarify it can be a subordinate lender and that it does not have to be in first place for capital advance recordation.

Specific concerns:

Language at Issue	Senior Lender Concern
<u>Use Agreement, § 3:</u> "If there is any approved commercial use or non-assisted units in the Project, rents from the assisted units shall not be used to pay any expenses incurred with respect to the commercial use or non-assisted units."	<u>Concern:</u> HUD would require lender to limit the assignment of rents and leases securing the senior loan to exclude rents from assisted units (including assistance payments under the Project Rental Assistance Contract), thereby diminishing the senior lender's security.
<u>Use Agreement, § 6:</u> "HUD has been granted and is possessed of an interest in the above described assisted units such that the Owner shall remain seized of the title to said property and refrain from transferring, conveying, assigning, leasing, mortgaging, pledging, or otherwise encumbering or permitting or suffering any transfer, conveyance, assignment, lease, mortgage, pledge or other encumbrance of said assisted units in the property or any part thereof without the release of said covenants by HUD."	<u>Concern:</u> The quoted language precludes the senior lender from foreclosing without HUD consent.
<u>Use Agreement, § 6:</u> "The Owner has constituted HUD as its attorney-in-fact to transfer the assisted units to another entity in the event of default under the Capital Advance Agreement or the Regulatory Agreement."	<u>Concern:</u> Default in the Capital Advance Agreement or the Regulatory Agreement allows HUD to transfer the units to a new owner.

Language at Issue	Senior Lender Concern
<p><u>Capital Advance Regulatory Agreement, § 5</u></p> <p>“As security for the Capital Advance...and for all other obligations of the Mortgagor under this Agreement, the Mortgagor hereby assigns, pledges and mortgages to HUD all its rights to the income and charges of whatever sort which it may receive or be entitled to receive from the operation of the Assisted Units, subject, however, to any assignment of rents or project income in the [HUD Mortgage].”</p>	<p><u>Concern:</u> HUD is granted all the rights to the income from the assisted units, and the Regulatory Agreement is in a senior position to the Deed of Trust/Assignment of Rents of the senior lender.</p>
<p><u>Capital Advance Regulatory Agreement, § 8</u></p> <p>“Mortgagor shall not without the written approval of the Secretary:</p> <p>a) Transfer, dispose of or encumber any of the mortgaged property Any such transfer shall be only to a person or persons or corporation satisfactory to and approved by HUD, who shall, by legal and valid instrument in writing, to be recorded or filed in the same recording office in which conveyances of the property covered by the Mortgage are required to be filed or recorded, duly assume all obligations under this Agreement and under the Note and Mortgage;</p> <p>b) Assign, transfer, dispose of, or encumber any personal property, including rents or charges derived from the Assisted Units, and shall not disburse or pay out any funds except as provided herein and in the Capital Advance Agreement.”</p>	<p><u>Concern:</u> Borrower cannot transfer, dispose or encumber the mortgaged property or assign any rents without HUD consent.</p>
<p><u>Capital Advance Regulatory Agreement, § 10</u></p> <p>“Mortgagor shall not...permit...the seizure and sale of the mortgaged property or any part thereof under judicial process or pursuant to any power of sale and fail to have such adverse actions set aside within 45 days.”</p>	<p><u>Concern:</u> The mortgaged property cannot be part of any sale/seizure under judicial process that is not set aside within 45 days</p>

Issue: Status of Any Amendment Funds

Significant funding caps, compared to original cost projections and awards, remain for many awardees. When this issue was raised in 2022, HUD was confident there would be some funding available for some amendment awards under some scenarios. However, funding gaps remain due to greatly increased and unexpected supply and labor costs and there is no recognition by HUD that there are amendment funds or there is any formal process for securing those funds. Overall, awardees are greatly disappointed in the lack of sunshine on these funds, if there are any funds at all.

Suggestion:

- HUD should share information with all awardees about availability of any amendment funds and describe the eligibility process for applying for these funds. HUD should work with awardees to close their funding gaps.

Positives

The list of issues and suggestions outlined above should not fully overshadow the positives we have seen in the latest Section 202 award round. There are certainly many examples of HUD offices being

patient, holding regular calls and meetings, quickly and constructively responding, giving extensions, turning around approvals and needed paperwork efficiently, etc. For the program to survive and be as successful as possible, we should all strive for these kinds of practices to be the norm.

Looking Ahead

Again, we see tremendous value in Section 202 program. The program's three key features, deep income targeting, deeply affordable rents for each household, and connection to services and supports, make the Section 202 program critical to meeting the affordable housing needs of older adults. Collectively, we have all worked very hard to fund the program again and now have new Section 202 homes serve more older adults. To protect and expand the program in the future, the program must run as efficiently as possible so deals can close and funds do not go unused.

To better administer this critical program, we generally see four options for the future of the Section 202 program:

1. Go back to no leveraging and revert to almost just a capital grant and the operating subsidy.
2. Take on a huge training endeavor for HUD's entire field and update all the guidance necessary.
3. Follow the logic that HUD's Office of Recapitalization took with RAD for PRAC and keep Section 202 transactions with specialists at HUD headquarters.
4. Move the Section 202 program to 100% rental assistance to serve ELI older adults.

Thank you again for meeting with us, and for expressing the need for this to be a continual conversation to work together to improve the Section 202 program.

cc: Ethan Handelman, Deputy Assistant Secretary, Office of Multifamily Housing Programs, HUD