

UNITED STATES DEPARTMENT OF AGRICULTURE
RURAL DEVELOPMENT
BISMARCK, ND 58502

July 8, 2004

SUBJECT: Multi-Family Housing (MFH) Workout Plans

TO: All Rural Development Offices

PURPOSE/INTENDED OUTCOME: The purpose of this Administrative Notice (AN) is to clarify North Dakota State Rural Development's policies pertaining to Workout Plans (also referred to as Servicing Workout Plans).

COMPARISON WITH PREVIOUS AN: This AN replaces ND AN No. 1400 (1965-B) dated May 19, 2003.

IMPLEMENTATION/RESPONSIBILITIES: Workout plans are needed when owners are deviating from their responsibilities. Workout plans are required whenever restoring compliance with Agency regulations is unlikely to be achieved within a typical 12-month budget cycle using normal servicing techniques. Workout plans will be used to cooperatively work with the owner to effectively resolve defaults if the owner is acting in good faith to actively propose realistic corrective actions. Workout plans can be used at any point with any owner. However, at a minimum, workout plans will be required when one or more of the below listed criteria are met:

1. Delinquent Accounts (60 days or more delinquent).
2. Underfunded Reserve Account (a reserve account that cannot be brought current within a normal budget cycle).
3. Owners who have incurred added non-trade debt without agency consent.
4. Owners who have encumbered Rural Development security without agency consent.
5. Unpaid real estate taxes.
6. Inadequate insurance including fidelity coverage
7. High vacancy levels (vacancy level that exceeds 30% on an annual basis).

EXPIRATION DATE:

June 30, 2005

FILING INSTRUCTIONS:

Following RD Instruction 1965-B

*USDA Rural Development is an Equal Opportunity Lender, Provider, and Employer.
Complaints of discrimination should be sent to: USDA, Director, Office of Civil Rights,
Washington, D.C. 20250-9410.*

8. Inadequate cash to meet project needs (income does not equal or exceed the total O&M expenses, RHS debt payment, and the required reserve deposit).
9. Failure to maintain property in good repair as documented by repeated unresolved findings on the physical inspection reports.

Owners meeting one or more of the above listed criteria will be notified by use of the servicing letters in Exhibit D to this AN. Guide Letter 1 gives the owner 15 days to contact the servicing official with a proposal to correct deficiencies either immediately or with a workout plan. Guide Letter 2 and 3 will be sent when deficiencies are not resolved with the owner in a timely manner. When the owner does not correct deficiencies in response to the initial guide letter and the subsequent guide letters are used, the owner will be considered in default of the loan obligation. (Copies of the servicing letters will be sent to limited partners.)

If a project meets one or more of the above listed criteria and a workout plan is not being required, the reason for the waiver of the workout plan must be clearly justified in the servicing file.

All workout plans will be in writing, executed by the owner and address the following:

1. Background Information.
2. Description of the deficiencies to be solved.
3. Identify the underlying causes of the project's weaknesses.
4. Give an overview of the plan to correct project weaknesses and/or deficiencies.
5. Provide detail as to how the plan will work.
6. Identify the anticipated results with periodic, measurable interim goals.

Normally workout plans should not exceed 2 years. Any plan requiring a timeframe for completion in excess of 2 years must be revised and re-executed at the end of each 2-year period, providing satisfactory progress is being made.

Attachment A contains bullets to consider when developing workout plans. Attachment B is the workout plan format. Attachment C is general instructions for completing workout plans.

In North Dakota, all workout plans will require approval by the State MFH staff. The State Office will coordinate approval with the National Office for those plans which in the case of seriously under funded reserve accounts recommend an annual reserve contribution which is less than the normal annual contribution plus 10% of the under funded amount or when a plan calls for a zero dollar Rural Development loan payment.

/s/ Barbara A. Neubauer
CLARE A. CARLSON
State Director

BULLETS FOR WORKOUT PLANS

1. Workout plans are used when:

- Temporary marketing problems exist
- Management deficiencies exist
- Deferred maintenance evident
- Project experiences correctable cash-flow deficiencies

2. Workout plans are not used when:

- Intentional misappropriation of funds
- Fraud
- Health and Safety violations are an immediate threat to the safety and well-being of residents
- Project no longer considered necessary or economically viable

3. Health and Safety Violations:

- Need to be corrected immediately
- Determine if cause was within owner's control
- Use reserve account funds, if available
- If beyond owner control, may consider protective advance and reamortization, approval of an owner loan to the project, a junior lien or a subsequent loan. (Note: State or National Office staff will approve protective advances).
- If it was within owner's control, owner will be considered responsible for cash flows shortage

4. Appeals:

- Workout plans are not appealable, but budgets and rent increase requests are

5. Remember:

- Define the default
- It's the owner's problem. This is an investment!
- Management works for the owner
- Providing professional management is a core eligibility requirement
- Owners have a legal responsibility to maintain the property and pay bills under all circumstances
- Let the owner provide the solution
- Analyze the solution to determine if it solves the core problem
- The solution must address the "whole" project and result in an operational, financially stable project at a specific future date
- Give timely straightforward responses

6. Determine Project Viability:

- Is other affordable, decent, safe and sanitary housing available?
- Is the housing still needed to meet the original loan objectives?
- Are there obsolescence factors that are economically unfeasible to correct?
- Can the project be rehabilitated cost effectively?
- Would basic rents be reasonable and comparable to similar like projects after rehabilitation?

7. Tenant Protection:

- Service accounts in default immediately before long term damage is done
- Hold owner accountable
- Zero tolerance for health and safety violations
- Follow approved servicing methods

8. Information to Consider When Evaluating a Workout Plan:

- Current supervisory visit
- Current unit by unit physical inspection with estimate of repairs
- Current budget reflecting changes implemented by the workout plan (incentives, deferred reserve deposits, deferred payments, etc.)
- All identity of interest relationships
- Rents of other similar 515 projects in the servicing jurisdiction
- Rents typical for community
- Availability of other housing
- Status of reserve account
- Status of real estate taxes
- Current vacancy-history of turnover in past 12 months
- Accounts payable
- Accounts receivable
- Knowledge of local economic conditions
- Itemized defaults on loan obligations
- Trend analysis of past several years activity

9. What the Agency Can Do:

- Know conditions at project. Do not take the situation for granted.
- Grant realistic rent increases based on local conditions and project needs now and in the future
- Notify owner immediately by servicing letters when defaults become evident
- Do not become a property manager
- Hold owner responsible
- Send copy of servicing letters to the limited partners
- Notify State Housing Finance Agency when a project receiving Section 8 or tax credits is in default

- Set time-frame for owner actions
- Know all possible servicing options
- Negotiate workout in best interest of the Government
- Give timely straightforward responses
- Perform timely follow-up actions

10. Possible Servicing Options:

- Increase rents to level of other similar projects or local conventional rents to improve cash flow
(RD Instruction 1930-C, Exhibit C)
- Modify reserve requirement based on 5-year capital improvement plan
(RD Instruction 1930-C, Exhibit B XIII B 2 c)
- Approve rent incentives to improve occupancy
(RD Instruction 1965-B, Exhibit B III A 3 (A))
- Approve special market rents after a workout plan is in place for 3 months.
(RD Instruction 1930-C, Exhibit C IX)
- Provide servicing RA (if available)
(RD Instruction 1930-C, Exhibit C)
- Consolidate project operations if cost effective
(RD Instruction 1965-B, Section 1965.68)
- Reamortize debt over estimated useful life of project to lower debt service and increase operating capital (need exception to current RD Instruction 1965-B in cases of non-monetary default)
- Change plan code to full 1% interest credit to increase operating capital (where applicable)
(RD Instruction 1930-C, Exhibit B IV A 2 e)
- Release Reserve for emergency or unusual operating deficiencies for specific short term reasons
(RD Instruction 1930-C, Exhibit B XIII B 2 c (20) (1))
- Approve loan from owner to project for unusual short-term emergencies. Consistent cash-flow deficiencies is owner's responsibility
(RD Instruction 1930-C, Exhibit B XII C 1-5)
- Defer Reserve requirement for specific short term goals
(RD Instruction 1965-B, Exhibit B III B 2 e)
- Short term payment deferral for specific reasons
(RD Instruction 1965-B, Exhibit B III 2 e)
- Release rental assistance intended for debt service for operations
(RD Instruction 1965-B, Exhibit B III B 3 d)
- Grant exception to waive late fees
(RD instruction 1951-K Section 1951.510 (c) (2) (v) and RD Instruction 1965-B Exhibit B III 2 e)
- Approve junior liens or subordination
(RD Instruction 1965-B, Section 1965.79 (a) and Section 1965.83 (b))

11. Monitoring Problem Loans and Workout Plans:

- Servicing Office must require and review quarterly reports from management.
- To ensure correction of deferred maintenance, the Servicing Office must inspect the project when the work is in progress and/or is completed to ensure compliance with workout plan.
- When owner is found out of compliance with the workout plan, notify State Office immediately.
- Notify the owner immediately of non compliance and give the owner 15 days to meet conditions of the workout agreement.
- Failure to comply voids the workout agreement and initiates continued loan servicing.
- Remember, a workout plan is the last resort effort to avoid liquidation for non-compliance and should be monitored as such.
- Workout plans should not be renegotiated unless there are new conditions rising beyond the owner's control.
- Workout plans will not be renegotiated just to bring the owner into compliance in order to become eligible for additional loans.

12. Protective Advance:

- Only used to protect the Government's interest in the property in emergency situations
- Are not subsequent loans
- Must have National Office approval for anything but property taxes
- Are not appealable
- Are not for convenience of the owner
- Are not economical. Project is charged note rate interest
- Amount is due and payable immediately
- Only amortized in conjunction with long term workout plan
- Do not amortize when liquidating account

E. **ANTICIPATED RESULTS:**

F. **APPROVAL OF PLAN:** In all cases, Management is responsible for making quarterly financial reports on Form RD 1930-7 and quarterly progress reports with regard to the workout plan compliance to Rural Development and the owner. The quarterly financial and progress reports will be due on the 20th day of

_____, _____, _____
and _____.

Check the Appropriate Box:

- Initial SWP
- Renewal of SWP
- Renegotiated SWP. There has been _____ previous SWPs on this account.

The workout plan will expire on _____.

Owner's Signature

Date

Rural Development Approval Official's Signature

Date

G. **CANCELLATION OF WORKOUT PLAN:** If the objectives of this workout plan are met before the expiration date, the Servicing Office will provide written notice to the owner and management.

GENERAL INSTRUCTIONS FOR COMPLETING A WORKOUT PLAN

All workout plans will be in writing and executed by the owner or the owner's designated representative and Rural Development. After approval is received, the original of the executed workout plan will be placed in the Servicing file and copies will be provided to the owner and the manager.

Prior to approval, all plans must be evaluated on whether the plan realistically achieves the objectives of the loan. All plans must be re-evaluated at the end of the two-year period. If the workout plan includes a time frame for completion of more than two years, the workout plan must be revised and re-executed by the owner and Rural Development at the end of each two-year period, if satisfactory progress has been made.

Listed below are items you may want to consider in Part D of your workout plan:

- Require management to perform
- Hold contractor responsible for construction warranty and construction defects
- Market aggressively
- Implement effective tenant selection policy and occupancy standards
- Implement effective enforceable occupancy rules
- Determine rents are comparable to similar projects and conventional market area to maximize cash-flow
- Plan ahead! Develop capital improvement plan (5 year plan)
- Modify reserves to a realistic level but no lower than the original loan agreement/resolution requirement.
- Maintain property in a timely manner to minimize repair cost
- Ensure that all work paid for is performed acceptably for reasonable cost
- Keep all units in rentable condition
- Remove non-performing management
- Negotiate property taxes
- Infuse cash as needed with prior written authorization from the Agency
- Work with Agency to determine servicing options
- Take responsibility! Utilize hands-on ownership
- Remove and substitute General Partners
- Sell the project

A. **BACKGROUND INFORMATION:** Provide history and describe past goals and accomplishments.

- B. **DESCRIPTION OF THE DEFICIENCIES TO BE SOLVED:** Identify project weakness / needs making sure to cover:
1. Compliance deficiencies (i.e., delinquent amounts, underfunded reserves, nonpayment of taxes, deferred maintenance, etc.)
 2. Serious financial concerns (i.e., high vacancies, inadequate cash flow, high O&M expenses, etc.)
- C. **UNDERLYING CAUSES OF DEFICIENCIES:** Attempt to identify the cause of the deficiencies.
- D. **OUTLINE OF THE PLAN:** Provide details on the proposal to resolve the problems / concerns identified in the above Section B. Timetables for completing the workout plan and key components of the workout plan need to be addressed.
- E. **ANTICIPATED RESULTS:** The goals to be reached should be clearly identified and have periodic and measurable interim goals to determine that full implementation are on track.
- F. **APPROVAL OF WORKOUT PLAN:** All workout plans will be approved by the State MFH Staff. A copy of the quarterly financial report and the quarterly progress report provided by the management will be submitted to the State Office.

ROUTINE NOTICE OF SERVICING RESULTS/CONCERNS

Date

Owner's Name and Address

Dear Owner _____:

We recently reviewed [year-end report, supervisory visit report, physical inspection report, compliance review records, notice of payment due, MFIS reports, etc.] and have some serious concerns regarding [give explanation of findings].

We are asking that you contact this office within 15 days of the date of this letter to discuss the corrective actions you have taken, or plan to take, to correct the concerns listed.

If you plan to correct the deficiencies over a period of time, a workout plan will be required. Attached are the workout plan format and a guide for completing it. The workout plan will be completed by [insert date].

Sincerely

[Signature and title of Agency Official]

Attachment

Cc: Management

NOTIFICATION OF SERIOUS SERVICING CONCERNS

Date

Owner's Name and Address

Dear Owner _____:

This is a follow up from our previous letter dated [insert date]. We have not [heard, received a response, etc.] from you regarding [insert information].

We would like to arrange a meeting to discuss these concerns. [Please contact our office to confirm if you can make the tentatively scheduled meeting at the following time, date, and locations:] OR [Please contact our office within 15 days of the date of this letter to make the necessary arrangements].

Sincerely,

[Signature and title of Agency Official]

Attachment

Cc: Management

NOTIFICATION OF INTENT TO PURSUE MORE FORCEFUL SERVICING ACTIONS

Date

Owner's Name and Address

Dear Owner _____:

We regret that earlier attempts to resolve [state the problems] have not been successful.

We are writing to inform you that Rural Development intends to take further action unless alternative arrangements are promptly made with this office. If you have not contacted us within 15 days, we intend to pursue the [following actions:] [attached actions.]

[List actions, e.g., Forward a problem case report to the State Director, recommend an investigation by the Office of the Inspector General, demand a change in project management, place a recoverable cost charge on the account, forward a recommendation to the State Director to issue a Notice of Acceleration, etc.]

We are hopeful we can avoid the necessity of taking the steps outlined above. Unfortunately, we will be forced to do so unless we hear from you within 15 days from the date of this letter. Please contact our office immediately if you wish to avoid the actions described above.

Sincerely,

[Signature and title of Agency Official]

Attachment

Cc: Management