



Klein Hornig Housing Alerts

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HUD Seeking Feedback on Draft Section 202 PRAC RAD Conversion Guidance

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Last year, Congress authorized conversions of properties currently assisted by Section 202 Project Rental Assistance Contracts (**PRAC**) to project-based vouchers (**PBV**) or project-based rental assistance (**PBRA**) under HUD's Rental Assistance Demonstration (**RAD**) program. On February 26, 2019, HUD posted draft implementation guidance for such "RAD-for-PRAC" conversions (**Draft Guidance**) and requested public feedback by March 12th.

Many owners of PRAC properties hope that RAD-for-PRAC will provide an opportunity to stabilize, rehabilitate, and ensure the long-term preservation of these critical affordable properties for seniors. While the Draft Guidance is nearly 40 pages long, we have summarized below a few key elements of HUD's proposed approach:

- **Initial Contract Rent Levels:**
 - For PBRA conversions, the initial contract rents would be set at the lower of: (a) "the approved PRAC rents" (i.e., rents that may be adjusted to reflect new/increased "Operating Expense Amounts" and/or by "rent bundling," as discussed below); or (b) 120% of the applicable FMR (or SAFMR), less any utility allowances.
 - For PBV conversions, the initial contract rents would be set at the lower of: (a) "the approved PRAC rents;" (b) the reasonable rent, as defined in HUD regulations; (c) the public housing authority's normal rent standard, not to exceed 110% of the applicable FMR or applicable exception payment standard, minus any utility allowance; or (d) the rent requested by the owner.
 - To enhance low PRAC rents, owners would apparently have an opportunity to seek budget-based rent increases during the annual PRAC renewal and prior to the RAD conversion, although it is unclear if prospective costs could be included.
- **Rent "Bundling" of Properties:** To address low PRAC rents at initial rent-setting, HUD would also allow owners with multiple PRAC properties to spread the subsidy among the properties through "rent bundling." Rent bundling would permit projects with lower rents to bump up

their rents from higher-rent projects as long as the reallocation of the subsidy among the bundled projects is budget neutral.

- **Rent Adjustments:** For PBRA conversions, rents would be adjusted annually by OCAF, subject to a “Maximum Rent” limitation (i.e., the greater of 120% of the FMR/SAFMR or the market rents). For PBV conversions, rents would be eligible for adjustment annually in accordance with the PBV regulations, but capped at the “OCAF-adjusted rent.”
- **Use of Residual Receipts:** HUD would allow the application of any residual receipts balance to the development budget for pre-development, development, or rehabilitation costs of the property, or to establish the replacement reserve or operating reserve.
- **Release of Section 202 PRAC Documents:** At closing, RAD-converting PRAC properties would be released from obligations under the Capital Advance Agreement, the Capital Advance Mortgage Note, the Capital Advance Program Regulatory Agreement, the Capital Advance Program Use Agreement, and related PRAC documents, to be replaced with an Elderly Housing Use Agreement.
- **Elderly Housing Use Agreement:** HUD proposes that a new use agreement would be recorded in first position at closing, having a term of 20 years plus the balance of the term remaining on the Capital Advance Program Use Agreement. The new use agreement would impose certain eligibility, income, and rent restrictions for new tenants if the HAP Contract is terminated due to breach, non-compliance, or insufficiency of federal appropriations (e.g., occupancy limited to elderly residents at 50% of AMI, and rents capped at 30% of 50% of AMI during the first portion of the use agreement term).
- **Length of Contract:** The initial term of the PBV or PBRA HAP Contract would be 20 years, subject to federal appropriations. Owners would be obligated to accept extensions of the initial HAP contract term for at least as long as the term of the new Elderly Housing Use Agreement.
- **Eligibility:** A PRAC property would be eligible for RAD if it is currently receiving assistance through a PRAC that is in its initial or renewal term; the owner is in compliance with HUD and fair housing requirements; and the property substantially complies with the Housing Quality Standards (for PBV conversions) or achieves a REAC score of 60 or above post-conversion (for PBRA conversions).
- **Ownership and Control:** HUD would require ownership or control of the property by a non-profit entity or non-profit-controlled entity (with some flexibility on “non-profit-control”) after the RAD conversion.
- **Financing and Repairs:** HUD would require that the owner demonstrate the availability of financing to address critical, immediate, or required repair needs, and how capital replacement

reserves will fund ongoing capital repair and replacement needs or how periodic recapitalization will be used to address life cycle improvement needs.

- **Supportive Services:** Owners seeking conversion would be required to demonstrate that the needs of the residents are adequately being met through a service coordinator funded by the annual property budget or through another service coordination/provision arrangement. HUD also proposes to nearly double the limits on eligible service costs that can be paid from rental assistance after conversion, if necessary to provide effective supportive services.
- **Application Requirements:** HUD proposes several key application requirements, including: a scope of work and capital needs assessment with a 20-year replacement schedule, a demonstration that the capital needs will be addressed through a replacement reserve and proposed financing, a replacement reserve, an operating reserve, and environmental review.
- **Operating Reserve:** HUD proposes that each property would have an operating reserve of at least \$250 per unit, separate from the replacement reserve. If the operating reserve dips below \$250 per unit, then HUD would prohibit surplus cash distributions.
- **Occupancy Requirements:** PRAC properties converting assistance under RAD would be required to continue to serve elderly persons, and new residents would need to meet certain income requirements. Existing residents would be grandfathered-in and could not be subject to re-screening, even if such residents were over LIHTC or other income-restrictive financing programs used for conversion.
- **Davis-Bacon:** Davis-Bacon prevailing wage requirements would not apply to RAD-converted PBRA properties, but would apply to RAD-converted PBV properties with 9 or more assisted units where rehabilitation or construction will occur.
- **Transfers of Assistance:** HUD proposes three scenarios where the assistance converted pursuant to RAD may be transferred from the existing site. HUD would utilize the evaluation criteria from Section 8(bb) transfers, as well as considering whether conversion on-site is economically non-viable or if the property is physically obsolete or severely distressed; how the transfer would affect the residents; and civil rights requirements.
- **Relocation and Tenant Right to Remain/Return:** Current tenants would have the right to remain in or, in the event that rehabilitation requires relocation of residents, a right to return to an assisted unit at the property. Any relocation must be done in accordance with the Uniform Relocation Act.

Although the Draft Guidance does not provide for a formal notice and comment process, HUD is accepting public comments via email (RAD2@hud.gov) until March 12, 2019. Following consideration of public feedback, the HUD Office of Recapitalization will revise the draft guidance as needed and release

a new RAD Notice (HUD Notice PIH 2012-32, REV-4), which will include final RAD-for-PRAC implementation guidance as well as some changes to other types of RAD conversions.

Should you have any questions about this KH Housing Alert or require any further information, please contact Jessie Cassella (jcassella@kleinhornig.com), Andrew L. Gilmore (agilmore@kleinhornig.com), or Dan Ehrenberg (dehrenberg@kleinhornig.com).

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