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**Subject:** ***DEMO Accounting Q&A's***  
***Portfolio Reengineering Demonstration (Demo) Program Notes Financial Reporting and Compliance***

*Dear (Owner/Agent) and/or Owner's Accountant:*

**Background.** On October 1, 2004 HUD created the Office of Affordable Housing Preservation (OAHP) as the successor to the Office of Multifamily Housing Assistance Restructuring (OMHAR) in the administration of the portfolio of subordinate notes created under the Portfolio Reengineering Demonstration Program ("Demo Notes"). OAHP has been testing methodologies for servicing the Demo Notes, which, unlike the permanent Mark to Market (M2M) program notes, have few standardized features. For the permanent program notes, OAHP has routinely reviewed post-restructuring property operations and financial reporting to ensure accurate calculation of payments on the M2M notes. OAHP is now undertaking this same process for the Demonstration project portfolio.

**Purpose.** We address below some unique accounting issues associated with the Demo Notes portfolio. These issues arise primarily because, unlike M2M permanent program Mortgage Restructuring Notes and Contingent Repayment Notes, the Demo Notes vary in their provisions. These questions and answers are intended to assist owners and their accountants in complying with HUD requirements. ***Of particular interest to owners and accountants*** will be the first question, which provides a standardized definition for "Net Income" and "Net Cash," which are not otherwise standard among the various Demo Notes, and not standard in other HUD accounting. This clarification enables us to concurrently implement a streamlined methodology for calculating and filing Demo properties' Annual Financial Statement (AFS) in HUD's FASS system. OAHP analysis of this methodology shows it captures the intent of the Demo Note documents, greatly enhances ease of accounting and AFS filing because it follows accepted practices in the industry, and should benefit the project and HUD.

**Effective Date.** These questions and answers are effective immediately for owners of Demonstration Projects with respect to AFS for fiscal years ending December 31, 2005 and later, and will be applied retroactively by HUD in reviewing prior AFS periods. Owners are not required to recalculate payments or re-file AFS's on Demo Notes for prior years. OAHP has engaged a Post Closing Portfolio Management (PCPM) Contractor, currently RER Solutions, Inc., to examine prior years' financial statements to determine their accuracy. The results of those analyses and any adjustments necessitated by their findings will be communicated to you in writing.

## DEMO Accounting Questions and Answers.

1. ***Q: How should the owner of a Demo Project interpret the definitions of “Net Income” and “Net Cash” in the Demo Note?***

“Net Cash” is equal to Surplus Cash as reflected on FASS account S1300-150 from the Computation of Surplus Cash (or zero, if Surplus Cash is negative). Owners will no longer compute “Net Income” to determine Demo Note payments.

2. ***Q: How should the owner of a Demo Project interpret the definition of “Payment Period” found in their Demo Note?***

Owners should construe Payment Period to be the project’s fiscal year as documented and approved in HUD’s Financial Accounting Sub System (FASS). If the approved fiscal year end (FYE) does not match the Payment Period in the Note, OAHP will accept that the FYE date in FASS reflects specific owner action and approvals by the HUD PM, and thus will regard the FASS FYE as the Payment Period for calculation and billing purposes.

3. ***Q: Where do we reflect the Demo loan payment amount in the FASS template?***

To date, payment amounts on Demo Notes have been reflected in Notes to the financial statements, as there was no specific template for filing a Demo Note audit. HUD is currently modifying FASS to enable owners to file AFS’s for Demo Notes using the same AFS template as for regular M2M projects. We anticipate that these FASS changes will be completed in time for submission of AFS’s for fiscal year periods ending 12/31/2005. Please refer to the 2006 M2M Accounting Q&A’s (posted contemporaneously) which provide additional guidance on the regular M2M AFS template.

4. ***Q: If we will now file Demo AFS’s using the M2M permanent AFS template in FASS, can we also receive CRP and IPF like on M2M permanent program notes?***

No, while the FASS template will include all M2M accounts (CRP, IPF, Surplus Cash, distributions, etc.) accountants must carefully review Demo Notes and only claim provisions that are reflected in the terms and conditions of the Demo Note (e.g., some Demo Notes provide for a distribution to the Owner of a fixed amount per unit per annum, similar to IPF; others include an amount similar to CRP which is sometimes referred to as New Equity Distribution, based on a % of new cash equity invested by the owner).

5. ***Q: My M2M Demonstration Note defines “Payment Date” so that a payment may be required before my accountant has finished the Annual Financial Statements (AFS). Will I be penalized if I submit payment within 10 days after the due date for filing Annual Financial Statements?***

HUD values the audit process. HUD will not regard payments as late, notwithstanding the language in the relevant Demo Note, if payment in full is received within ten (10) days of the date the AFS are submitted to HUD (provided that such AFS are submitted on or before the deadline established by HUD).

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6. *Q: If my Demo Note is ever transferred to a third party, will the responses to these questions bind the new noteholder?*

OAHF anticipates that some Demo Notes may eventually be sold by HUD. HUD's experience in previous notes sales has been that purchasers prefer to continue the practices HUD has put in place despite any ambiguous language appearing in the loan documentation. However, if Demo Notes are sold, the purchaser will determine its own practices.

7. *Q: I have not received any communication from HUD about my prior AFS submissions. Does this mean HUD agreed with my computations and accepted my prior year payment amounts?*

No. OAHF's review process for servicing these Demo Notes is very similar to the process currently operational for M2M permanent program notes. HUD's PCPM contractor will review your most recent and prior years' AFS submissions for accuracy, and to review "reasonable and necessary operating expenses" per your Regulatory Agreement. The results of those analyses and any adjustments necessitated by their findings will be communicated to you in writing with a detailed explanation of HUD's analysis. All payments due, and all payments received to date, will be reconciled and reflected on your monthly billing statement (sent monthly to the project owner or managing agent by HUD's servicer for these Demo Notes, DynAccSys).

8. *My accountant has received other accounting letters from HUD relating to M2M accounting issues (and posted on the OAHF Owner's webpage); how are those applicable to Demo Notes?*

We encourage you to review the prior accounting letters posted on our webpage at <http://www.hud.gov/offices/hsg/omhar/mhrowner.cfm>. These letters were written to specifically address accounting issues relevant to M2M permanent program projects (not Demo Notes), so not all will be applicable to Demo properties. If you have questions regarding how to apply the subject of a specific M2M Q&A to a Demo project, please send a request via email to OAHF's resource desk at [resourcedeskweb@oahp.net](mailto:resourcedeskweb@oahp.net).

9. *Q: Where do I send payments for my Demo Note?*

Checks should be **payable to FHA**, and sent to the Chicago payment lockbox at:

Multifamily Payment Service Center  
PO Box 70764  
Chicago, IL 60673

All payments should include a schedule clearly identifying the appropriate accounts for crediting of funds. The schedule must include the property name and (pre restructuring) FHA number(s).

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**For Additional Information.** This guidance is offered as a resource for Demo Note owners and their accountants and addresses specific accounting requirements for Demonstration transactions. Please submit deal specific or general Demo questions to the OAHP Resource Desk at [resourcedeskweb@oahp.net](mailto:resourcedeskweb@oahp.net) . You may also direct questions to Jo Anne Garrison, or Mike Murphy of my staff by telephone at (202)708-0001.

For questions specific to the filing of financial statements via the FASS system, contact the REAC Technical Assistance Center (TAC) at 800-245-4860 or <http://www.hud.gov/offices/react/support/tac.cfm>

Sincerely,



Theodore K. Toon  
Acting Deputy Assistant Secretary  
Office of Affordable Housing Preservation