

## Year of Conversion Funding Instructions for Public Housing Projects Converting Under RAD

This document provides guidance to PHAs and their developer partners related to the funding of public housing projects during the year in which the property converts through RAD to project-based Section 8 Housing Assistance Payments (HAP) contracts as either Project-Based Rental Assistance (PBRA) or Project-Based Vouchers (PBV)

### Background

- 1) For the Year of Conversion (defined as the balance of the months remaining in the calendar year following the effective date of the HAP contract), projects will continue to be supported by the public housing Operating and Capital Funds that have been or will be obligated.
- 2) In the first full Calendar Year following conversion, projects will be funded from the Section 8 accounts, in accordance with the HAP contract rents.<sup>1</sup> HUD will place new funds on a Section 8 HAP contract (for PBRA) or Voucher ACC (for PBV).
- 3) In the second full calendar year and in each succeeding year, the HAP contracts will be included in the renewal funding formulas for either Section 8 account.

	Year of Conversion	First Full Year	Second Full Year (and ongoing)
	Contract Effective Date	January 1	January 1
Project Revenue	<ul style="list-style-type: none"> <li>Pro-Rated Operating and Capital Funds, Tenant Rents</li> </ul>	<ul style="list-style-type: none"> <li>HAP Rents or Rehab Assistance Payments Tenant Rents</li> </ul>	<ul style="list-style-type: none"> <li>HAP Rents or Rehab Assistance Payments Tenant Rents</li> </ul>
PBV Specific	<ul style="list-style-type: none"> <li>HUD adds units and \$1 to voucher ACC</li> <li>No VMS Reporting</li> <li>No Administrative Fee</li> <li>PBV 50058 submissions begin</li> </ul>	<ul style="list-style-type: none"> <li>New Funding added to voucher ACC</li> <li>VMS reporting begins</li> <li>Administrative fee begins</li> </ul>	<ul style="list-style-type: none"> <li>Funding renewed through normal HCV re-benchmarking process, based on prior year HAP expenses reported in VMS</li> </ul>
PBRA Specific	<ul style="list-style-type: none"> <li>PBRA 50059 submissions begin</li> <li>\$0 requested in voucher submissions</li> </ul>	<ul style="list-style-type: none"> <li>Owner begins requesting HAP funding in voucher submissions</li> </ul>	<ul style="list-style-type: none"> <li>Owner continues requesting HAP funding in voucher submissions</li> </ul>

<sup>1</sup> Public Housing funds will be transferred to the tenant-based rental assistance (TBRA) or project-based rental assistance (PRBA) accounts in order to provide funds for these contracts.

## **Year of Conversion Funding Instructions for Public Housing Projects Converting Under RAD**

### **I. HAP Payments From Conversion to the End of the Initial Year:**

#### **A. Conversion Effective Date**

Typically, a RAD HAP contract must be effective on the first day of the month following the completed closing. Upon the Project Owner's request and consent of the PHA, the RAD HAP contract may be made effective on the first day of the second month following the completed closing. For example, if the project closes on October 20, 2017, the HAP contract can be effective on either November 1, 2017 or December 1, 2017. Please note that HUD considers a closing to be complete when the RAD Use Agreement has been recorded. Also note that for HAP contracts with an effective date of January 1, the Initial Year funding provisions remain in effect for a full 12 months.

#### **B. Funding in the Year of Conversion**

During the Year of Conversion, a Covered Project (defined as the post-conversion property with assistance converted from one form of rental assistance to another under the RAD program) will be funded through the public housing Operating Fund and Capital Fund at the level of public housing subsidy available to that project in that fiscal year.<sup>2</sup> The rent schedule in the HAP contract does not take effect until January 1 of the first full calendar year following conversion. HUD has produced the "Initial Year Funding Tool" (available on the Resource Desk) so that PHAs and Project Owners can calculate the amount of public housing subsidy, in addition to tenant rents, that would be available to a Covered Project during the Initial Year.<sup>3</sup> The Initial Year Funding Tool must be submitted twice: first, as part of the Financing Plan to ensure that the parties understand the funding available in the Year of Conversion and can take steps, if needed, to manage to this funding level; and then again following closing so that HUD can make the funds available to the PHA. For both the Operating Fund and the Capital Fund, the Initial Year Funding Tool calculates the maximum public housing subsidy that can be available to the Covered project in the Initial Year; the PHA and Project Owner have the option to elect a lesser amount. Once the RAD units have converted, PHAs will draw the public housing funds down from LOCCS and convey the agreed-upon subsidy amounts directly to the Covered Project. PHAs do not need HUD authorization to draw down and convey these funds. PHAs and Project Owners should coordinate on the timing and frequency of the payments.

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<sup>2</sup> Following conversion, the public housing units that are included in the RAD conversion will be removed from the Public Housing Information Center (PIC). This action will not impact public housing subsidy for the converted project for the balance of the Initial Year

<sup>3</sup> Where a Covered Project includes units converting from multiple AMPs, a PHA must complete an Initial Year Funding Tool for each AMP.

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There are different procedures for calculating the maximum amount of the Operating Fund and Capital Fund subsidy available to Covered Projects:

Operating Fund – The maximum amount available for the Covered Project shall be a percentage of each month’s Operating Subsidy obligation (RAD Operating Fund %), as detailed below:

$$\text{RAD Operating Fund \%} = \frac{\text{Units Covered under RAD}}{\text{ACC units}}$$

As a result, for full-AMP conversions, 100% of Operating Funds provided for the AMP for the balance of the year can be conveyed to the Covered Project. For partial-AMP conversions, a portion of the Operating Funds provided to the AMP for the balance of the year, based on the percentage of ACC units removed as part of the conversion as compared with the total number of ACC units in the AMP at the beginning of the calendar year, can be conveyed to the Covered Project.

For MTW agencies that receive an alternative Operating Fund subsidy, the formula is adjusted to reflect that the Operating Funds are provided to the PHA as a single grant, rather than by project:

$$\text{MTW RAD Operating Fund \%} = \frac{\text{Units Covered under RAD}}{\text{PHA's Total ACC Units}}$$

Unlike the Capital Fund, HUD will not move funds into a dedicated RAD BLI. Instead, the PHA is responsible for ensuring that the amounts conveyed to the Covered project do not exceed the RAD Operating Fund percentage and for properly recording such transfers in their Financial Data Schedule.

Capital Fund – The maximum amount transferred to the Capital Fund RAD BLI 1503 will be based on the PHA’s Capital Fund Formula Grant<sup>4</sup> attributable to the project (“Project amount”) in the year of conversion and will be calculated as follows:

$$\text{RAD BLI} = \text{Project amount} \times \frac{\text{Units Covered under RAD}}{\text{Standing Units}} \times \frac{\text{Months Remaining in CY from HAP Effective Date}}{12}$$

The PHA calculates and HUD’s Office of Capital Improvements (OCI) reviews this amount for each converting property. To effectuate the transfer of Capital Funds into BLI 1503

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<sup>4</sup> Net of any Replacement Housing Factor (RHF) or Demolition/Disposition Transition Funding (DDTF).

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for rental assistance, once the closing occurs the PHA must submit to the RAD Closing Coordinator and to the PIH Field Office:

- the Initial Year Funding Tool showing the calculated and requested amount of Capital Funds to be used for rental assistance in the Initial Year; and
- a revised HUD Form 50075.1 Budget Adjustment Request Worksheet showing the Capital Funds identified in the Initial Year Funding Tool moving to BLI 1503 in LOCCS. (Since BLI 1503 does not appear on HUD Form 50075.1, PHAs are instructed to manually cross out an unused BLI and write in "1503").

### Funding in the Year of Conversion - Prior to Capital Fund Award

PHAs that convert with a HAP contract effective date early in a new calendar year, before Capital Fund awards have been made, must wait until the new calendar year grants are disbursed to utilize Capital Funds for BLI item 1503. PHAs are NOT permitted to utilize Capital Funds from the prior calendar year for BLI 1503. When the new grants are available, the Office of Recap will upload to the RAD Resource Desk an updated version of the Initial Year Funding Tool (IYFT) for the new calendar year. Once that occurs, the PHA must:

1. complete the IYFT;
2. complete the corresponding 50075.1 for BLI 1503;
3. submit the documents to [RADCapFunds@hud.gov](mailto:RADCapFunds@hud.gov) with a copy to the PIH Field Office; and
4. the PHA should also upload the 50075.1 and the IYFT to the Closing transaction page on [www.radresource.net](http://www.radresource.net)

PHAs who are concerned about waiting until receipt of the new Capital Fund grant in order to have funds to operate the property in the first quarter of the new calendar year may wish to consider setting up an operating reserve for the project to cover this period. To do so, PHAs can increase the Capital Fund contribution by placing funds from prior year Capital Fund grants in their RAD Sources and by establishing a corresponding “operating reserve” in the RAD Uses to cover this gap period. In order to use these funds, they must appear in the final HUD-approved RAD Sources & Uses (Exhibit B to the RAD Conversion Commitment) prior to closing. **THIS MUST OCCUR PRIOR TO CLOSING.** After closing, PHAs are not permitted to add Capital Funds to a converted RAD project.

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**Initial Year Funding Example:** A project with 100 1-BR apartments converts with a HAP effective date of April 1, 2017. It is part of an AMP with an additional 100 units that will remain in the public housing program.

**Operating Fund:** The portion of Operating Funds that can be conveyed to the Covered Project is the percentage of units being removed from ACC as part of the conversion compared with the total units in the AMP:

$$RAD\ Operating\ Fund\ \% = \frac{100}{200} = 50\%$$

The PHA applies the RAD Operating Fund % to each month's Operating Fund subsidy. The table below shows a fictional depiction of HUD's Operating Fund obligation schedule for 2017 for this project:

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec
Operating Subsidy (thousands)	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50	\$50
RAD Operating Fund %	0	0	0	50%	50%	50%	50%	50%	50%	50%	50%	50%
Available for Covered Project (thousands)	0	0	0	\$25	\$25	\$25	\$25	\$25	\$25	\$25	\$25	\$25

**Capital Fund:** The "Project Amount" posted for this property pursuant to the Capital Fund formula is \$240,000. Accordingly, the portion of these funds that can be conveyed to the Covered Project for rental assistance is:

$$RAD\ BLI = \$240,000 \times \frac{100}{200} \times \frac{9}{12} = \$90,000$$

HUD will transfer this amount to the RAD BLI in full and at once, as opposed to monthly transfers.

**C. Ongoing submission of Operating Fund and Capital Fund forms**

Because a converting project will rely on Operating Fund and Capital Fund subsidy in the year of conversion, until a project has converted, PHAs should prepare subsidy eligibility documents for both Operating Fund (submitting HUD Form 52723) and Capital Fund (certifying to Capital Fund eligible standing units and executing the ACC Amendment) as if the project were remaining in the public housing program. However, a PHA should withhold submission of Operating Fund and Capital Fund forms if a public housing property has converted prior to the Capital Fund or Operating Fund submission due dates since the PHA is not entitled to the following year's funding.

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HUD will remove units that have converted from the public housing Operating Fund and Capital Fund formulas in the year following conversion.

### D. Adjustments

During the Initial Year, HUD will **not** provide additional subsidy to the project if the amount provided through the public housing Operating Fund and Capital Fund differs from the HAP subsidy that would be due under the HAP rents. PHAs and Project Owners may choose to establish an operating deficit reserve or other reserve, as approved in a Financing Plan, to make up for any such difference, but are under no HUD-imposed obligation to do so.

#### **How Should A PHA and Its Partners Underwrite Project Income During the Initial Year?**

In the event that income made available to a property in the year of conversion is less than the HAP contract rents or the Rehab Assistance Payments, PHAs have a few options:

- A. For transactions that will not be taking on any new debt, the property will continue to receive the subsidy that was supporting operations prior to conversion, plus a portion of the PHA's Capital Fund. Given that HUD has underwritten the transaction with an expense cushion, the public housing amounts and tenant rents should cover project operations. These PHAs don't have any third parties to satisfy.
- B. For transactions that are financed with debt, often the debt service payments will not begin until the construction loan is converted to a permanent loan. All deals underwritten by FHA fall into this category. In non-FHA deals, if the debt service payments do begin immediately, there is typically sufficient debt service coverage built into the underwriting to withstand a temporary and what is almost always a small revenue gap. When needed, a PHA can create a reserve to cover any projected revenue differential in the first year. The key is communicating expectations with the lender so that the lender understands how the first year funding works.
- C. For transactions that involve tax credits, investors typically require a lease-up reserve and a six-month operating reserve. Owners can negotiate with investors to use a small portion of these funds to cover any revenue gap to the extent that it would impact the owner's ability to pay operating costs, or create a separate reserve for this purpose.

### **II. HAP Payments Beginning In the First Full Calendar Year Following Conversion:**

In the January following a converted property's HAP effective date, funding will begin to flow through the Section 8 accounts. For PBRA conversions, please review the [RAD Quick Reference Guide to Multifamily Requirements](#) for instructions on accessing and using the Tenant Rental Assistance Certification System (TRACS) to requisition for funding. For PBV conversions, please review the [Quick Reference Guide for Public Housing Projects Converting to Project-Based Voucher \(PBV\) Assistance](#) for background on how funds are provided to PHAs and recorded in VMS.