RAD CASE STUDY

KNOXVILLE'S COMMUNITY DEVELOPMENT CORPORATION

Knoxville's Community Development Corporation (KCDC) is the public housing authority for Knoxville and Knox County, TN and is recognized by the U.S. Department of Housing and Urban Development as a high-performing public housing authority. The organization manages and rents more than 3,700 units across more than 20 properties and manages the application process and distribution of 4,000 Section 8 vouchers. KCDC started with a total of 21 public housing developments and now has only 3 public housing developments remaining, which all will be converted through RAD to Section 8 Project-Based Rental Assistance (PBRA) within the next two years.

We talked with Ben Bentley, Executive Director and CEO of Knoxville's Community Development Corporation (KCDC), regarding Lonsdale Homes. This interview has been lightly edited for clarity.

What brought you to the PHA? What was your background and goals when arriving?

After almost five years working in HUD's Nashville and Denver Offices of Public Housing, I wanted the opportunity to interact more directly with residents and partners on the local level to create affordable housing in communities of opportunity. The experience working for HUD equipped me with knowledge and understanding of the importance of a federal system and how to navigate it, while also understanding how critical it is to establish and maintain relationships and partnerships at the State and local level, attracting additional resources to complement and supplement the federal programs.

What were your goals for this particular property? What were the long- standing issues with this property? Physical, Occupancy Rates, and Financial?

Lonsdale Homes is a well-maintained property that sits in the midst of the strong and historic Lonsdale community just two miles northwest of downtown Knoxville. Like many older Public Housing properties, capital funds alone were insufficient to make the capital upgrades necessary to substantially rehabilitate the units on a regular cycle. KCDC used HUD's Capital Fund Financing Program from 2004-5 to renovate and rebuild units. In planning for the recent RAD conversion in 2017, the units were coming up on 15 years since their last major rehab, and we thought it was important to complete a substantial rehab of the property in order to position the asset for the next 15-year operational and financial cycle.

INTERIOR REHABILITATION RESULTS

LOCATION: **Lonsdale Homes**

How did you hear about RAD? What convinced you it was time to move forward with RAD for this property?

There are many benefits to RAD, and the flexibility of the program can allow it to be used in multifarious ways, but our organization valued the ability to borrow against the value of our existing assets in order to make capital improvements; we appreciated the small funding increases in the way of Operating Cost Adjustment Factor (OCAF) adjustments and the greater funding predictability inherent in the PBRA program; and we saw tremendous strategic opportunity in increasing our ability to utilize unrestricted operating income for reinvestment in affordable housing at existing and future sites.

You decided you wanted to reposition your property using RAD, what other elements were in your strategy to recapitalize your property?

It's important that PHAs consider their recapitalization needs at both the property and portfolio level to ensure strategic deployment of limited capital. The capital needs at Lonsdale Homes were manageable relative to some other properties which would need to be entirely rebuilt, and the contract rents were sufficient to allow for significant debt service. The aforementioned circumstances allowed for use of a 4% Low Income Housing Tax Credit (LIHTC) bond deal coupled with Fannie Mae debt and some PHA contributions, through RAD, to the partnership in the form of secondary debt and deferred developer fees.

Have you dealt with mixed finance multifamily transactions before this project? What were the steps taken to organize your funding sources (in addition to RAD)?

It's important to understand property level and portfolio wide goals prior to organizing funding sources for a given transaction. Within the Public Housing Program, KCDC has closed a number of multifamily transactions related to HOPE VI, CFFP, and EPC. KCDC has experience with 4% and 9% LIHTCs; FHA 221(d)4 and 223(f) programs; Fannie Mae and Tennessee Community Investment Tax Credit (CITC) debt programs; and grant funds including the City of Knoxville Affordable Rental Development Fund, Federal Home Loan Bank – Affordable Housing Program, and HUD's HOME, CDBG, and National Housing Trust fund grant programs. Within a given PHA's portfolio, some assets need to be replaced, some assets require substantial rehabilitation to be preserved, and others are in pretty good condition. Some properties have high contract rents relative to Operating expenses and generate considerable operating income that can be used as reserves to be later put into the property or used for other affordable housing purposes while other are forces to operate on very tight margins. There are decisions to be made about how to best utilize cash flow from one property to assist in the recapitalization of others. In the case of Lonsdale Homes (and other similar 4% deals), the ability to take a developer fee and reinvest in future RAD developments, for instance, high-rise facilities that do not cash flow enough to support debt, was strategically very important to us.

Who was part of your team to complete the conversion (consultants, local developers)? What steps did you take to form your team?

The use of consultants and co-developers is a decision that should be made in the context of a particular housing authority, and will change drastically based on in-house experience and capacity to take on additional workload. KCDC has reached a point where we self-develop all RAD and other affordable housing deals, relying on Partners Development, a local third party development company, to provide high-quality construction management services. At the time of this transaction, we did not feel that we had the internal experience to close three large bond deals (Lonsdale was closed in conjunction with North Ridge Crossings-270 units and The Vista-175 units, two other properties in the KCDC portfolio), so we brought on The Communities Group as co-developers. Depending on what pieces of the team you are looking for, RFPs and RFQs are appropriate methods to solicit and evaluate the expertise of potential partners. After understanding the volume of work you are expecting, there are flexible methods to procure services of a certain quantity or time period that may extend beyond the confines of a particular deal structure or construction project, and this can be beneficial in creating economic and administrative efficiencies.

What challenges did you need to overcome to complete the property conversion?

We were attempting to close this transaction in the midst of the turmoil in the LIHTC markets following the realization of corporate tax reform in late 2016 and early 2017. While very low cost of capital, and our ability to assume additional debt, offset a portion of the hole in the development budget left from reduction in tax credit pricing, there was still a need to put additional PHA funds into the deal, increase the amount of deferred developer fee, and undertake limited value engineering.

Please describe how the property is performing now. Physical, Occupancy rates, Financial?

Since rehabilitation has been completed, occupancy rates have averaged a steady 98-99%. Lonsdale Homes has generated over $400,000 in surplus cash and $280,000 in net operating income within its first year of full occupancy. The property debt service coverage ratio ranges 1:30 to 1:50 which is well above the required 1:15 ratio. With funding at $350 per unit, Lonsdale Homes has accumulated approximately $251,000 in replacement reserves to date.

How is on-site staffing managed?

In the initial RFP for equity providers, as well as the negotiation of the Limited Partnership Agreement, KCDC made it clear that we were intent on retaining our role as the management entity for Lonsdale Homes, and because of our long track record of effective property management, our tax credit investors were agreeable. KCDC is the management company for Lonsdale Homes and eight other tax credit partnerships within our portfolio.

What comments have you received from tenants before and after the conversion?

Initially, residents were concerned about the relocation process and about their right to return. Once those fears were allayed, they became excited and wanted to know what upgrades would be included in the rehabilitation. We received many comments from residents regarding the quality of finishes and stating that they were really excited to have new tubs, sinks, countertops and appliances. They were also very excited that we were repainting the outside siding and replacing or repainting shutters. Residents and maintenance staff have expressed happiness with the new HVAC units as the old ones were beginning to have many problems. Many commented that they were very surprised that we had such a large rehab and felt as though they had actually gotten a "NEW APARTMENT".

What would you say to Executive Directors, other PHA senior staff, and Board members that are considering RAD? Do you have any particular advice you would like to share?

RAD is a great program, but in order for any organization to derive a benefit from RAD, you must first establish the goals of your organization as well as any other local interests, and once that conversation is complete, then you can begin to effectively determine whether RAD (or some other repositioning strategy) might be right for you. While there are talented and honest partners out there to assist with affordable housing development and community revitalization, all of them have personal interests, and in some cases those interests may not align perfectly with that of the PHA and the local community. That's why identification of goals on the front end is so critical to success. Lean heavily on the experience of PHAs that have been through these processes, as you can learn from our mistakes. Identify strong legal partners who have experience in real estate transactions, as they will be your greatest asset, working with Agency leadership to create contracts and legal structures that reflect your organizational goals and priorities.

What are current and future goals for your PHA? Do you expect to complete more public housing repositioning?

In 2016, KCDC had 21 Public Housing sites, and we are now down to three sites left to convert. All three will convert to Section 8 PBRA in the next two years. We will continue our focus on the physical recapitalization of our existing sites, reinvesting in communities of opportunity that will serve residents for decades to come. Our efforts over the next several years will focus on investing in partnerships in the areas of affordable housing, connectivity, education, workforce development, and public health – making sure families have access to the resources they need to improve their quality of life while providing younger generations with the support they need to create future economic success.