



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Weaver Federal Building

451 7th Street SW, Room 6230, Washington, DC 20410

OFFICE OF AFFORDABLE HOUSING PRESERVATION

November 19, 2007

Name

Address ALL M2M AND DEMO OWNERS

Address

Address

**Subject: Supplemental 2007 M2M and DEMO Accounting Q&A's
Full Restructuring Financial Reporting and Post Closing
Portfolio Management Compliance**

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

We have been contacted by many owners and accountants with project specific accounting questions related to Mark-to-Market (M2M) and DEMO aspects of upcoming annual financial statement (AFS) submissions. We appreciate that you are contacting us directly with your questions, and we have attempted to respond individually to all such requests. However, we recognize that many of these questions have a broader application so we decided to provide a second letter this year to summarize some of those questions and answers. Additionally, providing a second letter gives us an opportunity to share recent policy developments relating to AFS submissions for M2M and DEMO properties and HUD's reviews of those submissions. It is packed with information; we hope you find it helpful despite its length.

First please note that some answers provide specific "effective dates". These were established to avoid inequities in the review process when we were installing a change or a firm rule where none had existed previously. Information contained in earlier accounting letters continues to be applicable except as noted here. You may go to OAHP's web site to view copies of all earlier letters. The web address is: <http://www.hud.gov/offices/hsg/omhar/mhrowner.cfm>. You will also find a new EXCEL spread sheet on that page, containing all Q&A's to date; this is a searchable tool. A column in the spreadsheet describes the general topics addressed in each question. It should assist you in sorting and filtering (e.g., filter for all that contain CRP).

Most of the backlog of prior year Surplus Cash Analyses (SCA) have now been finalized and issued to owners by HUD's Post-Closing Portfolio Management (PCPM) contractor, RER Solutions, Inc. The backlog is expected to be completely cleared by the end of December. OAHP has begun assigning the SCAs for the most recent fiscal year filings (e.g., December 31, 2006) on those assets with completed prior year SCAs, to our new PCPM contractor, MacArthur and Baker, Intl. dba MBI Consulting, for processing. We hope to provide feedback to you on those reports prior to the end of the current filing period. However, because of the lateness of the final contract award, all FY2006 reviews will not be completed until early 2008. As always, owners need to provide their accountants with copies of all project specific final SCAs. With the anticipated delays in issuing the FY2006 SCAs, timing in getting this new information to your accountant will be critical.

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Supplemental 2007 Q&A's

1. Q: Why is HUD paying such close attention to property operations after a M2M closing? Specifically, why is there such an in-depth review of operating expenses, surplus cash, R4R withdrawals, etc? (This scrutiny creates an additional burden on owners and accountants.)

A: A M2M restructuring implements the plan agreed to by HUD and the owner regarding the current and future needs of the property. HUD takes a partial payment of claim against the FHA Insurance Fund on behalf of the owner in order to facilitate the restructure, and the M2M Notes document the owner's commitment to repay that claim. Since the M2M Notes are repayable from surplus cash from operations of the property, and since that expected surplus cash payment stream after restructuring is dependent upon future operation of the property as anticipated in the plan, HUD has a fiduciary responsibility to monitor operations and scrutinize material variances from those anticipated expenses. When unjustified variances increase expenses, reduce surplus cash, and minimize cash flow payments to the M2M Notes, HUD holds property owners accountable. Thus, the PCPM review process continues to implement the terms of the M2M restructuring, agreed to by HUD and the owner, and in so doing, protects the value of the M2M Notes portfolio.

2. Q: These Accounting Q&A letters are helpful but are full of acronyms that I don't understand, please help! Why are the same terms capitalized in some answers but not in others (e.g., surplus cash)?

A: Some frequently used terms have defined meanings under the M2M/DEMO legal documents beyond their general usage. When 'Surplus Cash' and 'Restricted Surplus Cash' are capitalized they refer to the defined terms in the M2M legal documents signed at closing rather than the broader HUD accounting usage. A list of many acronyms commonly referred to in this letter follows:

AFS – owner's Annual Financial Statement filed in FASS

CSC –owner's Computation of Surplus Cash Schedule in the AFS

CRN – Contingent Repayment Note (usually the M2M "third mortgage")

CRP – Capital Recovery Payment, plural refers to monthly payments of CRP

DEMO – Portfolio Reengineering Demonstration program (precursor to M2M)

FASS – HUD's Financial Assessment Subsystem-Multifamily, the system used to file AFS electronically with HUD

FY – Fiscal Year

FYE – Fiscal Year End

IPF – Incentive Performance Fee

M2M – Mark-to-Market program

M2M/DEMO –loans restructured under the Mark-to-Market or DEMO program

MF – HUD's Office of Multifamily Housing

MRN – Mortgage Restructuring Note (usually the M2M "second mortgage")

OAHP – HUD's Office of Affordable Housing Preservation

PCA – Physical Condition Assessment, part of the restructuring plan addressing immediate rehab needs and 20 year needs

PCPM – OAHP's Post Closing Portfolio Management contractor

PM - HUD project manager

R4R – Reserve for Replacement Escrow Account

REAC – Real Estate Assessment Center

REMS – HUD's Real Estate Management System

SCA – Surplus Cash Analysis prepared by the PCPM contractor, often referred to as a PSCA (preliminary) or an FSCA (final)

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3. Q: Can a property have negative surplus cash at the end of its fiscal year and still be eligible to pay itself an IPF?

A: No. Positive surplus cash is an absolute requirement to earn and pay the IPF (or any other distribution) to the owner. This requirement is discussed in Question 2 in the 2004 Accounting Letter, and is prescribed in the Rider to the Regulatory Agreement, as well as paragraph 2-25 of HUD Handbook 4370.1.

4. Q: An owner took monthly payments of CRP during part of the year but had negative surplus cash at year-end. Does CRP paid monthly have to be repaid because the property had negative surplus cash at year-end?

A: Generally when a property has negative surplus cash it cannot meet the first CRP precondition (all expenses paid) and should not have taken CRP. However, if the owner took monthly CRP payments during part of the year based on a reasonable expectation that the property would have positive surplus cash and unanticipated changes occurred, the owner *may* only be required to reimburse the project account for monthly CRP disbursements after the unexpected change. To meet this standard, the property must have had positive surplus cash in the prior year and available surplus cash documented at the time of each monthly disbursement. In the "notes" to the financial statement (AFS), the owner's accountant must fully document the basis for asserting that the owner is entitled to retain any monthly CRP that was disbursed. That documentation will be reviewed as part of HUD's SCA review.

5. Q: If a project had negative surplus cash last fiscal year is the owner barred from taking monthly CRP this year?

A: Yes, the M2M Rider to the Regulatory Agreement (paragraph 7a.) states that when a project has negative surplus cash in a filing period, the owner is prohibited thereafter from disbursing monthly CRP until after "...the next annual review by HUD of the Owner's audited AFS confirms, as determined by HUD, that there is sufficient cash then available to resume." However, while HUD reserves the right to require strict compliance with this provision on a case by case basis, owners may resume payment of CRP once a subsequent AFS shows positive surplus cash. See also question 1 in the 2005 accounting letter.

6. Q: A project scored a "58" on its physical inspection in May of 2006, prior to closing the M2M Restructuring and shortly before starting rehab work. The owner completed the work, but was unable to get the re-inspection scheduled and completed by December 31, 2006. In February 2007, the project received a passing score. Can the ownership pay itself the CRP and the IPF for FY2006?

A: Yes, if the other preconditions are satisfied, CRP and IPF for FY2006 can be paid. In performing the surplus cash analysis each year, OAHP uses the most recent REAC physical inspection score prior to the FYE to determine if the third precondition for payment of CRP and IPF (most recent REAC physical inspection of 60 or above) is met. However, effective for FYE December 31, 2006 filings and after, OAHP will apply a presumption that the M2M restructuring will address or has addressed all repairs necessary to obtain a passing score in the M2M rehabilitation plan. OAHP monitors rehab escrow progress and can issue management findings if progress is not satisfactory.

7. Q: A project scored a "58" on its physical inspection in May of 2006, three years after the M2M Restructuring but shortly before starting additional repair/rehab work covered by the Reserve for Replacement account (R4R). The owner completed the work in November 2006, but was unable to get the re-inspection scheduled and completed by December 31, 2006. In February 2007, the project received a passing score. Can the owner distribute the IPF for FY2006 and retain all monthly CRP disbursed prior to issuance of the failing inspection report?

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A: No, the owner is ineligible for the IPF for FY2006. While CRP disbursed prior to the failing inspection may be retained if all other preconditions were satisfied, no monthly payments of CRP are permitted after issuance of the failing score by REAC. In this example, any CRP disbursed after May 2006 must be repaid to the project account. The HUD Regulatory Agreement signed by owners requires properties to be maintained in good repair at all times and owners should not wait for, or rely on, the REAC inspection to find out what repairs are needed.

8. Q: Please clarify the implications of a late M2M loan payment to HUD on the owner's eligibility for IPF. For example, if a project has a December 31, 2006 FYE, and the payment was due April 10, 2007 and paid May 22, 2007, does the late payment impact eligibility for FY2006 IPF?

A: Yes, in this case, the owner forfeits IPF for FY2006 because of the late 2006 payment to HUD and if IPF was disbursed already (at year-end) it must be repaid to the project account. Satisfaction of the precondition that "all required payments have been made on the Mortgage Restructuring Note and on any 1st mortgage" is based on whether the payment due for that period was made timely. However two other caveats should be noted:

1. If the owner paid on time, but an error in the calculation was later discovered, so long as any additional amount due is promptly remitted there is no loss of IPF; and
2. A late note payment for FY2006 would not affect IPF for FY2007.

NOTE: The fact patterns presented in questions 9 through 12 below are very similar, but the slight variations in each result in significant differences in the answers. To assist the reader, the distinctive differences are bolded in each of these questions.

9. Q: The owner had positive surplus cash on its FYE date (December 31, 2006). However, on April 23, 2006, HUD notified the owner of a Fair Housing violation, and the owner disputed the violation. On **October 14, 2006** HUD notified the owner that no violation had occurred. As of December 31, 2006, the remaining CRP and IPF preconditions were satisfied. Can the owner earn and pay the FY2006 IPF? Pay CRPs that have become due through December 1, 2006? Distribute the owner's share of FY2006 surplus cash (Surplus Cash minus IPF minus Restricted Surplus Cash) also sometimes called the "owner's split"? *Variations from the questions presented in # 10, 11 and 12 are highlighted in bold.*

A: Yes to all of those questions.

10. Q: The owner had positive surplus cash at the end of FY2006 (December 31, 2006). However, on April 23, 2006, HUD notified the owner of a Fair Housing violation, and the owner disputed the violation. On **October 14, 2006** HUD notified the owner that a final determination had been made, that a **violation had occurred**, and that the Fair Housing violation constituted a default under the Regulatory Agreement. As of December 31, 2006, the remaining CRP and IPF preconditions were satisfied. Can the owner earn and pay the FY2006 IPF? Pay CRPs that have become due through December 1, 2006? Distribute the owner's share of FY2006 surplus cash (Surplus Cash minus IPF minus Restricted Surplus Cash) also sometimes called the "owner's split"? *Variations from the questions presented in #9, 11 and 12 are highlighted in bold.*

A: No. The FY2006 IPF may neither be earned nor paid. Beginning with the May 2006 CRP (the first CRP after the notice of alleged default), no further CRPs may be paid unless and until HUD notifies the owner that the Regulatory Agreement default has been cured. The FY2006 "owner's split" may not be distributed, does not accrue, and may not be distributed (as a FY2006 distribution) in subsequent periods. The funds must remain in the project account, increasing surplus cash and the required FY2006 payment due to HUD. The HUD Regulatory Agreement prohibits any distributions when there is a default under the Regulatory Agreement, Note or mortgage.

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11. Q: The owner had positive surplus cash at the end of FY2006 (December 31, 2006). However, on April 23, 2006, HUD notified the owner of a Fair Housing violation, and the owner disputed the violation. On **January 22, 2007** HUD notified the owner that a final determination had been made, that a **violation had occurred**, and that the Fair Housing violation constituted a default under the Regulatory Agreement. As of December 31, 2006, the remaining CRP and IPF preconditions were satisfied. Can the owner earn and pay the FY2006 IPF? Pay CRPs that have become due through December 1, 2006? Distribute the owner's share of FY2006 surplus cash (Surplus Cash minus IPF minus Restricted Surplus Cash) also sometimes called the "owner's split"? Is there any effect on the 2007 IPF, CRPs and "owner's split"? *Variations from the questions presented in #9, 10 and 12 are highlighted in bold.*

A: The HUD Regulatory Agreement prohibits any distributions when there is a default under the Regulatory Agreement, Note or mortgage.

With respect to **FY2006**:

- The FY2006 IPF may neither be earned nor paid.
- The May 2006 through December 2006 CRPs may not be paid unless and until HUD notifies the owner that the Regulatory Agreement default has been cured.
- The FY2006 "owner's split" may not be distributed, does not accrue, and may not be distributed (as a FY2006 distribution) in subsequent periods. The funds must remain in the project account, increasing surplus cash and the required FY2006 payment due HUD.
- With respect to **FY2007**: unless, prior to 12/31/2007, HUD notifies the owner that the Regulatory Agreement default has been cured:
 - The FY2007 IPF may neither be earned nor paid.
 - The January 2007 through December 2007 CRPs may not be paid (but remain for potential future payment if the preconditions are satisfied at some future point).
 - The FY2007 "owner's split" may not be distributed, does not accrue, and may not be distributed (as a 2007 distribution) in subsequent periods. The funds must remain in the project account, increasing surplus cash and the required FY2007 payment due to HUD.

12. Q: The owner had positive surplus cash at the end of FY2006 (December 31, 2006). However, on April 23, 2006, HUD notified the owner of a Fair Housing violation, and the owner disputed the violation. On **March 13, 2007** HUD notified the owner that a final determination had been made, and that a **violation had not occurred**. As of December 31, 2006, the remaining CRP and IPF preconditions were satisfied. Can the owner earn and pay the 2006 IPF? Pay CRPs that have become due through December 1, 2006? Distribute the owner's share of FY2006 surplus cash (Surplus Cash minus IPF minus Restricted Surplus Cash) also sometimes called the "owner's split"? Is there any effect on the FY2007 IPF, CRPs and "owner's split"? *Variations from the questions presented in #9,10, and 11 above are highlighted in bold.*

A: With respect to **FY2006**:

- The FY2006 IPF may now be earned and paid, subject to satisfying the remaining IPF preconditions.
- Any CRPs not paid while HUD was reviewing the owner's appeal may now be paid, subject to satisfying the remaining CRP preconditions.
- The FY2006 "owner's split" may now be distributed.
- If the FY2006 AFS has already been submitted to HUD, reflecting no IPF, the owner should communicate with HUD and the PCPM in order to agree on how to document the post-submission change to reinstate the IPF and re-calculate the MRN payment and "owner's split".
- With respect to **FY2007**: there is no effect on the FY2007 IPF, CRPs or "owner's split".

13. Q: Is a HUD PM authorized to waive a precondition for payment of CRP and IPF?

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A: No, the preconditions are a function of the HUD Regulatory Agreement and are not waivable by the PM. If unusual circumstances (outside of the owners control) occurred which resulted in the owner's failure to meet the preconditions, the local HUB Director may submit a request for waiver to the Director of the Office of MF Asset Management in HUD headquarters for consideration. The request must be accompanied by specific documentation supporting the Hub Director's request. No owner distributions or incentive payments may be distributed while such a request is pending.

14. Q: Please clarify whether all unpaid CRP are to be listed as obligations or only those for years in which the preconditions were satisfied?

A: This question has been addressed in prior years, but warrants clarification here. The correct treatment is that all unpaid CRP should be listed as obligations, whether or not the preconditions have been satisfied. While CRP may accrue (and will reduce surplus cash by the amount of that accrual) even if the preconditions for payment are not met, it cannot be distributed until a period in which all of the preconditions are met. (Previous instructions to include CRP as obligations only if the preconditions for payment had been satisfied were incorrect.)

15. Q: Section 8 HAP payments have been delayed for many months for some projects this year, for reasons that are outside of the owners' control. What are the implications on surplus cash if those HAP payments have not been received as of FYE, and as a result the owner does not meet the preconditions for CRP and IPF payments? What are the implications on CRP and IPF payment and accrual?

A: Specific guidance that enables owners to accurately and fairly reflect whether a project had surplus cash when a HAP receivable (in excess of 30 days) remains at FYE, and avoids unduly penalizing the owner for the lack of cash on hand, is provided below:

- **Reflect the HAP receivable as follows:**
 - The full amount of the HAP receivable must be included in the cash portion of the CSC (using account 1135) even if the HAP receivable isn't expected to be paid within 30 days of year end. Accountants may segregate the late HAP receivables from normal HAP receivables in the Notes to the AFS.
- **Reflect the offsetting obligation(s) on the CSC.** The full HAP receivable and the full offsetting obligation must be included in the CSC. If they are treated inconsistently (receivable as current on CSC, payable as long term), this will distort surplus cash.
 - If owners were approved to borrow funds from the R4R account the borrowed amount should be reflected as an obligation (using account S1300-110) on the CSC.
 - If owners were approved to suspend monthly deposits to the R4R and the suspended/deferred deposits remained unpaid at FYE, the suspended/deferred deposits must be shown as an obligation on the CSC even though the repayment obligation would not normally be an accounting obligation. Accountants should provide explanatory comments in the Notes to the AFS.
 - If owners advanced funds to cover project expenses the amount should be reflected as a payable to the owner on the CSC.
 - If owners were unable to access other funds and incurred sizeable short- term payables, those payables must be included in the CSC.
- Monthly disbursement of CRP to the owner must be temporarily suspended during any period when either deposits to the R4R are suspended, or funds are borrowed from the R4R (and amounts in either scenario have not been repaid). In such a situation, the owner would be unable to accurately and reasonably document that monthly cash flow is adequate to pay all project expenses. If the CSC at year end shows positive surplus cash, CRP may be disbursed then for all eligible months in the year.
- No changes are required in accounting for IPF for the reporting period.

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- The HAP receivable does not distort (increase) surplus cash when the offsetting obligation is included in the CSC. HUD's PCPM contractor and the HUD PM will review carefully to assure that the preconditions for CRP and IPF are satisfied. Owners are encouraged to provide comments in the Notes to the AFS for clarification.

16. Q: If HUD approved suspension of monthly deposits to the R4R account during the year because the project was at risk of default (unrelated to late Section 8 HAP payments), can the owner take CRP and IPF to the extent there is positive surplus cash at the FYE2007?

A: No. Suspending deposits to the R4R is a form of relief to the owner which makes them ineligible for any distributions for that filing period. The exception to this scenario is addressed in question 15 above. Section 8 regulations at 24 CFR 880.205(b), prohibit an owner from taking distributions unless all project expenses have been paid and all reserve requirements have been met. No monthly disbursements of CRP are permitted in this instance, and no other distributions may be paid either until the owner has paid all suspended/deferred deposits to the R4R. If the owner repaid the suspended/deferred deposits during the year, the accountant must include an explanatory Note in the AFS. If the suspended/deferred deposits remained unpaid at FYE, the suspended/deferred deposits must be shown as an obligation on the CSC, an explanation must be included in the Notes to the AFS, and no distributions may be paid until the suspended/deferred deposits have actually been paid to the R4R.

17. Q: The owner of a project with significant surplus cash prefers not to request reimbursement from the R4R escrow account. Is it okay to absorb such expenses from operations even though the items are eligible for reimbursement from the R4R?

A: No, this practice is not acceptable for a M2M or DEMO property. The M2M statute and regulations, and the property-specific M2M underwriting, to which the owner agreed, include a clear intent that the R4R be utilized to meet ongoing major repair and replacement needs. M2M restructurings examine the adequacy of the R4R, typically fund a significant additional deposit at closing, and typically provide for a significantly increased deposit after closing, so that 100% of anticipated 20-year needs can be funded from the R4R. Failure to promptly request R4R reimbursement understates surplus cash, which in turn understates the required payments due to HUD. This practice may lead to disallowed expenses resulting in adjustments to the CSC, increasing the payment due to HUD. In such instances HUD's Office of MF Asset Management may direct PMs to issue management findings which, until corrected, will block further IPF and CRP payments and further increase the payment due to HUD.

18. Q: What type of expenses should be reimbursed from the R4R after being paid for out of operating accounts?

A: The PCA, developed by the owner and HUD and agreed upon in the Restructuring Plan, includes a 20-year schedule of R4R needs. In general, reimbursement from the R4R should be sought for all expenditures for items included in the PCA, so long as such reimbursements would not lead to a R4R balance below the "floor" established in the M2M underwriting.

19. Q: How should an owner reflect R4R-eligible expenses in the AFS that were paid for from operating accounts when they are either: 1) approved for reimbursement from the R4R by the HUD PM but the funds have not been received at FYE, or 2) the request for reimbursement from the R4R has not been acted upon by the HUD PM?

A: 1) If a request for R4R reimbursement has been approved by the HUD PM but not yet received, it should be shown as an expense in operations and as "other cash" Account S1300-030 on the CSC (the detail for this account should explain that the R4R release was approved by the PM but has not been received). 2) If the

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HUD PM has not acted upon the request yet, it cannot be reflected on the CSC. Any such requests pending with the HUD PM should be described in the notes to the AFS.

20. Q: HUD's PCPM review of my AFS refers back to the operating expenses as underwritten at the time of restructuring, and a principle of "reasonable and necessary" operating expenses. What does HUD consider "reasonable and necessary" operating expenses for a project post-restructuring?

A: During the M2M restructuring process, the owner and HUD examined historic, current, and projected operating expenses for the property based on the best information available. This expense baseline, agreed upon by all parties in the restructuring (and adjusted annually for inflation), is what owners should use to develop their budget post-restructuring. By executing the Restructuring Commitment, which survives M2M closing, the owner and HUD acknowledged the terms of the restructure including the expense underwriting. The annual PCPM review examines expenses that are materially above or below those expected from the adjusted, agreed-upon baseline, and the PCPM will ask the owner for documentation and justification of these expense line items. If the expenses cannot be satisfactorily justified, HUD may determine that certain expenditures were not reasonable and necessary to the project, and those expenses may be disallowed from the computation of surplus cash. This may result in greater surplus cash, and additional amounts due on the M2M/DEMO notes. Whenever expenses diverge significantly from the baseline, the owner should keep the HUD PM apprised of the reasons for such changes. Question #17 above illustrates one of the most common disallowed expense categories, repairs and replacements made from operating accounts without a concurrent request for reimbursement from the R4R account.

21. Q: FASS provides accounts for various entity expenses (FASS 7100 series accounts). How do these accounts impact surplus cash?

A: Entity expenses are any expenses not directly related to the operation of the project (e.g. legal fees related to the ownership, supervisory asset management fees, general partner fees, owner income taxes, etc.) and do not impact the calculation of surplus cash.

- Entity expenses are not allowable project expenses.
- Entity expenses may not be paid from the operating account.
- Entity expenses are distributions that may only be paid from distributed surplus cash.
- Entity expenses should not appear as obligations in the CSC in the AFS.

22. Q: The owner received a letter from HUD saying that, because the owner failed to respond to questions from the PCPM contractor, HUD's SCA will be finalized without the owner's input. What does this mean?

A: HUD's PCPM contractor contacts the owner (by means of a series of emails and letters) to request clarification regarding questionable expense items, significant variances from baseline expenses, or unusual accounting treatments. Most owners respond fully, but if the owner fails to fully respond, does not respond in a timely fashion, or does not respond at all, HUD will finalize the SCA without the owner's input and notify the owner accordingly.

- The PCPM attempts to collect information from owners for a period of about thirty days and thereafter issues a 15-day warning letter to the owner (with a copy provided to the HUD PM). When the 15-day grace period expires, OAHF notifies the owner that since they have not responded (at all, fully or timely, as appropriate), HUD will finalize the SCA without the owner's input.
- SCAs finalized without the owner's input may result in adjustments to expenses and supplemental payments due to HUD.
- HUD's Office of MF Asset Management may direct PMs to issue management findings for failure to respond (at all, fully or timely). Such findings will:
 - i.) block IPF and CRP payments until corrected,

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- ii.) further increase the payment due to HUD, and
- iii.) lead to other enforcement action, if unresolved.

23. Q: Question # 5 from the 2005 M2M Accounting Letter regarding the prorating of IPF during the year in which the M2M closing took place stated that the owner could choose to follow the new M2M requirements for the full year, but the IPF had to be prorated. Owners have asked OAHP to reconsider this position. Currently, if the owner elects to treat the property as if it were under M2M for the full year, then for the period prior to the closing they lose access to any distributions available under the previous Regulatory Agreement and yet gain only a portion of the M2M owner distributions covering the same period (no IPF for that period).

A: OAHP has revised its policy for AFS submissions for FYE December 31, 2006 and thereafter.

- IPF no longer has to be prorated during the year of closing. If the owner chooses to follow the M2M requirements for the entire year then the IPF may be paid for a full year.
- Alternately, the owner may still elect to compute surplus cash up to the date of the M2M closing under the old Regulatory Agreement and take pre-M2M distributions through that date, and then prorate the IPF for the period of time from the first day of the month following the M2M restructuring through the end of the fiscal year.
- The owner has one opportunity to decide which approach to use (when preparing the AFS for the year of closing) and that choice is final.

24. Q: Question # 6 in the 2005 M2M Accounting Letter had a typo, and the wrong account number was given for the long term principal portion of the balance on the M2M or DEMO notes. What is the correct account information? Also please clarify what accounts to use the following year to reflect those actual loan payments on the Statement of Cash Flows.

A: FASS Account 2322 – Other mortgages payable long-term, is the correct account number to use for the long term portion of the unpaid principal balance of all M2M or DEMO notes. The following reiterates the other accounts to be used to reflect the short term principal and interest payments from the 2005 Q&A:

- Any MRN / CRN principal balance that is to be paid from current surplus cash should be shown as a short term obligation in the AFS (FASS account 2172) and
- All accrued interest on the M2M/DEMO notes should be shown in FASS account 2132 – Accrued Interest Payable – Other mortgages.

The actual M2M payments to principal and interest are reflected on the Statement of Cash Flows in the following year's AFS using account S1200-181 for interest and account S1200-361 for principal.

25. Q: The owner submitted a question to OAHP and REAC that was not answered before the AFS filing deadline. Should the owner wait for an answer before filing?

A: No, the owner must complete and file the AFS for the current period and make any payment required on the MRN/ CRN timely unless an extension has been approved by HUD. Failure to do so jeopardizes owner incentives, may place the property at risk of default under the HUD Regulatory Agreement and at risk of other sanctions. Similarly, unresolved questions from prior year SCAs must not be used as a basis for late filing of an AFS with HUD. If HUD's PCPM Contractor ultimately determines that the AFS had errors affecting the payment due to HUD, they will notify the owner of required adjustments.

For Additional Information: This guidance is offered as a resource for post-M2M and DEMO owners and their accountants. If you have other M2M accounting related questions, you may find those answered in the previously issued accounting letters at OAHP's web site at <http://www.hud.gov/offices/hsg/omhar/mhrowner.cfm>. If not, please submit your questions to the OAHP

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Resource Desk at resourcedeskweb@oahp.net. You may also call Jo Anne Garrison or Mike Murphy at (202) 708-0001 for assistance.

For additional information on the M2M program, visit the OAHP website at <http://www.hud.gov/offices/hsg/omhar/>.

For questions specific to the filing of the AFS 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,

A handwritten signature in blue ink, appearing to read 'Theodore K. Toon', is centered on the page.

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

CC: Project accountants identified in FASS via email
HUD PMs, DEC and REAC staff