RENTAL ASSISTANCE DEMONSTRATION

April/May 2016 | Issue 17

U.S. Department of Housing and Urban Development

Secretary Julián Castro

"The affordable housing crisis is growing. RAD is part of the solution."
Secretary Julián Castro

Director's Corner

Year-end 2015 seems like yesterday, but the RAD team is working hard to make the 2016 year-end crunch as productive, and as responsive to your needs as possible. While we work on streamlining our own processes, we hope all of you can avoid the traps that have (sometimes surprisingly) delayed past closings. This newsletter provides some tips to inform your closing plans and explains the funding process which people mistakenly believe creates an incentive to close at year-end. If anything, due to the OCAF structure, there's a long-term financial advantage to closing earlier. We're already seeing an accelerating pace of transactions and expect that to increase dramatically over the coming months!

—Tom Davis, Director, Office of Recapitalization

When is the best time of year to convert?

Over half of the conversions that took place in 2015 occurred in the last three months of the year. While some of these conversions had tax credit deadlines that drove the timing of closing, many did not have any financing deadline influencing the timing of conversion. Conversations with PHAs, as well as comments made in a Listening Session in late March, suggest that a significant factor informing many of these late-in-the-year closings is a misperception about the funding process used for RAD. As a result of what we heard, HUD will publish funding instructions that provide a comprehensive description of the funding process used for RAD conversions. In the short-term, this article highlights that with good planning, underwriting, and communication across all members of a transaction team regarding the revenue available during the initial year, there is no significant reason to convert in the last three months of the calendar year.

Background: Funding in the Initial Year of Conversion

In the year of conversion, projects continue to be funded from the public housing accounts at the level of public housing subsidy they are due to receive in that calendar year. Then, in the next year, funding is based on the RAD contract rents. Some PHAs and their consultants have concluded that there is a financial benefit to convert later in the calendar year so as to minimize the number of months in which a project is subsidized through public housing. Some lenders and investors want to minimize the number of months they are involved in a transaction before the RAD rents come into effect.

A property never receives more subsidy because it converts later in the year. Regardless of the timing of conversion, a converting property will be supported through the public housing subsidy for the remainder of the year. Consider a property that receives $1.2 million a year in Operating and Capital Fund subsidies, or $100,000/month. No matter when that project converts, the total subsidy for that project will be just $1.2 million. If the project closes in, say, March, then the effective date of the Housing Assistance Payments (HAP) project will be April 1. It will have received $300,000 for the first three months as a public housing property and will receive $900,000 for the remaining nine months as a RAD project. If it closes in September (with an October 1 HAP effective date), it will have received $900,000 as a public housing property and will receive $300,000 for the remaining three months as a RAD project. In either event, the project still only generates $1.2 million in subsidy, whether as public housing or as a Section 8 RAD project.

Moreover, there is no financial benefit to converting after the annual allocation of Capital Funds or after the Capital Fund reporting date. Neither date impacts the amount of funding HUD will obligate to a PHA nor the amount of funds a PHA may utilize on a converting property, either as rental subsidy or in the development budget. HUD will put out additional guidance shortly on the handling of

Best Time of Year to Convert Continued...

A property that converts earlier in the year actually receives more revenue over the course of 20 years. All contracts receive an Operating Cost Adjustment Factor (OCAF) rent increase at each annual anniversary of the HAP contract. The earlier in the year that a conversion occurs, the earlier in each subsequent calendar year the OCAF will be effective. Properties that convert earlier in the year receive up to a full additional OCAF increase relative to year-end conversions. Compare two 100-unit properties converting this year: one with a February 1 effective date and one with a November 1 effective date. Both have an initial contract rent of $650, with an average expected OCAF of 2% for the next twenty years. In each calendar year following conversion, the revenue for the property that converted earlier in the year will be 1.5% higher due to the earlier OCAF increase in that year. Over twenty years, this will total to $300,000 in greater revenue for the property that converted effective February 1.

In nearly every conversion, the funding in the initial year does not create financial risk to the project. While the funding available to a Covered Project through Operating Funds, Capital Fund, and tenant rents may differ modestly from the rent schedule in the HAP contract, the difference is typically small and almost always surmountable:

- **For transactions that will not be taking on any new debt**, the property will continue to receive the subsidy that was supporting operations prior to conversion, plus a portion of the PHA's Capital Fund. Given that HUD has underwritten the transaction with an expense cushion, the public housing amounts and tenant rents should cover project operations. These PHAs don't have any third parties to satisfy after the conversion and should not delay their closing because of issues related to the flow of Capital and Operating Funds.
- **For transactions that are financed with debt,** often the debt service payments will not begin until the construction loan is converted to a permanent loan. All deals underwritten by FHA fall into this category. In non-FHA deals, if the debt service payments do begin immediately, there is typically sufficient debt service coverage built into the underwriting to withstand a temporary and what is almost always a small revenue gap. When needed, a PHA can create a reserve to cover any projected revenue differential in the first year. The key is communicating expectations with the lender so that the lender understands how the first year funding works.
- **For transactions that involve tax credits,** investors typically require a lease-up reserve and a six-month operating reserve. Owners can negotiate with investors to use a small portion of these funds to cover any revenue gap to the extent that it would impact the owner's ability to pay operating costs, or create a separate reserve for this purpose.
- **For transactions that require relocation,** while the Section 8 programs would typically not fund the vacant units, under RAD they are eligible for Rehab Assistance Payments so there is more subsidy available compared with typical affordable housing development.

The key for transactions that are working with third party financing sources is to make sure expectations around the revenue available during this period are well understood, can be planned for and can be accurately incorporated into underwriting.

It is risky to try to close near the end of the year. The steps leading to conversion depend on actions by the PHA and HUD in the simplest cases, and a developer, lender, investor, Housing Finance Agency, contractor and local and state government in more complex cases. Setting out to convert at a particular time of year can easily backfire. Any given variable may throw off a PHA's timing, including the heavy workload for HUD staff at the end of the year. PHAs should be mindful that because of the holidays and the year-end volume, HUD is not able to hold closings on all deals if PHAs wait until the final quarter of the calendar year. Some PHAs that submitted Financing Plans late in 2015 with the hopes of converting before the end of November discovered that the RAD closing pipeline was too full to accommodate their request. While HUD prioritizes high-impact transactions, including those at risk of losing a 9% tax credit allocation, HUD cannot provide this treatment for every conversion. Please remember that those developments that do close in December receive a January 1 effective date and thus remain on the public housing accounts for another full year. If a PHA's primary goal is to close in a particular calendar year, it is best to close as soon as the transaction is ready.

In sum, PHAs should focus on closing their RAD deals as soon as they have all necessary approvals and documentation. PHAs should not attempt to time their closings at the final quarter of the calendar year in search of an insignificant or non-existent financial benefit.

For more information about RAD please visit our website and resource desk. For specific questions please contact the RAD team at RAD@hud.gov. Click here to sign up for the RAD Mailing List!

Six Best Practices for Closing a RAD Conversion

After completing all the requirements to arrange and submit a Financing Plan, it's critical for PHAs and their partners to shift gears and prepare for closing. For some PHAs and their partners, especially those completing their first RAD conversion, this poses a new and unique challenge. We've culled the following best practices, based on PHAs that have successfully completed closing with minimal disruption and on target with their timeline:

1. **Review the Closing Checklist.** HUD has created a 7-page Closing Overview & Checklist that describes the closing process and provides a full list of the documents that will be required. This is the single most important document that you can read to prepare for and master your closing. Best practice is to begin to compile the related documents once you've submitted your Financing Plan.

2. **Don't wait for the RCC before reviewing title.** We strongly encourage PHAs to order and review the title report early — even before submitting the Financing Plan. In some cases, these items have significantly delayed conversion, as PHAs discovered, and had to resolve unexpected issues related to title. Additionally, let HUD know if the public housing declaration of trust is missing.

3. **Use Experienced Counsel.** Whether they are complex deals using multiple financing sources or no-debt conversions, the smoothest conversions occur when PHAs and developers have used counsel with RAD closing experience. While using in-house counsel for a simple transaction can be tempting, on multiple occasions it has delayed closing. If using inexperienced counsel, build in extra time.

4. **Submit your draft closing package.** Once the RCC is issued, there is nothing HUD can do to assist your closing and work towards a desired closing date until you have submitted the draft closing package. Once the draft closing package is sent in, it is typical to take 4-6 weeks to work with HUD to make sure that all requirements have been met and all documents are complete and ready to be signed by HUD. Don't forget to plan for the logistics of getting paper documents signed, notarized, and delivered to the closing location.

5. **Avoid the End of the Year.** The end of each calendar year is the busiest time for closings, by far. Accordingly, HUD must prioritize closings during this period, which in years past has meant that some closing s that PHAs hoped would occur in November or December were pushed off until early in the next calendar year. In previous years, PHAs' assertions of urgency of closing deadlines have proven unreliable. That has led HUD to have to make its own determinations of priority.

6. **Communicate with your closing coordinator.** Unexpected events may delay your closing. Your closing coordinator can help you get to a successful closing, and will be the one gathering the information to determine whether or not to prioritize a closing or extend an RCC in the face of the unexpected. It's always better to keep your closing coordinator informed. Help us help you.

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RAD Surpasses 30,000 Units Closed

Just over three years after HUD made its very first awards under RAD, 30,000 public housing units have completed conversion to new long-term, project-based Section 8 contracts. This milestone reflects a dramatic achievement by those PHAs who have taken advantage of a new tool and have provided HUD with critical feedback as the program developed. It's also an achievement for HUD, representing exponential growth in the program. Most importantly, though, this milestone means that 30,000 homes have been preserved and improved for low-income households across the country.

RAD has proven to be a versatile tool for PHAs to act on their local affordable housing strategy, whether to preserve and stabilize, to demolish and rebuild, or to re-site in better neighborhoods. 17% of conversions included the demolition of distressed public housing and replacement with newly constructed housing. Another 36% involved high levels of rehabilitation to replace major building systems and modernize the assets, while 47% of conversions addressed more moderate rehab of existing sites while ensuring a reliably funded replacement reserve to address future needs as they accrue. Spread across these categories, 11% of conversions involved converting and transferring the assistance generally out of blighted or isolated locations and into neighborhoods of greater opportunity. Meanwhile, 43 housing authorities, most of them small, have converted their entire public housing stock and streamlined the number of federal programs that they administer.

HUD, for its part, has learned from the demonstration's early years and has both modified program policy to meet better align with local community development needs and developed a robust infrastructure and processes to handle large waves of conversions.

Update on RAD Expansion:

Senate Appropriations Committee Includes Key RAD Provisions in FY 17 HUD Appropriations Bill

On April 21st, the Senate Appropriations Committee approved the FY2017 Transportation, Housing and Urban Development, and Related Agencies Appropriations Bill that would fund a FY2017 budget for HUD that would achieve needed program goals.

- HUD's FY17 Budget Request included an elimination of the cap on the number of public housing units that could convert under RAD, in part to eliminate burdens on PHAs that derive from any cap, such as the allowance for only a single 9% LIHTC application attempt. The Senate Appropriations Committee approved an increase of the cap on the number of public housing units that could convert under RAD to 250,000.
- HUD's request to expand the second component of RAD to include the cost neutral conversion of properties assisted by Section 202 Project Rental Assistance Contracts (202 PRACs) was fully adopted by the Appropriations Committee;
- HUD requested $50 million to provide incremental subsidy above current funding levels to Public Housing and Section 202 PRAC conversions. The Committee's approval would make $4 million available to provide incremental subsidy, above their current funding levels, to Section 202 PRAC conversions.
- The Bill also includes other provisions to strengthen tenant rights and clarify eligibility for certain properties under the second component, as well as standardize the ownership and control requirements for public housing conversions.

The Department supports any efforts to expand the number of properties that could be preserved through RAD. The bill is available here.

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Busy Closing Season Expected for 2016

The Office of Recapitalization recently published a schedule for processing and closing RAD transactions before the end of the 2016 calendar year. We know that we will have another busy end of year and we expect November-December to be the program's busiest-to-date.

If you intend to close your RAD transaction by November 30, 2016 (in order to have an effective HAP date of December 1, 2016) or by December 31, 2016, you must meet or beat the following schedule. Please note that adherence to these dates does not guarantee that HUD will be able to accommodate your November or December closing.

	To close by 11/30/16 Complete this step on or before	To close by 12/31/16 Complete this step on or before
Upload all required Financing Plan documents	July 1	August 1
Receive a RAD Conversion Commitment (RCC)	September 1	October 1
Submit complete closing package	September 15	October 15
All RAD documents approved and ready for HUD signatures	November 18	December 16

First Mod-Rehab SRO Conversion Closed

The first Mod-Rehab Single Room Occupancy (SRO) project conversion using a 20-year Section 8 Project Based Rental Assistance contract has closed under RAD Component 2. This historic building, the Sean Herrick Apartments, formerly the Marion Hotel, is located in Ogden, UT and consists of 86 zero bedroom units. The transaction utilized a Section 221 (d)(4) FHA insured loan in the amount of $3,260,000 in conjunction with 9% LIHTC which were competitively awarded to the Kier Girls, LLC by the Utah Housing Corporation. Kier Girls, LLC obtained a "one-off" exception/waiver from HUD in order to allow this SRO project under HUD's Section 221(d)(4) multifamily mortgage insurance program. This is the first project granted such an exception in the country. Rehab work includes unit upgrades with new carpeting, paint, cabinets, and appliances that totaled about $42,000 per unit. Building improvements also include air conditioning and elevator systems, new energy efficient heating system, new windows, addition of a new community room, individual tenant storage, bike storage and a TV/game room with extensive structural improvements to the interior of the building and improvements to the exterior façade.

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ICYMI Choice Neighborhoods Implementation Grant NOFA Released

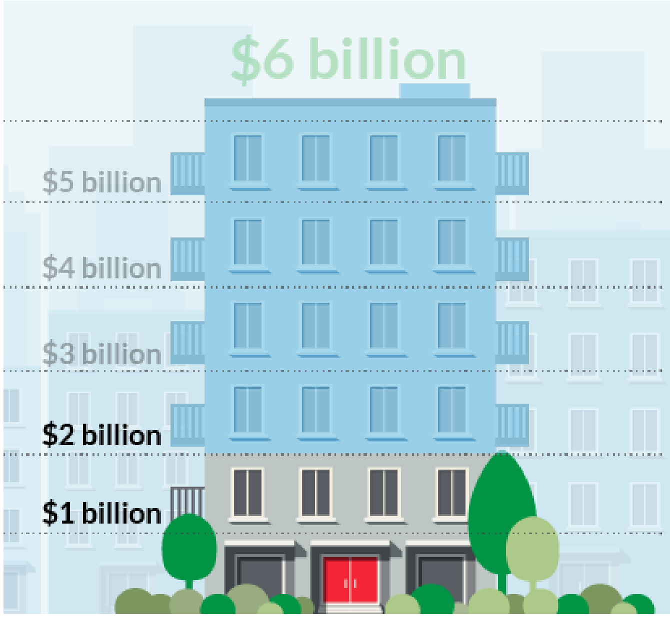
On March 31, HUD published the FY2016 Choice Neighborhoods Implementation Grants Notice of Funding Availability (NOFA). The funding announcement makes approximately $120 million available for awards. The NOFA and full application package are now available on www.grants.gov. Information is also be available at www.hud.gov/cn. With awards of up to $30 million, Choice Neighborhoods Implementation Grants help communities transform neighborhoods by revitalizing severely distressed public and/or assisted housing and by and leveraging and investing in well-functioning services, high quality public schools and education programs, high quality early learning programs and services, crime prevention strategies, public assets, public transportation, and improved access to jobs. Applications are due on June 28, 2016. Any questions regarding the NOFA must be directed to: choiceneighborhoods@hud.gov.

RAD Stats As Of 5/1/2016

RADOMETER

Total construction activity leveraged (closed projects, 1st component)

$2,246,189,301



RAD 1st Component

	Units	Projects
Active CHAPs	97,325	856
Multiphase/Portfolio Reservations	45,691	328
Closed Conversions	32,396	301
Waiting List/Applications Under Review	13,653	161
Total	**189,065**	**1,646**
Statutory Cap	**185,000**	**N/A**

RAD 2nd Component

	Units	Projects
Active Conversions	10,058	94
Closed Conversions	18,368	157

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