RAD preservation in Lavonia, GA.

The Many Flavors of RAD

Unique challenges of completing conversions

By Bendix Anderson

Public housing is threatened – again – with deep funding cuts in the latest proposed federal budget, released in March by President Donald Trump.

News like this makes housing authorities even more eager to access programs, like the Rental Assistance Demonstration (RAD) from the U.S. Department of Housing and Urban Development (HUD). "RAD was originally conceived to address just that problem," says Joseph Hague, vice president for Red Capital Markets.

RAD allows housing authorities to convert public housing apartments to housing that receives project-based operating subsidies through HUD's Section 8 program. All HUD programs are subject to potential budget cuts by Congress, but the project-based Sec. 8 program has historically been consistent.

Housing authorities starting a RAD conversion will face a set of challenges as unique as the property they are converting. Even relatively simple conversions can be full of surprises. The latest proposed cuts to housing programs will make these conversions even more challenging.

Simple RAD refinancing provide consistent operating funding

Public housing has been underfunded for years. The shortage of money has forced many housing authorities to defer basic maintenance. Public housing communities across the country need major repairs that would cost $26 billion, according to HUD.

However, of the public housing properties that go through RAD, some properties are in relatively good condition and can often go through a simple RAD conversion with little or no other funding.

In October 2014, the Lavonia Housing Authority (LHA) in Lavonia, GA, closed on the RAD conversion of its entire 180-unit portfolio.

It was the simplest kind of RAD transaction. The public housing apartments were in good condition. The housing authority didn't need to take loans, soft funding or LIHTC equity to make the deal work.

In Lavonia, RAD converted the public housing apartments into affordable housing with a project-based Sec. 8 contract to provide rental subsidies to the people living in the apartments.

That's a huge relief for the authority, because the federal subsidies that are supposed to pay the costs to operate public housing have not been dependable.

Congress often passed federal budgets that provided less money to public housing than what federal officials at HUD estimated housing authorities would need to operate the properties.

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"Sec. 8 has traditionally been funded at the budgeted level. But public housing operating subsidies – 'Sec.9' has not been," said Red Capital's Hague.

Prior to its RAD conversion, LHA operated its portfolio with funds that, in some years, only covered 77 percent of what good management would require.

Also, Congress sometimes failed to pass a budget. The "continuing resolutions" passed instead made it challenging for LHA to keep the lights on, let alone pay for major repairs.

Project-based Sec. 8 subsidies have been more dependable over the years. Conversion set the new Sec. 8 rents at the portfolio at 95 percent of what LHA received in Fiscal 2012 – much closer to the actual cost to operate the properties than what the property received in other years.

Unlike other, more complicated RAD conversions, LHA kept ownership of its portfolio, though the apartments are no longer subject to public housing rules. LHA's role is now similar to a private company that manages a private, project-based Sec. 8 property.

"They became enlightened landlords of a Sec. 8 property, though they have a charitable mission," says Richelle "Shelly" Patton, principal with Tapestry Development Group, which consulted with LHA on the conversion.

LHA can also now take out a loan secured by the portfolio. "If they want to bring debt onto the property later they can," says Patton.

HOPE VI redevelopments benefit from RAD

Tens of thousands of public housing units have been comprehensively redeveloped in recent decades to become new, mixed-income communities through the HOPE VI program. Many of these communities are still in solid physical condition, but their public housing apartments can still benefit from RAD conversions.

For example, Monterey Place in New Haven, CT, and Southwood Square in Stamford, CT, were two of the first public housing communities comprehensively redeveloped through HOPE VI. Both completed RAD transactions in late 2016.

Just like in Lavonia, these HOPE VI properties are still in very good condition. "All we did was a subsidy swap," says Darcy Jameson, development director for Beacon Communities Development, which partnered with the housing authorities to complete the transactions. "Neither property needed an infusion of new tax credits."

RAD conversions simply allowed these communities to move to a more dependable form of operating subsidy.

"Both of these properties were starting to face challenges before their RAD conversions," says Jameson. "If you don't have enough operating subsidy, it is difficult to maintain the apartments in a standard that attracts market-rate residents."

RAD conversions have also eased the stress levels of many private partners in HOPE VI transactions, who no longer have to manage the budget shortfalls from public housing apartments.

Substantial rehabilitation

Public housing communities that need more serious repairs can find funding – but there are limits to how much RAD can provide.

By late 2017, renovations will be complete at Twin Lakes of Leesville, which includes 194 affordable apartments spread over four properties in Leesville, LA. Until recently, these apartments comprised the entire public housing portfolio of the Leesville Housing Authority.

The housing authority partnered with Bennett Group Consulting to complete a RAD conversion that turned these public housing units into affordable apartments subsidized with project-based, Sec. 8 rental subsidies.

Because Twin Lakes is no longer subject to public housing rules, Twin Lakes can now support a $3.5 million tax-exempt bond mortgage secured by the property. The U.S. Department of Agriculture Rural Development program provided the loan.

One of the challenges of RAD conversions, however, is that even though Sec. 8 operating subsidies have been much more consistent than public housing operating subsidies, they still are not very large.

More income would support a larger loan. To increase the net operating income at Twin Lakes, the developers made the apartments much more energy efficient. Most of these savings will reduce the utility bills for residents, which are paid for by HUD. The developers convinced HUD to recognize the energy savings, lower the utility allowances for the apartments and shift the savings over to the operating subsidies provided to the apartments.

"We can reduce the utility allowance to recognize up to 75 percent of the energy savings," says Holly Knight, vice president of development for Bennett Group Consulting, based in Auburn, AL.

Renovations at Twin Lakes will save $66,000 a year. HUD has allowed the developers to reduce the utility allowance accordingly, resulting in more income for the property, which allowed the properties to take out an extra $800,000 in debt.

The developers made the loan even larger by convincing the town of Leesville to forgive for 15 years the already low "payment in lieu of taxes" that the property would have had to pay. The extra net operating income allowed the property to support a little more debt.

RAD conversion also allows the housing authority to sell the property – just like the owners of any other Sec. 8 affordable housing property. At Twin Lakes, the housing authority sold the buildings and retained ownership of the land underneath, which it leased to the development.

That sale meant Twin Lakes could receive an allocation of LIHTCs and sell them, along with an ownership interest in the property, to Enterprise Community Investments for $8.3 million.

Again the developers squeezed all the funding they could out of their reservation of LIHTCs. For example, they made sure the property was appraised to reflect the property's unrestricted value, even though the covenants that will keep Twin Lakes affordable are layered and strong, says Knight.

A higher appraised value increased the price the LIHTC partnership paid the housing authority to buy the buildings. The housing authority accepted a $6 million note from the partnership, instead of cash. Meanwhile the purchase prices got included in the development cost and helped generate more LIHTCs to pay for redevelopment.

Even with all this work, the RAD redevelopment and conversion only added up to a total development cost of $23.4 million, or $121,000 per unit – and much of that expenditure was soft costs like the price of land.

RAD demolitions move public housing

The most intense kinds of RAD conversions involve the demolition of obsolete public housing.

In January 2017, the Wicomico County Housing Authority (WCHA) and affordable housing developer Pennrose opened 84 new apartments at Stone Grove Crossing in Salisbury, MD. It's the $17 million first-phase of the redevelopment of Booth Street, a former, 100-unit public housing site. Fifty of the apartments at Booth Street were demolished to make room for the new development.

However, even this success illustrates the complexity and difficulty of redeveloping public housing. HUD approved the RAD conversion of the subsidy from just 50 of the units at the old Booth Street to the new Stone Grove Crossing.

But the remaining 50 units cannot be redeveloped in the same location, according to HUD, because of Fair Housing Law.

"All RAD transactions must be approved by HUD's Office of Fair Housing and Equal Opportunity (FHEO)," says Ivy Carter for Pennrose. "They won't approve a transaction to place public housing in areas where minorities and poverty are already concentrated."

So the second phase of the RAD conversion of Booth Street must use the rental subsidies converted by RAD in a "community of opportunity," according to HUD. Pennrose

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has now secured a site for its second phase in the City of Salisbury and is applying to LIHTCs.

And HUD did not approve phase one immediately. A full year after phase one received a reservation of LIHTCs, FHEO questioned whether redevelopment was legal. Several months of anxiety followed before the deal could move forward.

"We had already spent $800,000 in predevelopment costs," says Carter.

The lesson learned for Pennrose is to make as sure as possible that there are no unexpected hurdles to redevelopment early in the process.

"Make sure you get your deal into FHEO before you go too far," says Carter.

Pennrose's Stone Grove Crossing in Salisbury, MD

RAD deals have so many moving parts, and often include so many different lawyers for the various partners, it pays to go over deals again and again, looking for potential issues and failures of communication. Problems can lurk in any aspect of the deal, from compliance with Fair Housing law to the title for the land under the public housing, which probably hasn't been examined in decades and may contain mistakes.

"In these transactions there are so many parties involved, communication is really key," says Red Capital's Hague.

HAs caught by funding cuts

Housing authorities that have already completed RAD conversions are now in a much better position the next time Congress dramatically cuts funding for HUD programs. However, a funding cut will put stress on housing authorities trying to complete RAD conversions.

For example, the New York City Housing Authority is expected to run a $28 million surplus this year. That would go a long way in hiring and training staff to manage complicated, difficult deals, like RAD conversions.

But if President Trump's budget plan is enacted, that surplus is likely turn into a $153 million budget gap, according to NYCHA officials who briefed city politicians on March 3.

NYCHA recently announced plans to convert 3,100 public housing apartments through the RAD program – including some of the City's "most challenging" public housing.

Many RAD deals depend on some contribution of funding from their local housing authority, such as capital funds. For RAD deals that are underway now, housing authorities, like NYCHA, have probably already set aside those funds.

"Most of the capital funds that the HAs are contributing, they have those funds already," says Red Capital's Hague

However, as cuts push housing authorities into the red, they are less likely to be able to sweep in to help RAD projects that have budget shortfalls for other reasons, like the fall in the price of LIHTCs.

The funding shortage might also squeeze the capacity of housing authorities to maintain the staff and resources they need to complete a RAD transaction.

The rest of the HUD budget also creates challenges for housing authorities attempting to complete RAD conversions. The proposed HUD budget eliminates the $950 million HOME program and the $3 billion Community Development Block Grant program.

"You are looking at deals that are maybe not going to be able to move forward," says Carter. TCA