



## HUD Issues Revised Implementation Notice for Rental Assistance Demonstration (RAD)

By Chris Hornig and Stephen Niles

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On June 15, HUD released its long-awaited revision of the implementing instructions for the Rental Assistance Demonstration (RAD) program, Notice PIH-2012-32 (HA), REV-2. The Notice contains many new provisions inspired by situations and questions that have arisen during the course of early program implementation. While some of these provisions codify rules that have been generally in effect and known to practitioners, others are HUD's attempt to settle outstanding questions or to direct new emphasis to areas that could be seen as having received insufficient attention to date. The Notice also implements recent statutory changes, and more generally consists of a re-ordering and re-wording of the earlier version.

The new Notice addresses both the First Component of RAD (generally, the conversion of public housing units to Section 8 Project-Based Rental Assistance (PBRA) or Project-Based Vouchers (PBVs)) and the Second Component (generally, the conversion of tenant protection vouchers to a PBV or PBRA platform for projects that were originally funded under various rental subsidy "orphan" programs).

The following summary addresses the most salient program changes reflected in the Notice. Should you have questions about other areas of the Notice, or about the application of new RAD rules to a particular situation, please call Chris Hornig (D. 202.495.4088), Stephen Niles (D. 202.495.7210) or another Klein Hornig attorney.

### **RAD First Component**

Major revisions to the First Component reflected in the Notice include:

- Reflecting the increase in the unit cap from 60,000 to 185,000 units as approved by Congress in the FY2015 Appropriations law. While HUD reports that current applications already account for most of this increased cap, there are related provisions that facilitate HUD's recapturing RAD authority from PHAs that are not moving forward, and permitting HUD to allocate remaining cap based on factors of importance or need instead of mere date-of-application as in the past. A new application period will open on July 15, 2015.

- Substantially increasing the program focus on Fair Housing compliance, including by:
  - Requiring that all new construction projects, including those on the converting public housing site, comply with site and neighborhood standards. This is a change from the previous version of the notice, which indicated that new construction on an existing public housing site would not be subject to this review. HUD will not permit RAD new construction on a site that is in an area of minority concentration (which HUD defines generally as an area whose minority concentration is more than 20 points above the MSA average) unless:
    - The new area is a revitalizing area experiencing significant private investment, or
    - There are sufficient comparable housing opportunities in areas outside of minority concentration.
  - Requiring a front-end review of all projects that potentially raise fair housing issues, including all new construction projects, projects where units will be eliminated or reconfigured, or projects that will change the population served (e.g. from family to elderly).
- Revisiting a challenge that has confronted many new construction projects: how to treat residents of converted public housing units while new RAD units are being constructed. On the one hand, the notice reaffirms HUD’s baseline expectation that the owner of the new site is responsible for housing these tenants (e.g. through a Master Lease of current units from the PHA or through individual Section 8 Pass-Through leases). On the other hand, there is now an explicit opportunity for owners to request that the converting units remain under the public housing program until new units are completed. In this alternative scenario the owner would receive something akin to an “AHAP” – with the existing residents remaining in the public housing development as tenants of the PHA while the new owner begins to receive subsidy only after the RAD units are complete.
- Clarifying when non-dwelling property and land can be removed from the public housing program if vacated in conjunction with a RAD conversion. Generally, HUD now requires that property either be sold for fair market value or be dedicated to affordable housing uses, and requires that a Declaration of Trust remain on the property until an appropriate disposition is approved and implemented.
- Requiring that in instances of “rent bundling” (when the PHA has two or more projects and moves rent from one property to the other) – donor property must close before or at the same time as the receiving property.
- Facilitating multiphase projects by
  - Providing additional time through July 1, 2018 for submitting an application for the final phase; and
  - Permitting, in some cases, early demolition to facilitate later phases. Pre-closing demolition is otherwise prohibited in RAD.
- Fixing contract rents at 2014 levels, plus an annual operating cost adjustment factor (OCAF) for new awards.

- Preserving RAD Section 8 authority in situations where a current resident’s income is above the level where Section 8 would provide assistance, or where a resident’s income rises above that level, so that the assistance can be revived for a subsequent resident or if the first resident’s income drops.
- Eliminating interim program milestones in order to streamline processing.
- In order to incentivize energy conservation measures, permitting RAD contract rents to increase by 75% of estimated savings on tenant-paid utilities. This feature is available by right in PBRA projects, and HUD has encouraged PBV projects to seek a waiver to permit project-specific utility allowances.
- Permitting Section 8 assistance to float, if public housing mixed-finance units floated previously.
- Providing additional flexibility for Choice Mobility programs.
- Clarifying requirements for the operation of waiting lists under different circumstances.
- Clarifying that various tenant protection rules may not be altered by MTW agencies.
- Clarifying the means by which a PHA or a nonprofit must exercise “ownership and control” over a RAD project.

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### **RAD Second Component**

The Notice incorporates several significant changes relating to the Second Component of RAD (RAD II). In the past, RAD II permitted owners of projects with Rent Supplement (Rent Supp), Rental Assistance Payments (RAP) or Section 8 Mod Rehab (Mod Rehab) assistance to convert their HUD subsidy to PBV assistance when the Rent Supp/RAP/Mod Rehab contract terminated or expired. The RAD II program has already allowed dozens of project owners to convert their subsidy to long-term PBV contracts (often covering most of the projects’ units) and leverage new debt and equity for rehabilitation and redevelopment of their projects. As further discussed below, under the Notice (and the FY 2015 appropriations law), the potential subsidy contract options available to project owners participating in RAD II were expanded – and the RAD II program requirements were modified and/or clarified.

We have highlighted below a few particular RAD II program changes incorporated into the Notice that we think may be of particular interest to you.

**Option of PBRA or PBV Contracts:** The most notable change for RAD II is that Owners now have the option to receive a Section 8 PBRA instead of a PBV contract. The PBRA contracts offer some potential advantages over PBV contracts, such as:

- **Initial Rents:** The initial rents under the RAD II PBRA contracts may prove to be higher than those under PBV contracts – and avoid PHA “discretion” on rent-setting. PBRA contract rents will be set at the lesser of (i) 110% of FMR, less the applicable utility allowance (110% FMR), and (ii) the market rent, as confirmed by the owner’s rent comparability study (RCS Market Rent). For PBV contracts, the rents will be set at the lesser of (a) the PHA’s payment standard (generally not to exceed 100% FMR), and (b) the “reasonable rent,” as determined by the PHA (PHA Reasonable Rent).

- Post Rehab Rents: For PBRA contracts (unlike PBV contracts), if rehabilitation is contemplated, the market rent cap may reflect the “post rehab” market rents (i.e., the market rents after rehabilitation).
- Rent Adjustments: The PBRA contracts will provide for automatic, annual OCAF rent adjustments, but not to exceed the higher of (i) 110% FMR, and (ii) the RCS Market Rent (with a new RCS every 5 years).<sup>1</sup> Under the PBV contracts, the owner may request a rent increase at each anniversary, but the rents shall be capped at the lesser of (a) 110% FMR, and (b) the PHA Reasonable Rent. The PBV rent may also be reduced if there is a 5% or greater decrease in the published FMR. All such adjustments are, of course, subject to appropriations.
- Term: PBRA contracts provide an initial contract term of 20 years; PBV contracts, 15 years.
- Familiarity and Stability: PBRA contracts and rent-setting rules are typically more familiar to investors/lenders. Also, the PBRA funding source – project-based Section 8 appropriations – is typically considered “more stable” (less subject to Congressional wrangling) than voucher funding underlying PBV contracts.
- No Percentage Cap: PBRA contracts impose no percentage cap on the number of assisted units; PBV contracts impose a 50% limit, subject to certain exceptions.
- Contract Administration: PBRA contracts are administered by HUD’s Office of Housing (or a Contract Administrator); PBV contracts are administered by PHAs.
- Utility Allowances: PBRA contracts typically offer some additional flexibility on setting UAs.
- Future MAHRA Renewal: Under current law, upon expiration of the initial 20 year term, the PBRA contracts should permit renewal at the true “market rents” (i.e., “street rents”) upon contract expiration. No such option currently exists for PBV.

Many owners were hoping that RAD II PBRA would permit the owners to increase contract rents to the true market rents upon RAD II conversion -- meaning, a substantial rent increase for many projects. However, as indicated above, the initial rent-setting for RAD II PBRA contracts limits the contract rents to no more than 110% FMR.

The Notice also addresses the following matters, among others:

- 60 Day Restrictions on Rent Increases Following Prepayments: Provides special procedures to allow Rent Supp and RAP contracts to remain in effect for 60 days following prepayment to permit compliance with the applicable prepayment statute and PBV rent-setting requirements. (This addresses a statutory quirk that has caused a glitch in the start of subsidy for RAD II conversions in the past.)
- Mod Rehab and Mod Rehab SRO: Indicates that all Mod Rehab projects must be processed under RAD II (despite legislative authority to participate in RAD I as well). Also, Mod Rehab Single Room Occupancy projects funded under McKinney-Vento are now eligible to participate in RAD II.

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<sup>1</sup> The RCS Market Rent is presumably adjusted each year by OCAF, but that issue is not clearly addressed in the Notice.

- Tenant Protections: Clarifies tenant protection provisions addressing the existing residents “right to remain or return” to RAD II property following rehabilitation.
- Davis Bacon: Reiterates guidance previously provided by HUD indicating that Davis Bacon requirements apply in the context of “development” (including remodeling and rehabilitation) of PBV RAD II projects – at least to the extent occurring within 18 months of PBV HAP contract. The same 18-month threshold is applied to PBRA RAD II projects.
- 236 Decoupling Rent-Setting: Clarifies PBV rent setting procedures for Section 236 decoupled projects.