

March 12, 2019

Via Email

Mr. Lamar Seats
Deputy Assistant Secretary
Office of Multifamily Housing
U.S. Dept. of Housing and Urban Development
451 7th Street SW
Washington, D.C. 20410
Attention: Mr. Tom Davis, Director, Office of Recapitalization

Re: Comments on draft Section IV, HUD Notice PIH 2012-32/Housing 2017-03

Dear Mr. Seats and Mr. Davis:

The law firm of Klein Hornig LLP submits these comments in response to HUD's draft Section IV of HUD Notice PIH 2012-32/Housing 2017-03 (the draft RAD for PRAC notice section) that was posted to the Office of Multifamily Housing's Drafting Table for public feedback on February 26, 2019. Klein Hornig is a law firm that specializes in affordable housing transactions. We regularly represent public and private developers in the development, revitalization, and preservation of affordable housing projects, including Section 202 PRAC projects and RAD conversions.

We submit these limited comments with a general perspective that in these times of diminishing resources for affordable housing, it is critical that HUD guidance be cognizant of the practical issues of timing and cost that control the development process. We commend HUD's commitment to the preservation of Section 202 PRAC properties, which provide affordable homes for elderly and disabled residents nationwide. The draft RAD for PRAC notice section is an important and helpful step forward to ensure the long-term preservation of these important homes.

To further improve the ability of Section 202 PRAC owners to attract and integrate the necessary resources to rehabilitate these properties through the RAD program, we encourage HUD to consider the recommendations below to improve the draft notice section.

Initial Contract Rent Levels

The draft notice section states that for PBRA conversions, the initial contract rents would be set at the lower of: (a) the approved PRAC rents; or (b) 120% of the applicable FMR (or SAFMR), less any utility allowances. In addition, the draft notice section states that "HUD may modify the PRAC Rents if necessary to adequately fund the replacement reserves or if necessary to support a Service Coordinator or Supportive Services to meet the needs of the residents." Given that HUD's goals are to position these properties for long-term preservation while meeting the needs of aging residents, the need for resources to

rehabilitate these Section 202 PRAC properties is of tantamount importance. Recognizing the important role that rent levels play in leveraging additional private funding resources, HUD should explicitly clarify that the approved PRAC rent level will include and account for: the RAD operating reserve requirement, the RAD replacement reserve requirement, the cost of capital needs identified in the most recent Capital Needs Assessment, and the Service Coordinator costs. In addition, HUD should clarify when and how Section 202 PRAC owners can seek off-cycle budget-based rent increases in advance of a RAD conversion and that the determination of these rent increases will be performed by the Office of Recapitalization. The timing and processing of these off-cycle rent increases will be critical to leveraging private financing resources. Lenders and investors will need to know with certainty what the post-conversion rents will be in order to be able to finance and invest in these projects.

Contract Rent Adjustments

The draft notice section states that “Contract rents will be adjusted by an OCAF at each anniversary of the HAP Contract, subject to (a) the availability of appropriations for each year of the initial term of the HAP Contract, and (b) the Maximum Rent.” HUD should allow for future budget-based rent increases, if necessary, to account for unexpected expenses, such as increased insurance costs, energy costs, and tax increases that are created by uncontrollable circumstances. HUD should also recognize that properties will likely need to be recapitalized before a 20+ year term has expired, and that OCAF alone may not be enough to meet these unanticipated or recapitalization needs. In the alternative, HUD should consider allowing the RAD-converted PBRA HAP contracts to be terminated and simultaneously renewed under MAHRAA, subject to the requirement that the term of the Elderly Housing Use Agreement shall be extended to correspond with the term of the Preservation Exhibit attached to the MAHRAA renewal HAP Contract.

Elderly Housing Use Agreement

The draft notice section states that at the time of the RAD conversion, converting projects will be released from outstanding obligations under the Capital Advance Agreement, Capital Advance Mortgage Note, Capital Advance Program Regulatory Agreement, Capital Advance Program Use Agreement, and related PRAC documents. Instead, an Elderly Housing Use Agreement will be recorded as a restrictive covenant in first position. HUD should take into consideration the Section 202 PRAC properties that have recently been able to obtain resources for recapitalization, and thus may already have existing financing resources, such as Low Income Housing Tax Credits, with related priority liens. Such existing lien priority has already been negotiated and agreed upon by existing lenders, owners, and other involved partners and principals. Therefore, HUD should reserve the authority to subordinate the Elderly Housing Use Agreement to existing priority liens when necessary to ensure the continuation of existing financing sources and the long-term preservation of the property.

The draft notice section also states that the Elderly Housing Use Agreement will have a term of 20 years plus the balance of the term remaining on the Capital Advance Program Use Agreement at the time of conversion. HUD should recognize that not all Capital Advance Program Use Agreements have a defined

term (i.e. some have a term length of “not less than ___ years”). HUD should ensure that there is a defined term length in the new Elderly Housing Use Agreement to prevent any future uncertainty.

The draft notice section notes that the Elderly Housing Use Agreement will state that if the HAP Contract is terminated due to breach, non-compliance, or insufficiency of federal appropriations, new tenants of all units previously covered under the HAP contract must be elderly and meet certain income restrictions. If the HAP contract is terminated due to insufficiency of federal appropriations, HUD should review the financial feasibility of the property and allow for necessary revisions to the Elderly Housing Use Agreement restrictions in order to preserve the property, even if this means that a certain number of units may have higher income restrictions to provide needed operating revenue.

HUD should also clarify that housing for non-elderly residents of various income levels could be developed or redeveloped in conjunction within RAD Section 202 PRAC properties (while noting that the non-elderly residents and/or properties would not be subject to the Elderly Housing Use Agreement). Such flexibility would support multigenerational and/or mixed-income redevelopments and creative financing mechanisms. The final notice should provide HUD’s affirmative support for this proposition.

Service Coordinator Cost Limits

The draft notice section states that HUD may approve service costs to be paid from project rental assistance up to \$27 per unit per month if it is necessary to provide effective supportive services for the elderly. Given the importance of these supportive services, HUD should reserve the right to increase this \$27 per unit per month limit in high cost areas, in order to provide adequate resources for supportive services in high cost areas.

Rent Bundling

The draft notice section allows for rent bundling “across multiple Projects in order to modify initial contract rents that would be established in the HAP Contract, as long as the subsidy adjustments do not exceed the aggregate subsidy for all of the Projects that the Project Owner has submitted for conversion under RAD and as long as the rents do not exceed applicable rent limits described in 24 CFR part 983 subpart G.” HUD should broaden this rent bundling option to allow Section 202 PRAC properties to be rent bundled with Section 202 Direct Loan projects with PBRA assistance (and, perhaps, other non-202 elderly properties with PBRA or PBV assistance). This would provide additional flexibility for RAD-converting properties.

Defining the “Project Owner”

Throughout the draft notice section, there are many references to the “Project Owner.” HUD should take into consideration the fact that Section 202 PRAC properties are owned by single asset entities, many of which are directly or indirectly controlled by large nonprofit sponsors. HUD should clearly define and flexibly interpret that the “Project Owner” includes the nonprofit sponsor in order to ensure that such sponsors are able to pursue rent bundling and utilize other RAD tools described in the draft notice section for their portfolio of Section 202 PRAC properties, as well as clarify that such sponsors will be

responsible for meeting the RAD eligibility requirements. For example, HUD should clarify that nonprofit sponsors (and joint ventures of nonprofit sponsors) can “bundle” projects that they control, directly or indirectly, through various single asset entities.

Complex Section 202 PRAC Properties

HUD should also recognize and flexibly address the needs of more complex Section 202 PRAC properties that have direct loans and capital advances. Some of the Section 202 PRAC projects were completed in phases and, as a result, also have Section 202 Direct Loans and PBRA assistance. In certain instances, these properties have been recapitalized and refinanced with new loans and LIHTC equity (among other sources) – and the properties are now encumbered by new mortgages, regulatory agreements and restrictive covenants (“Existing Encumbrances”). To ameliorate potential problems relating to the subordination of such Existing Encumbrances, HUD should agree that the Existing Encumbrances may remain in a superior position to the new Elderly Housing Use Agreement so long as (1) the covenants imposed under the Elderly Housing Use Agreement will survive any foreclosure (or other enforcement action) under the Existing Encumbrances, and (2) any covenants imposed under the Elderly Housing Use Agreement that conflict with the Existing Encumbrances can be resolved in a manner that assures long-term preservation of the property(ies) as affordable housing for the elderly.

Use of Sales Proceeds

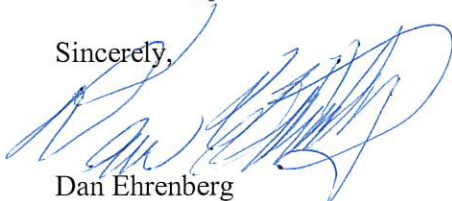
Any restrictions on the use of sale proceeds should be interpreted broadly to allow nonprofit sponsors to access necessary resources to support their charitable purposes. HUD should also clarify how seller financing and other structures will be treated after the RAD conversion. Seller financing and ground leases are important tools to support the preservation of these properties, and repayment should not be restricted during the term of the original Capital Advance Use Agreement.

Transactional Costs

Just like other real estate transactions, and in order to comply with additional RAD requirements, RAD for PRAC conversions will involve a significant amount of transactional costs (i.e. legal fees, rent comparability study fees, environmental review fees, title agent fees, lender/equity application fees, capital needs assessment fees). HUD should explicitly clarify that these transactional costs are allowable conversion costs and include them in the approved PRAC rent levels.

Thank you for your consideration of these comments and for the opportunity to submit comments on this draft notice section. We greatly appreciate HUD’s stakeholder engagement and solicitation of public feedback on the RAD for PRAC program. Should you have any questions or require any further information, please contact Dan Ehrenberg (dehrenberg@kleinhornig.com).

Sincerely,



Dan Ehrenberg

