



PRESERVATION OF SECTION 202 DIRECT LOAN PROPERTIES: KEY CONCEPTS

**HUD Office of Multifamily Housing Programs
Preservation Clinics**

SECTION 202 DIRECT LOAN PROGRAM OVERVIEW



Bishop Boardman
Senior Apartments
Brooklyn, NY

Section 202 Direct Loan Program Overview

- The Section 202 Direct Loan program ran from 1959-1990.
 - Projects financed from 1959 to 1974 had below market interest rates (6% or less), little or no rental subsidy and rented to low and moderate income tenants.
 - Projects financed from 1975 to 1990 had market interest rates (some very high – above 10%), most had Section 8 assistance on some or all units, and rented to low and very low income tenants.
- Owners were single purpose nonprofit entities.

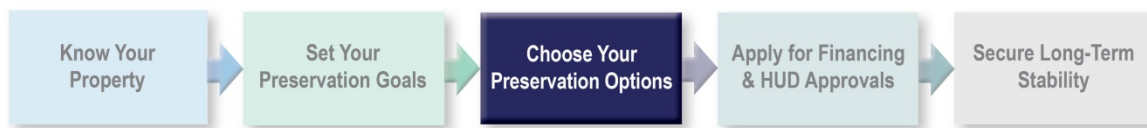
Section 202 Direct Loan Program Overview (continued)

- To successfully position a Section 202 project that may be aging, an owner may prepay and refinance the loan, or may choose to partner with another nonprofit organization, or form a tax credit limited partnership to syndicate tax credits and raise equity.
- Other owners may choose to sell the project to a qualified purchaser who will maintain affordability.

Section 202 Direct Loan Program Overview (continued)

- If a Section 202 owner wishes to refinance the project, the proceeds from the new financing may be used for project purposes or for the benefit of residents of the project or residents of other HUD assisted senior housing.
- If the owner chooses to sell the project, the owner may use the net proceeds from the sale for project purposes or for other charitable purposes of the nonprofit.

CHOOSE YOUR PRESERVATION OPTIONS



What are my Preservation Options?

1. Replace high interest debt with lower interest debt.
2. Refinance to complete capital upgrades.
3. Extend the Section 202 Use Agreement to protect Option 4 HAP Contracts.
4. Subordinate a Section 202 loan when there are not enough refinancing proceeds to pay it off.
5. Sell your Section 202 and retain the proceeds.

SECTION 202 DIRECT LOAN PREPAYMENT

Q: Why prepay your Section 202 Direct Loan?

A: To enable refinancing of a property for capital improvements or to lower the interest rate.

New Preservation Requirements

- If HUD approval for the prepayment is required, HUD may approve the prepayment but the Owner must execute a Use Agreement to ensure the continued operation as a Section 202 property at same level of affordability for at least 20 years beyond the original mortgage maturity date.
- This requirement is a change from the prior law, which just required a Use Agreement through the original maturity date of the Section 202 loan.
- Owners must comply with tenant notification and tenant comment requirements.

Types of Section 202 Prepayments

- 1. Prepay and refinance to reduce interest rate:** For projects financed between 1975 & 1991 (except for project noted below):
 - HUD permission to prepay is required.
 - Owners may prepay and refinance if the owner can demonstrate **debt service savings** for the project.
 - Notice H 2013-17 provides guidance on these prepayments.
- 2. Prepayments which do not require HUD approval:** A small subset of Section 202 projects approved from 1977 to 1982 do not require HUD permission to prepay.
 - Owners of properties in this category may also opt to prepay under the notice in order to receive an incentive of retaining above-market Section 8 rents.

Types of Section 202 Prepayments (continued)

3. Refinance to address the physical needs of the project:

- Projects financed prior to 1975 had low-interest loans (below 6%). Even with today's historically low interest rates, these projects are not likely to result in a lower debt service if they refinance.
- HUD will approve a prepayment or refinance of a Section 202 project that will result in an increased debt service. However, HUD will approve a transaction with increased debt service only if the transaction will address the physical needs of the project.

New Flexibilities

- The Section 202 loan is allowed to be subordinated or assumed.
- Flexible Subsidy Loans can be deferred or assumed.
- Owner may use the proceeds of a Section 202 refinancing for the benefit of existing project residents, to convert units to reduce vacancies, to pay a developer fee, or for the benefit of elderly residents of other HUD-assisted senior housing.

New Flexibilities (continued)

- Proceeds can be used for support services for seniors.
- Owners authorized to receive a Mark-Up-To-Market or Mark-up-to-Budget for the Section 8 units.
- Under Notice H 2013-17, in the event of a sale of a Section 202 project, as opposed to a refinance, there will be no restrictions on the use of sale proceeds from the transaction that flow to the selling Owner, provided that the transaction meets the requirement of the Notice.

Key Provisions for Pre-1975 Properties

The new law makes special provisions for pre-1975 properties with direct loan interest rates of 6% or less:

- The Act specifies that no unassisted elderly residents may be displaced or face rent increases.
- To prevent displacement of these unassisted tenants, the Act authorized new project-based rental assistance for non-assisted units – SPRAC. However, no new SPRAC funds are currently available.
- If the project does not receive SPRAC assistance, HUD may provide vouchers to the unassisted residents.

Prepayment Approval Process

- The Owner applies directly to the field office.
- Approval will go more smoothly if the Owner discusses the prepayment application in detail with HUD prior to submission to make sure you understand the required information.
- Often a prepayment request is in conjunction with other approvals – deferrals of flexible subsidies, for example. Let your HUD project manager know what you are planning.

Prepayment Approval Process (continued)

- The final approval is done at HUD Headquarters.
- Often the prepayment is in conjunction with other financing, so it is important to time the prepayment request accordingly – the process may take several weeks.

SECTION 202 DIRECT LOAN SUBORDINATION

Q: Why subordinate your Section 202 Direct Loan?

A: Because of its low interest rate, or because there are not enough funds to pay it off.

Subordination of Section 202 Direct Loan

Owners with projects with Section 202 Direct Loans that have immediate needs for rehabilitation, significant or emergency repairs, and cannot be paid off using outstanding Section 202 refinance procedures, may propose a transaction to fund rehabilitation in which the existing Section 202 debt is subordinated to a new mortgage.

Requirements for Subordination of Section 202 Direct Loans

- Must be necessary to achieve long term preservation.
- Must demonstrate Section 202 loan can be repaid.
- Owner (or buyer) must be in compliance with HUD 2530 requirements.
- Meet ownership requirements of Section 202 program.
- **No equity take-out permitted.**
- Rent increases allowed to cover project costs only.
- New Use Agreement for 20 years beyond the original mortgage maturity date.
- Section 202 loan repayment under flexible terms.

Requirements for Subordination of Section 202 Direct Loans (continued)

To apply for subordination of a Section 202 Direct Loan, apply to the Regional Center Hub/Program Center.

The Regional Center Hub/PC will submit a request to HUD Headquarters for review.

Section 202 Preservation Resources

- Office of Recapitalization home page:
http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/hsgmfbus/aboutahp
- Section 202 Prepayment Notice (HUD Notice H 2013-17):
<http://portal.hud.gov/huddoc/13-17hsgn.pdf>
- Questions? Contact the HUD account executive/project manager for the project or email Section202@hud.gov.

**HUD CAN GUIDE YOU
THROUGH THE PROCESS!**

PIERREPONT HOUSE RENOVATION



Pierrepont Senior
Apartments
Brooklyn, NY

