

Conversion Milestones

00:00

Hello and welcome to another video in the “PRACTical RAD” series on Conversion Milestones. This is one in a series of videos that provides practical guidance to owners of Section 202 properties with Project Rental Assistance Contracts, or what we refer to as 202 PRACs.

The purpose of this video is to outline the major steps an owner will undertake to proceed with a RAD conversion of a 202 PRAC. During this video, we’ll provide an overview of the RAD conversion process from beginning to end. Future videos in this series will go into greater detail on the topics discussed here.

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HUD’s primary criteria for converting a property through RAD is to ensure the property addresses all current rehabilitation needs and will be financially viable throughout the term of the HAP contract. To this end, an owner must develop a plan to ensure financial viability of a property by doing the following:

1. Evaluating Goals to determine a basic strategy for the property’s future;
2. Communicating to HUD the owner’s interest in pursuing a RAD conversion;
3. Obtaining a Capital Needs Assessment (or ‘CNA’) to determine the capital needs of the property;
4. Developing a financing strategy to ensure all development and operating costs are addressed, including rehab and long-term repair and replacement needs;
5. Submitting a conversion plan for HUD’s review and approval; and
6. Closing that transaction, performing the rehab as needed, and preserving the asset for the next twenty years.

In this video, we will walk through each step of the Conversion process.

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Before beginning the conversion process, it’s important for an owner to determine his or her goals for the property by evaluating any relevant considerations. For example:

- How should resident needs be met going forward?
- Does the property need rehab?
- Is the property located in a location with adequate demand?

The owner can also take the opportunity to consider his or her ongoing role.

- Is the owner looking to maintain the current ownership structure? Or sell the property to another non-profit, or sell the property into a low income housing tax credit structure?

These are some considerations that should be evaluated by the owner in order to identify what it wants to achieve through the RAD conversion.

02:40

To get started with a RAD conversion, the owner needs to provide an initial submission of interest to HUD through the RAD Resource Desk.

To do so, you will need to sign up for a RAD Resource Desk account at www.radresource.net and provide some basic information about the property and owner.

The Resource Desk is where the owner will later submit the full Conversion Plan. Users will also be able to search for relevant information – like the RAD notice, program data, forms, FAQs, and other training materials.

This is a preliminary step that does not constitute a commitment by the owner to convert or to take any action. Rather, once the owner provides this submission, HUD assigns a Transaction Manager that can provide the owner with useful guidance and instruction on the conversion process.

The Transaction Manager will arrange for a Concept Call to briefly go over the RAD conversion process with you, discuss your project, and go over any questions or concerns you may have that may impact the property's eligibility.

Early awareness of key issues will allow HUD to help guide and support you throughout the process.

03:57

Owners must communicate and engage with residents throughout the conversion process to ensure they are informed about the conversion plan and have the opportunity to ask questions, comment, and provide input.

Owners are required to hold at least two meetings with residents prior to conversion. The purpose of the resident meetings is to provide residents with key information related to the conversion, including rehabilitation plans (if applicable), relocation (if applicable), and PBV or PBRA program rules that may differ from PRAC rules. The Project Owner must hold an additional meeting when there has been a material change to the plan that was not already discussed in a previous meeting.

At least one resident meeting must be held no less than 30 days before the conversion plan is submitted and another meeting must be held after submission of the conversion plan but prior to conversion.

04:56

One of the first steps an owner should take when planning a conversion is to have a capital needs assessment performed. The Project Owner should obtain one for 202 PRAC conversions unless one was already obtained within the last 12 months. The owner may wish to use the CNA E-tool. Regardless, the capital needs assessment must be compliant with the Multifamily Accelerated Processing, or MAP Guide.

A CNA identifies the property's rehab and long-term needs and their costs. Before a property can undergo a RAD conversion, the property owner must demonstrate to HUD that any rehab needs will be paid for and any future replacement needs will be addressed through deposits to the reserve for replacement account. The Capital Needs Assessment establishes the baseline minimum cost of these upfront repairs and the level of reserve funding needed to ensure that the property will be able to pay for subsequent repairs and replacements over the next twenty years.

Those overall needs can be balanced in two ways. A smaller rehab will result in higher long-term needs and higher reserve deposits. A larger rehab will result in lower long-term needs and lower long-term reserve deposits.

In a RAD Conversion your CNA will be configured both ways. PRAC rents are set based on a budget, which includes consideration of reserve for replacement needs. The approach with lower rehab and higher reserve deposits will be used to set your PRAC rents before conversion.

The Section 8 contract rents that a property will have after conversion are based on the PRAC rents prior to conversion. Thus, a CNA can be used to justify an increase to the PRAC rent, which would ultimately carry forward to the Section 8 rent.

The approach with higher rehab and lower reserve deposits will be used in your actual RAD transaction. The property will benefit from both the higher rents AND the lower reserve deposits.

07:05

As we just discussed, your PRAC rents form the basis for your initial Section 8 contract rents after conversion, so it's critical to make sure your PRAC rents are set appropriately before submitting your RAD conversion plan. This is done by approaching total physical needs identified in the CNA with a low rehab and a correspondingly high reserve deposit requirement.

All requests for budget-based rent adjustments for a PRAC are processed through your assigned Account Executive in the local HUD Multifamily Field Office. Your account executive and the Office of Recapitalization will coordinate to determine the proper reserve deposit for rent-setting purposes when RAD is contemplated. All other budget changes will be reviewed solely by the account executive.

An owner is not required to submit a CNA to solely request a change in reserve deposits if the requested change does not exceed \$250 per unit per year or represents an OCAF increase from the prior year's reserve deposit. Once PRAC rents have been adjusted appropriately, the owner can better model what financing the property can support and how the property will perform following a conversion to Section 8 through RAD.

08:24

The same total physical needs are now reconfigured toward a different balance between the rehab that gets done as part of the transaction, and the resultingly lower reserves that are needed to fund long-term replacements. Time your first resident meeting to obtain input on repairs and rehab requirements, so that this feedback can inform the CNA and rehab strategy.

As stated previously, in the Conversion Plan approach to addressing physical needs, you will propose a rehab. As a result of this investment, you will propose lower reserve for replacement deposits than the ones on which your rents are based. The difference between the higher rents HUD approved in your PRAC rent increase request and the lower reserve deposit needed after rehab will help you to support new debt in the Conversion Plan. In part, this debt will help pay for the rehab.

You now have the scope and likely cost of your rehab and a proposed reserve deposit that will be adequate to address—after rehab—the property's long-term physical needs.

These determinations carry forward as key elements of your Financing Strategy.

09:34

Your financing strategy must consider the various aspects that affect your sources such as new debt and uses such as the rehab. You've done most of the work at this point and will now assemble the pieces. On a separate track that we discussed earlier, you may have had your PRAC rents increased. These new rents will carry forward into your conversion, and may support the debt needed to pay for the rehab and other costs.

Your Strategy includes a careful re-examination of your operating expenses. Your resident engagement efforts will help you ensure that those operating expense levels include the right approach to resident

services. Your submitted Conversion Plan must include a resident services plan, so your operating budget must reflect those costs.

Under PRAC, that budgeted amount may be up to \$15 per unit per month. However, properties converting through RAD may obtain budget approval for up to \$27 per unit per month. Decisions about the rehab and your overall survey of physical needs have given you the answers to the scope and cost of the rehab, and the necessary reserve for replacement deposits to ensure the long-term viability of your property.

All RAD conversions are subject to an environmental review, which must be included in the Conversion Plan. For Project Based Rental Assistance, or PBRA conversions, the review is performed by HUD under Part 50. For Project Based Voucher, or PBV conversions, the review is performed by a local "Responsible Entity" under Part 58. The extent of the review will be based on the scope of the work to be completed as part of the conversion.

HUD has developed an online system called HEROS, which is used for HUD/Part 50 reviews. HEROS is a resource for developing, documenting, and managing environmental reviews which may serve as a helpful resource when determining what level of environmental review is required for your RAD conversion.

The environmental review may require the adoption of mitigating measures that must be completed as part of the conversion, which may impact rehab costs.

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The Conversion Plan you submit for RAD approval shows how the pieces fit together into a development budget in which sources and uses are equal. That is, all of the funds coming into the transaction must be equal to all of the costs. If you are obtaining new debt, that will be a key source.

The amount of debt you can obtain is partly driven by your rents, your operating expenses, and your RAD Reserve Deposits. These elements combine into an Operating Proforma, which must demonstrate operational viability for 20 years. Other sources could include low-income housing tax credits, existing reserves, soft loans, and developer equity.

In total, these sources must pay for the costs of your transaction. These costs include the RAD Rehab, payoff of existing debt, and other transactional costs. With your Sources and Uses balanced you have assembled a key component of your plan.

12:52

A Conversion Plan includes all of the documents HUD will need to review in order to approve the conversion. HUD will assess your Conversion Plan to ensure the property will be physically and financially viable, and that the project is in compliance with all programmatic requirements. HUD will ensure that all issues from the Environmental Review have been addressed, or will be addressed in the rehab.

HUD will ensure that all requirements have been met regarding resident engagement. The specific submission requirements are described in Attachment 4A of the RAD Notice and must be submitted through the RAD Resource Desk. The Conversion Plan includes the Capital Needs Assessment, Environmental Reports, evidence of financing commitments as needed, an Operating Pro Forma, the Services Plan, and other due diligence HUD needs to confirm the long-term viability of the property

If acceptable, HUD will issue a RAD Conditional Approval Letter and draft Conversion Agreement, which lays out the HUD approved terms and conditions of the RAD Conversion.

13:57

Following the issuance of the Conditional Approval and Draft Conversion Agreement, the owner will take the appropriate steps towards closing. HUD will provide the owner a closing checklist of items to be completed. At conversion:

- The Conversion Agreement will be fully executed
- The existing PRAC will be terminated
- The new Section 8 HAP contract will be executed
- All Capital Advance documentation, including the note and use agreement, will be released
- *A new RAD Elderly Housing Use Agreement will be recorded at the property*

Once all the HUD documents have been signed, you will have completed your Conversion.

This wraps up the overview of the RAD conversion process. Please remember that in addition to these videos, HUD is available to provide more information as needed, including for your specific project.

This video and future videos in the PRACTical RAD series covering various conversion milestone topics can be accessed through the link shown here. You can visit the RAD Resource Desk to register for an account and access more resources as well through the link shown here. For all other questions, feel free to email the general mailbox at RAD two at HUD dot gov.

14:38

To review, the full RAD conversion process is comprised of the steps we've walked through here.

Start with Evaluating your goals. With that done, you have a framework for where you want to go with your property. Then, reach out to HUD Set up a Resource Desk Account, and get a transaction manager assigned to you by HUD to help you through the process.

At the next stage you will obtain a Capita Needs Assessment. The first step will be to pursue an increase in your PRAC rents—by assuming the total physical needs will be addressed through an increased reserve deposit. The second step is to rebalance how you will address your physical needs, with a rehab and a lower reserve deposit.

You now have key elements, including the rents, rehab, and reserve deposits you will carry into your financing strategy. Combine these elements with determining your operating expenses through resident input and ensuring that the findings from your environmental review are integrated into the overall strategy, and you have the main elements that comprise your Strategy.

With this, you can craft your Conversion Plan. Generally, your Uses will include paying off existing debt, rehab, and soft costs, and your Sources will include the new 1st mortgage—which is based on your increased rents, operating expenses, and reserves.

With HUD approval you can close this transaction and take your property into the next stage of its life.

16:41

Thank you for your interest in RAD for Section 202 PRAC properties. We look forward to hearing from you.