

# HUD's Rental Assistance Demonstration – Component 1

Arizona Housing Alliance Academy - Developers Training  
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# The Need for RAD

- Address a growing backlog of public housing capital need
  - Over \$25 billion in deferred capital improvements
- Preserve affordable housing
  - 10,000 – 15,000 units of affordable housing are lost annually
- Allow access to capital that is not otherwise available to public housing
- Uses a budget neutral approach

# Precursors to RAD

- Transforming Rental Assistance
- Preservation, Enhancement and transforming Rental Assistance
- Rental Housing Revitalization Act

# RAD – 2012 Appropriations Act

- Public Law 112-55, adopted November 18, 2011
- Authorized through the budget process
- Addressed key concerns of Congress regarding:
  - Budget neutrality
  - Resident protections
  - Measuring the impact of the conversions
- Component 1 authorized the conversion of up to 60,000 public housing or Moderate Rehab units to a Section 8 model (as well as Component 2 allowing for the conversion of Rent Supplement, Rental Assistance Payment and Mod Rehab contracts at the point of contract termination or expiration)

# RAD Snapshot

- First RAD projects awarded in January 2013 to 68 housing Authorities
- As of December 31, 2013, HUD had awarded 55,065 units. Since then, commitments to enter into Housing Assistance Payments Contracts (CHAPs) have been issued for the 60,000 maximum.
- HUD continues to accept applications and will process them as awarded CHAPs are either rescinded by HUD or declined by the HAs.

# Two Types of Section 8 Assistance

<u>Element</u>	<u>Project-Based Voucher HAP</u>	<u>Project-Based Rental Assistance HAP</u>
Contract Term	15 years, but may obtain voucher administering agency approval for a 20 year term	20 years
Mandatory Contract Renewal	Project must be offered, and PHA must accept, a contract renewal	Project must be offered, and PHA must accept, a contract renewal
Administrator	PHA	HUD (for initial RAD conversions) or other HUD-approved contract administrator
Contract Rents	Lower of current funding, reasonable rent or 110% of FMR (minus utility allowance)	Lower of 120% of FMR (minus utility allowance) or current funding
Rent Adjustments	Adjusted by the Operating Cost Adjustment Factor, subject to appropriations; Section 8(o)(13)(I) of the Housing Act and 24 CFR §§ 983.301 and 983.302 are not applicable	Adjusted by the Operating Cost Adjustment Factor, subject to appropriations; Section 8(c)(2) of the Housing Act and 24 CFR § 880.609 are not applicable
Fees to PHA	Asset management fee may be paid to the PHA either as a "must pay" operating expense or from cash flow; for the remainder of the calendar year following conversion, a PHA will not receive any administrative fees under the HAP; such fees may be paid after the remainder of the first calendar year has expired	Asset management fee may be paid from cash flow

# Two Types of Section 8 Assistance, cont.

<b>Element</b>	<b>Project-Based Voucher HAP</b>	<b>Project-Based Rental Assistance HAP</b>
Resident Choice Mobility	Resident may move after one year of residency, using the first available Housing Choice Voucher in accordance with Section 8(o)(13)(E) of the U.S. Housing Act of 1937; the choice mobility requirement cannot be waived.	Resident may move with a Housing Choice Voucher upon the later of (a) 24 months from the date of the execution of the HAP; or (b) 24 months after the tenant's move-in date. The PHA providing the vouchers need not provide more than one-third of its turnover vouchers to the residents of covered RAD PBRA projects. On a project-basis, a PHA may limit Choice Mobility moves to no more than 15% of the assisted units within the project.
Cap on Number of Assisted Units	As permitted by a RAD waiver of Section 8(o)(13)(D), 24 CFR 983.56(a), up to 50% of the units may be assisted with PBV (or up to 100% for elderly, disabled and family units offered supportive services, noting that the leases for households which decline services will not be terminated)	No cap
Environmental Review	Required; completed environmental review must be submitted with the financing plan	Required; completed environmental review must be submitted with the financing plan

# Elements of RAD Notice 2012-32 (HA)

(as revised on July 2, 2013)

- Allows use of public housing capital funds (including Replacement Housing Factor funds) and operating funds to make loans or otherwise support conversion
  - Predevelopment costs
  - Development costs
  - Rehabilitation costs
  - Establish replacement and/or operating reserves
- Lifts limit on number of units a housing authority may submit and the number of mixed-finance projects eligible for conversion
- Expands eligibility of HOPE VI projects
- Allows multi-phased and portfolio-based RAD awards

# Elements of RAD, cont.

- Allows bundling of rent levels across multiple RAD sites
- Permits setting contract rents at FY 2012 rent levels for all applications submitted by Dec. 31, 2013
- Allows Moving to Work agencies to apply for RAD and continue to use MTW block grant flexibility
- Allows joint RAD/Choice Neighborhood Initiative applications

# Elements of RAD, cont.

- Section 18 public housing disposition not applicable for de minimis reduction in units (*i.e.*, greater of five percent or five units)
  - De minimis limitation does not apply where the additional units:
    - Were previously approved for demolition or disposition;
    - Have been vacant for 24 months or longer; or
    - The reduction of the units will allow the reconfiguration of the units (*e.g.*, convert efficiency units to 1BR units) or the facilitation of social service delivery.

# Elements of RAD, cont.

- Existing asset repositioning fees and Replacement Housing Factor funds may be used to support the conversion (although the units that are converted through RAD do not generate additional ARF or RHF funds)
- Faircloth Limit is permanently reduced, thus further limiting the number of public housing units an HA may develop following conversion

# Elements of RAD, cont.

- HUD will forgive any HUD-held debt as part of the conversion
- ROSS-SC and PH FSS programs still apply to former public housing residents following conversion
- PHAS scoring process does not apply to projects that have been issued a CHAP – but must undergo a physical condition assessment similar to the Mark-to-Market program
- Section 33 Required Conversion Review Process is not applicable to sites covered by a CHAP

# Elements of RAD, cont.

- Significant Amendment to PHA Annual Plan
- Green Building and Energy Efficiency Standards
  - Rehab -- Energy Star, WaterSense or Federal Energy Management Program
  - New Construction – 2006 International Energy Conservation Code or ASHRAE 90.1-2004 standard
- Section 504 of the Rehabilitation Act of 1973 applies to substantial rehabilitation;
  - For new construction, at least 5% of the dwelling units must be “readily accessible to and usable by individuals with mobility impairments”
  - Fair Housing Act design and construction requirements also apply to new construction

# Elements of RAD, cont.

- Site selection and neighborhood standards per the Fair Housing Act and Title VI of the Civil Rights Act
- HUD access to records (“any reasonable HUD request for data to support program evaluation”)
- Ongoing PHA Board monitoring and annual approval of operating budgets
- Davis Bacon and Section 3 applies to all RAD projects

# Elements of RAD, cont. - Wait Lists

- Waiting lists – residents on a project-specific wait list retain their position on the list; if assistance is transferred to another site and the existing site uses a project-specific wait list, the residents on the project-specific site will be allowed to apply to the new site and be provided a priority ranking based on date and time of application
- If no wait list previously existed, the PHA must establish a waiting list

# Elements of RAD, cont. - Insurance Coverage

- No prescribed specific levels of insurance
- Must always maintain “commercially available property and liability insurance”
- To the extent there are sufficient insurance proceeds, “promptly restore, reconstruct, and/or repair any damaged or destroyed property of a project” unless HUD provides written approval of an alternative approach

# Elements of RAD, cont. - Future Refinancing

- Any refinancing or restructuring of permanent debt during HAP term requires HUD approval
- HUD seeks to ensure financing supports the long-term preservation of affordable housing

# Resident Protections

- No re-screening of tenants upon conversion
  - Not subject to rescreening, income eligibility or income targeting
    - Thus a household with income in excess of 60% of AMI will not generate low-income housing tax credits and cannot be required to relocate
- Right to return
  - existing residents have the right to return following rehabilitation work or to occupy an assisted unit at a new site if the assistance is transferred to such a site
- Phase-in of tenant rent increases
  - Any rent increase by the greater of 10% or \$25 shall be phased in over three or five years (subject to HA discretion as described at Sections 1.16.C.4 and 1.7.B.3 of the RAD Notice)

# Resident Protections, cont.

- Public housing family self sufficiency and resident opportunities and self sufficiency service coordinator programs
- Resident organization formations and funding
- Resident procedural rights
  - Upon conversion, residents are afforded additional termination notification and grievance procedure protections

# Resident Protections, cont.

- Earned Income Disregard
  - Those who receive the EID exclusion at conversion will continue to receive it following conversion (typically the Housing Choice Voucher program only grants the EID exclusion to persons with disabilities)
  - Once the pre-existing EID rights expire or cease, rents will adjust to the appropriate rent level based on the resident's income without the benefit of the rent phase-in provisions
- Capital Fund Education and Training Community Facilities (CFCF)
  - Community facilities built with CFCF grant funds are required to serve public housing residents “[t]o the greatest extent possible”.
  - HUD will consider the residents of a RAD converted site to continue to qualify as “PHA residents” to satisfy the CFCF requirements.
  - The facility must otherwise continue to be available to public housing residents.

# CHAP Award and Milestones

Number of Days from CHAP Issuance	Milestone
30 days	<ul style="list-style-type: none"><li>Accepted lender engagement or commitment letter – must include the HUD-required language indicating the lender is aware of all relevant RAD policies including the RAD Use Agreement and the ongoing requirements upon a foreclosure or bankruptcy. Letter must identify the proposed loan amount, key business terms for the loan and a pro forma sources and uses and cash flow.</li><li>Statement of development team capacity, identifying and providing evidence of proposed development team members capacity with work similar to that involved with the RAD project.</li></ul>
60 days	Significant Amendment to Annual and Five Year Plans including: a decision about conversion of assistance to PBV or PBRA.
90 days	Due diligence certification from the PHA confirming that all industry-standard due diligence has been performed for and received by the lender and/or other financing provider. Due diligence must include the physical condition assessment (PCA) and the necessary environmental reports, as well as other lender-required items (e.g., appraisal, survey, pro forma title insurance policy).
150 days	A certification from the PHA confirming that all firm commitments for firm financing have been applied for.
180 days	Financing Plan submission to HUD (note if the RAD financing involves an FHA insured loan, this milestone is satisfied with the FHA firm commitment submitted at 150 days following CHAP issuance).
320 days (and no later than 40 days prior to closing)	PHA submits evidence of firm commitment for financing.
360 days	Closing
12-18 months	General timeframe for completion of all rehabilitation items, as approved by HUD depending on the scope of work funded with closing.

# Basic Economics of RAD Conversion

Per unit monthly finances, based loosely on City of Phoenix 34-unit McCarty on Monroe

PUBLIC HOUSING UNIT	RAD UNIT
<p><u>Income</u></p> <ul style="list-style-type: none"><li>• \$200 tenant-paid rent</li><li>• \$169 HUD ACC operating subsidy (PEL + UEL + add-ons)</li><li>• \$44 HUD capital funds</li><li>• \$413 total income</li></ul> <p><u>Expenses</u></p> <ul style="list-style-type: none"><li>• \$369 operating expenses</li><li>• \$44 capital repairs/replacements</li><li>• \$413 total expenses</li></ul>	<p><u>Income</u></p> <ul style="list-style-type: none"><li>• \$200 tenant-paid rent</li><li>• \$213 HUD Section 8 housing assistance payment</li><li>• \$413 total income</li></ul> <p><u>Expenses</u></p> <ul style="list-style-type: none"><li>• \$369 operating expenses</li><li>• \$44 capital repairs/replacements</li><li>• \$413 total expenses</li></ul>

# Despite Equivalent Subsidy Initially, RAD May Have Better Economics Than Public Housing Over Time

- Potentially lower operating costs
  - Simpler regulatory compliance
  - If PHA self-manages, could outsource property management to third-party firm more easily than under public housing
- Potentially higher certainty of ongoing annual Congressional appropriations
- Potential to lock in subsidy level at high proration factor
- Potentially higher subsidy inflation rate under Operating Cost Adjustment Factor
- Potential to leverage debt and tax credit equity

# RAD Financing Example #1: No Debt or Credits

- 50 unit development with no significant capital needs
- \$413 per unit per month RAD HAP contract rent
- \$413 per unit per month operating expenses plus capital repairs initially, but manage to cut costs by 10%
- Net operating income increases from \$0 to \$41 PUPM or nearly \$25,000 total per year for 50 unit development
- Owner gets to keep the NOI

# RAD Financing Example #2: Debt Only

- Same 50 unit development with 10% cost savings as in scenario #1
- \$25,000 of actual net operating income
- Lender will apply their underwriting standards to determine maximum borrowing amount
  - Minimum 5% vacancy loss typically (even if actual is much lower)
  - Minimum \$25 PUPM replacement reserve deposit typically, and potentially more – whatever it takes to satisfy all future capital needs identified in the physical needs assessment over the term of the loan
  - Minimum 1.15x – 1.20x debt service coverage requirement typically
- Approximately \$12,000 available for debt service after underwriting (owner gets to keep the \$13,000 of remaining actual NOI)
- \$165,000 maximum supportable mortgage if 6.5% rate and 30-year term

# RAD Financing Example #3: Debt Plus Tax Credits

- Same 50 unit development with 10% cost savings as in scenarios #1&2, but needs more than \$165,000 of upfront repairs
- Could the development qualify for 9% low income housing tax credits?
  - designed to fund approximately 70% of development costs
  - highly competitive allocation process
- Could the development qualify for 4% low income housing tax credits?
  - designed to fund approximately 30% of development costs
  - readily available without competition typically
- Need to consider drawbacks to using tax credits
  - Upfront transaction costs plus annual fees and costs
  - Minimum deal size for feasibility (at least \$3 million???)
  - Guarantees to limited partner and buyout at year 15

# Other RAD Financing Strategies

- Boost NOI at the original site by moving a portion of the RAD units off-site and charging higher rents on the freed-up original units
  - higher rents could come from new higher income residents or FMR-based Section 8 vouchers
- Use RAD to dispose of scattered site units with high operating costs and replace them with units with lower operating costs
- Use RAD to easily reallocate subsidy for any units being taken off-line
- Use RAD to address long-term vacant units
- Use RAD in a portfolio conversion to unlock restricted funds and preserve the future stream of RHF subsidies from past dispositions

# Financing Plan Submission

- Submitted to HUD Senior Transaction Manager
  - A description of the type of conversion
  - Physical Condition Assessment
  - Scope of Work
  - Completed environmental review
  - Accessibility and relocation plan
  - Development budget
  - Development team description
  - Proposed financing details
  - Operating pro forma
    - HUD has asked for evidence of property tax abatement
  - Market study
  - Rehabilitation/construction management;
  - Title/Survey

# Financing Plan Review

- Escorted through the review process by the HUD senior transaction manager
  - Prepares a transaction memo
  - Reviewed by HUD “loan committee”
- Upon approval, HUD issues a signed RAD Conversion Commitment (form RCC available at [www.radresourcenet./closing.cfm](http://www.radresourcenet./closing.cfm))
- Closing process begins

# RAD Conversion Commitment (RCC)

- Main Elements
  - “Applicable HUD Regulations and Requirements” – a broad set of rules applied to RAD deals and to which all transaction documents must be subject
  - Must be countersigned by HA and Owner within 30 days of issuance and closing to occur within 90 days of issuance
  - Any modifications to RCC must be set forth in an amendment to RCC
  - Unlikely HUD will include a written approval of transaction documents as part of the RCC or any amendment, but approval seems to be implied

# RCC, cont.

- Identifies Section 8 Rents
- Confirms milestones
- Sets out scope of repairs
- Contains a series of exhibits – RAD Use Agreement, HAP, Sources & Uses of Funds, Key Business Terms, List of Repairs or New Construction, Critical Repair Items (required prior to conversion), Cert re: Accounts Payable, Excess Obligations
- Rehabilitation escrow required for projects that do not involve LIHTC or conventional financing

# RAD Closing Process

- PHA and new property owner (if any) must countersign the RCC within 30 days of its issuance
- PHA then submits several transaction documents to HUD regional counsel's office and HUD closing manager for review
  - Closing checklists for PBV and PBRA deals are available at [www.radresource.net/doclibrary.cfm](http://www.radresource.net/doclibrary.cfm) under "Contracts and Closing Documents"
- Legal review tends to focus on title and survey and RAD Use Agreement with reliance on attorney's opinion to confirm compliance with applicable HUD regulations and requirements

# Key Closing Documents

- RAD Use Agreement
- Release of HUD Declaration of Trust/Restrictive Covenants
- Housing Assistance Payments Contract and applicable riders
  - If lender takes an assignment of the HAP, HUD will execute a HUD form of “Consent to Assignment”
- Consolidated Certification
- Opinions
- Termination of any mixed-finance documents (i.e., Mixed-Finance ACC Amendment, Regulatory & Operating Agreement)

# Lessons Learned

- Make submissions to HUD on a timely basis and in an organized manner
- Ensure legal descriptions used across survey and transaction documents do not include any discrepancies (no matter how minor)
- Be ready to accommodate unexpected requests – HUD is still working out elements of the process
  - E.g., Public Housing Lease Termination 30 day notice requirement runs counter to the resident protections imposed by RAD, but per must satisfy both

# For Questions and Additional Information

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