



Debt and Equity Market Updates

The Future of ESG Investing

Environmental, social and governance investing is on the rise, but remains a work in progress

Page 4

Syndicators Express Optimism in LIHTC Debt, Equity Markets

LIHTC panelists discuss construction complications, yields and more.

Page 18

CRA Regulations Could Increase Community Development Investment

The OCC, Fed and FDIC released a joint notice of proposed rulemaking to strengthen the CRA

Page 8

Maturing OZ Incentive Fueling Continued Surge in Investment

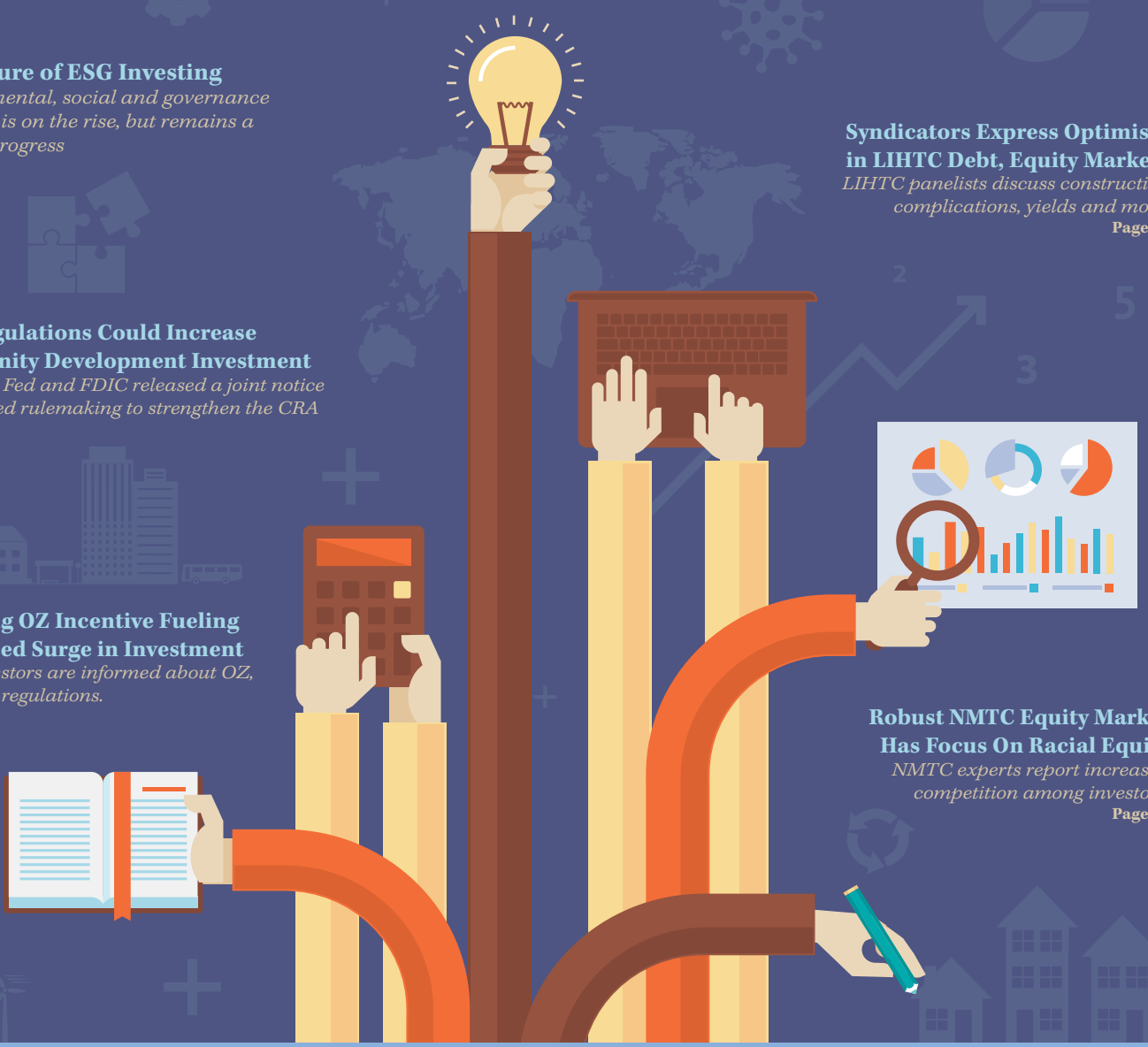
More investors are informed about OZ, rules and regulations.

Page 11

Robust NMTC Equity Market Has Focus On Racial Equity

NMTC experts report increased competition among investors.

Page 56





Faircloth-to-RAD Conversions Pose Possibilities for PHAs, Developers

NICK DECICCO, SENIOR WRITER, NOVOGRADAC

In March, The Michaels Organization (TMO), the District of Columbia Housing Authority (DCHA) and The Warrenton Group started building Kenilworth 166, a new development in Ward 7 in northeast Washington, D.C., with a novel financial process.

The development marked the first time for TMO and DCHA to venture into a Faircloth-to-Rental Assistance Demonstration (RAD) conversion. Such transitions allow public housing authorities (PHAs) to replace apartments that were demolished or disposed of and convert them to Section 8 housing after construction.

The program fuses a limitation placed on PHAs via federal legislation in 1998 with the RAD program, a partnership that preserves public housing by infusing

it with private capital. RAD has evolved during the past decade into an essential tool in the preservation of public housing.

As the Kenilworth 166 plan steered toward financial closing, the U.S. Department of Housing and Urban Development (HUD) unveiled guidelines for Faircloth-to-RAD conversions in May 2021.

“Regarding this concept, our team was talking to HUD about the concept right before HUD put out official guidance for the Faircloth-to-RAD conversion

Image: Courtesy of The Michaels Organization
An artist's rendering depicts the future Kenilworth 166, an affordable housing development in Ward 7 in Washington, D.C.

process,” said Christopher Earley, TMO regional vice president of development in the mid-Atlantic region. “We were going to proceed down the mixed-finance path via DCHA. As the project continued moving forward, we worked with DCHA to pivot toward what HUD had not quite yet dubbed the ‘Faircloth-to-RAD’ process. We were then able to get our lenders and investors comfortable with the Faircloth-to-RAD process such that got the RAD conditional commitment in time to reach a financial closing prior to the end of 2021.”

Kenilworth 166 serves as an example of what is possible with Faircloth-to-RAD conversions. There were 89 apartments within the original footprint of what will be Kenilworth 166, the first phase of a three-phase, 530-home development, with replacement public housing apartments to be rent subsidized by local rent subsidies and the 89 apartments of the existing development, dubbed Kenilworth Courts. The first phase will add 87 homes, converting the combined 166 through the Faircloth-to-RAD process.



Image: Courtesy of The Michaels Organization
An artist's rendering depicts the future Kenilworth 166, an affordable housing development in Washington, D.C., built in part using the Faircloth-to-Rental Assistance Demonstration process.

The History

The Faircloth Amendment, sometimes called “the Faircloth limit” and “the Faircloth authority,” bloom from the Quality Housing and Work Responsibility Act of 1998. It's named for former North Carolina Sen. Lauch Faircloth, who added a stipulation to the bill that capped PHAs from adding to their public housing stock as of Oct. 1, 1999.

However, many PHAs operate today with fewer apartments than they did in 1999, with estimates exceeding 220,000 homes lost due to demolition and disposal. HUD hosts a listing on its website of all PHAs with Faircloth authority and the number of new, rent-assisted apartments it is permitted to create. The list, called the “National List of Maximum Number of Units Eligible for Capital Funding and Operating Subsidy by PHA,” is accessible via HUD's Office of Capital Improvements page under HUD's Office of Public and Indian Housing (PIH).

Greg Byrne helps PHAs with business planning and board training through a consulting firm that bears his name. Byrne has spent more than 40 years in public housing, including more than a decade as the director of HUD's Affordable Housing Transaction Division. He called the 220,000-apartment deficit “staggering.”

“It's still unbelievable to me that there are 220,000 Faircloth units in this country,” Byrne said. “That means since the passage of the bill, ... that there have been 220,000 public housing units demolished or disposed of and not rebuilt. It's a mind-boggling number.”

RAD, authorized by HUD in 2011, allows PHAs to convert public housing into project-based Section 8 homes with financial assistance from private developers. Faircloth-to-RAD conversions allow HUD and PHAs to restore or add apartments to their stock by creating and/or redeveloping public housing and converting it to Sec. 8 through RAD.

“Before RAD, mixed finance deals were really the predominant way of rehabbing public housing properties, but that fell out of favor with investors due to the unpredictability of the public housing subsidy,” said Rich Larsen, a partner in Novogradac's Toms River, New Jersey, office.

As of early May, there were 34 Faircloth-to-RAD developments in the pipeline, according to Tom Davis, director of the Office of Recapitalization at

HUD. The transaction on which the process was modeled, a development in Baltimore, has completed conversion. Another highlight of the program thus far is in Galveston, Texas, where the local PHA is using the process to rebuild The Oleander at Broadway, a 419-apartment community that will restore 174 homes damaged by Hurricane Ike in 2008.



Image: Courtesy of The Michaels Organization

An artist's rendering depicts the future Kenilworth 166 in Washington, D.C. The development was one of 34 across the country to use the Faircloth-to-Rental Assistance Demonstration process, which allows public housing authorities to replace apartments that were demolished or disposed of and convert them to Section 8 housing after construction.

Making it Work

Counterintuitively, while the Faircloth amendment was intended to slow expansion of public housing, the 220,000-apartment deficit means some PHAs find themselves in the position to add housing to their stock, so long as they stay below the limit. This can be an acquisition/rehabilitation of an existing mixed-finance public housing property, a new construction or a federalization of a market-rate or other type of housing property.

“HUD is saying we’ll turn the spigot back on if you can do it,” Byrne said. “Where else can you find commitment like that in government?”

Larsen demonstrated how Faircloth-to-RAD works through a hypothetical development, one with 25 public financed homes and another 25 financed through low-income housing tax credits (LIHTCs). A Faircloth-to-RAD conversion allows a private developer to take a property leaving LIHTC

syndication and make all 50 apartments into public housing before converting them through the RAD process, which would deliver Sec. 8 housing.

The design is to “create an almost seamless underwriting process to bring the unit on under Faircloth, but immediately flip to a RAD transaction,” Byrne said.

Davis said the process provides multiple advantages to PHAs, delivering underwriting certainty regarding the future rents at a planned new development and it streamlines two HUD processes to occur in parallel rather than one after the other.

“These innovations make it much easier for a PHA, or its development partner, to plan and finance the construction of new units, knowing that the units will be able to receive Section 8 rental assistance upon their completion,” Davis said. “It also streamlines review processes within HUD, allowing for more efficient turn-times to approve and complete transactions.”

Biggest Obstacle

In the case of Kenilworth 166, Earley said TMO had worked with DCHA for more than a decade to bring together.

What makes a property a candidate for Faircloth-to-RAD conversion varies based on need. While some developments are ripe for demolition, others require renovation. It’s a question of finding the right financing tools. What might be an appropriate fit for Ward 7 in the District of Columbia, for example, may not be a fit for a development in Baltimore, Chicago or Dallas, Earley said.

“That’s part of the decision-making process,” Earley said. “I think it’s going to be market-driven as far as what jurisdiction we’re talking about. In the District of Columbia, DCHA is a relatively sophisticated housing authority with respect to the creative use of the affordable housing tools they have at their disposal—

and were open to pivoting to what is now known as Faircloth-to-RAD."

Earley, Byrne, Davis and Larsen agreed that the biggest challenge in Faircloth-to-RAD conversions is making the math work when it comes to rents. Larsen said taking on rent subsidies might be necessary to make Faircloth-to-RAD deals happen. This is because under public housing funding formulas, new units get less subsidy than existing inventory, which are already funded generally well-below market rents, Byrne said.

"Over the past year, as development teams have brought us ideas and explored potential transactions, we've learned a lot about the next tier of challenges," Davis said. "One of the biggest challenges is the relatively low rent levels. Certainty in knowing the rent is helpful, but it only goes so far if the rent is too low to make the underwriting work."

Davis said Moving-to-Work (MTW) agencies, a subset of the public housing authorities nationwide, have the power to supplement the rents. This is the route Kenilworth 166 took. Earley said that some of the Kenilworth 166 apartments will be subsidized through local rent subsidies, in addition to DCHA rent subsidy available via HUD's MTW Demonstration Program, which allows PHAs to design and test new strategies to use funding more efficiently. At Kenilworth 166, all 166 are 4% LIHTC apartments with rent restrictions up to 50% of the area median income (AMI), of which 118 will be replacement public housing apartments and the remainder will be LIHTC apartments at 50% of the AMI.

Note that DCHA's MTW designation allows for higher subsidized rents, which allows for additional project financing and a higher construction quality for both the replacement public housing and LIHTC apartments—thus benefitting community residents in the long run. Earley was proud of "deep affordability" across the project and praised the DCHA for taking an innovative approach to improving the housing stock within the Kenilworth Courts public housing community.

"Maybe I have on rose-colored glasses," Earley said. "Residents get newly built units, and no one will be able to tell what which apartments are being rent subsidized or not—additionally, the RAD conversion adds to the certainty of subsidy, which helps sustain households living in the subsidized apartments."

Byrne said the obstacles presented by making the math work on rents may contribute to why the development of Faircloth apartments has been slow other than MTW agencies, which have more flexibilities for Faircloth units.

"I'm trying to produce a unit that I'm not even getting the same funding that I get for a typical project in the public housing inventory," Byrne said. "There are creative minds out there. But the fact that this Faircloth number hasn't budgeted nationally for several years means it's a hard one to use."

Earley, Byrne and Larsen said the presence of Sec. 8 PBVs provides certainty for lenders and investors.

"Everyone feels if those really are like fixed, long-term contracts," Byrne said. "Congress has never failed to renew Sec. 8 contracts. The lending community is comfortable with that model."

Davis said HUD has also identified operational processes that it can enhance to further streamline the program.

"We're exploring what we can do to overcome these challenges," Davis said. "We know Faircloth-to-RAD is a work in progress, but already it has stirred the creativity of the development community."

An Eye to the Future

Davis said the first step for those interested in pursuing Faircloth-to-RAD conversions is to determine whether the local PHA has Faircloth authority. If they do, then it's a question of who might develop the units, such as the PHA or a developer working with it.

“The PHA is a critical participant in any Faircloth-to-RAD effort,” Davis said. “But neither the PHA nor any development partners need to have a precise plan before reaching out to us. HUD staff is happy to talk through the process and brainstorm ideas with teams considering Faircloth-to-RAD.”

Earley said that while the financing plan shift to the Faircloth-to-RAD structure required additional review due to the complex nature of Kenilworth 166 as a development, the Faircloth-to-RAD process could speed the closing process on a less-compliance transaction by 60 days.

Earley said communication between parties was crucial to bringing Kenilworth 166 to bear. That meant communication between the deal team and HUD, in addition to project lenders and investors, to make sure everyone understood the Faircloth-to-RAD process, particularly since Kenilworth 166 was in the Faircloth-to-RAD “pipeline” prior to HUD’s April 2021 official issuance of program guidance.

Byrne said PIH as well as the Office of Recapitalization deserve credit for coming up with the Faircloth-to-

RAD structure, which minimizes possible additional retransition work to get from public housing to Sec. 8 without having to re-underwrite a property.

“This is a wonderful thing PIH and the Office of Recapitalization have done, but it’s still incredibly hard to produce these units,” Byrne said.

Larsen encouraged PHAs with availability under the Faircloth limit to consider this as a possible way to add or rehabilitate apartments “because it is a way to service low-income communities.”

He said he’s hopeful that creative developers will find ways to use the structure going forward.

“A lot of housing authorities never want to be first one to do it,” Larsen said. “Let somebody else do it. That’s what happened with RAD, too. It didn’t take off right away. It took a couple years to really gain traction. Faircloth, when it gets done a few times and there are nice templates for success, I think you’ll see some more housing authorities utilize it. It’s a great tool to create new affordable housing.” ❖

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