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RAD for PRAC guidance published in Rev-4

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HUD's final RAD for PRAC guidance largely tracks the previously published draft guidance and offers some key improvements on the use of sales proceeds.

HUD has published Rev-4 of the RAD Notice ("Rev-4") on its website (now renumbered as Notice H-2019-09 / PIH-2019-23(HA)). Rev-4 sets forth the eagerly anticipated final guidance on "RAD for PRAC," implementing the authority to convert Section 202 PRAC projects through RAD to long-term Section 8 contracts. (Rev-4 also updates guidance on the other RAD components that convert public housing, Mod Rehab, Rent Supp, and RAP properties—for more information, see our Affordable Housing Blog.)

Rev-4's final RAD for PRAC guidance largely tracks the draft guidance published in February 2019. Some highlights of Rev-4 include:

— **Rents?** Questions remain on rent-setting provisions. Initial contract rents are limited to the lesser of (a) "approved PRAC rents" or (b) 120% of FMR for PBRA projects (110% of FMR for PBV projects). For many existing PRAC projects, conversion at existing rent levels is not possible. Rev-4 maintains the potential rent adjustment provisions set forth in the draft guidance: (i) Projects can use capital needs assessments (CNAs) to support rent increases at their annual PRAC renewal. Attention to this tool in the draft guidance sparked a greater than anticipated demand for rent increases in 2019, causing HUD to put a 5% limit on rent increases for the time being. However, HUD appears hopeful that future appropriations will not require such limiting measures. (We expect advocacy organizations to take this up with Congress in the coming session.) (ii) Owners can "rent bundle" to pool and share subsidy among several projects, presumably with some common ownership among the new project owners. (iii) HUD reserves the right to modify PRAC rents at conversion to support an approved project budget, subject to the availability of appropriations.

— **Use of proceeds allowed, limited.** The draft guidance restricted the use of proceeds from a sale or refinancing for the length of the original Capital Advance restrictions. Rev-4 aims to address some of the criticism the draft provisions received. As with the draft guidance, HUD will not restrict the use of proceeds for affordable housing purposes (for the benefit of the project, its residents, or other low-income housing). Additionally, Rev-4 allows sellers in third-party sales to use proceeds for transaction costs (including taxes, fees, broker fees, and legal costs), for limited withdrawal of equity (increasing the longer the project has operated), and for limited repayment of identity-of-interest loans. Project owners are also allowed to take distributions from surplus cash if a minimum operating reserve balance is met. These allowances realistically reflect market realities and help to avoid unnecessary disincentives to conversion.

- **PBV conversions are super complicated.** Because of budgeting and reapportionment quirks, RAD for PRAC conversions choosing PBV face additional challenges over those choosing PBRA. Among these complexities, PBV projects will need to be timed to correspond with the PRAC's expiration and will need to close in escrow for 90 days while funding is reallocated. PBRA conversions will be much simpler to implement.
- **Davis-Bacon requirements apply to previously unassisted units**. In the draft guidance, Davis-Bacon wage requirements did not apply to PBRA conversions but applied to PBV conversions. The final guidance makes applicability of Davis-Bacon more consistent for PBRA and PBV, but takes a step back for PBRA. In both PBV and PBRA, Davis-Bacon wages will only apply for housing units that did not previously receive rental assistance. This clears an obstacle for projects simply looking to convert existing assistance on site but might prove challenging for transfers of assistance and new construction.

Some key features of the guidance that didn't change but are worth noting include:

- **Capital Advance use restrictions and debt terminated and replaced.** Upon conversion, all existing Capital Advance debt and use restrictions are terminated. In their place, a new Elderly Housing Use Agreement will be in effect for the remaining term of the Capital Advance Use Agreement plus 20 years.
- **Social services required.** Responding to concerns from current providers and advocates, the conversion plan must account for the provision of social services.
- **Nonprofit involvement required, but flexible.** Nonprofits must participate in project ownership, but requirements are more flexible than current Section 202 loan prepayment requirements. Rev-4 allows LLC owners and for for-profit joint ventures with a nonprofit controlling 51% of a general partner or managing member interest.
- **Other common RAD requirements apply**. Common RAD features apply, including the Uniform Relocation Act, a 20-year CNA, site and neighborhood standards, and environmental review. Interested parties must first provide some basic project information in a letter of interest and conduct resident consultations before submitting a full conversion plan.

RAD for PRAC conversions may provide a valuable opportunity for existing project owners and new partners to preserve this important source of affordable housing for low-income elderly residents. Nixon Peabody's Affordable Housing team is one of the largest in the country, and we offer unparalleled knowledge in this field. Our experience and our key strategic relationships give our clients a special advantage in navigating these transactions.

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