November 23, 2022

Tom Davis
Director, Office of Recapitalization
U.S. Department of Housing and Urban Development
451 7th Street S.W. Washington, DC 20410

RE: Multifamily Housing Policy Drafting Table for The Section IV: 202 Project Rental Assistance Contract (PRAC) Project

Dear Director Davis,

Thank you for your leadership to preserve affordable housing options for low-income older adults and people with disabilities, including through the continued thoughtful administration of the Rental Assistance Demonstration (RAD). LeadingAge welcomes the opportunity to provide feedback on RAD for Section 202 Supportive Housing for the Elderly and Section 811 Housing for Persons with Disabilities with Project Rental Assistance Contracts (PRACs) as a crucial preservation mechanism for HUD-assisted Multifamily Housing communities across the country.

HUD is currently in the process of improving and expanding Section IV of the RAD Implementation Notice,[1] including to implement the new authority of RAD for 811 PRACs, and to adjust existing procedures for RAD for 202 PRACs. Throughout this process, we recommend HUD adopt several key policy features and adjustments to ensure the feasibility of, and improve, RAD as a preservation tool for the PRAC portfolio.

We look forward to continuing our work together with HUD to ensure that quality affordable housing communities are preserved for the hundreds of thousands of people served in Section 202 and 811.

About LeadingAge

LeadingAge represents more than 5,000 aging services providers, including non-profit owners and managers of federally-subsidized senior housing properties. Alongside our members and 38 state partners, we use applied research, advocacy, education, and community-building to make America a better place to grow old. Our membership encompasses the continuum of services for people as they age, including those with disabilities. We bring together the most inventive minds in the field to lead and innovate solutions that support older adults wherever they call home.

Recommendations to Improve the Rental Assistance Demonstration for PRACs

The Rental Assistance Demonstration serves an important preservation function within HUD's portfolio: allowing properties operating under certain HUD programs with limited recapitalization options to convert to other HUD programs that provide access to better financial leveraging. This frees up properties that currently have limited options for rehabilitation and long-term recapitalization, like HUD's Section 202 Supportive Housing for the Elderly, to convert to HUD's Section 8 platform, under

[1] PIH 2019-23, Housing 2019-09 Rev 4

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which properties can leverage public and private funding to make much-needed physical property improvements. In addition to rehab work, RAD also provides an avenue for the country to keep units affordable longer, because converting properties agree to new affordability restrictions and use agreements.

In other words, RAD is crucial for keeping the country's affordable housing stock in quality condition for the long-term by providing an avenue for physical property rehabilitation and renewed affordability commitments. Preservation in this sense is about the survival and continued improvement of affordable housing options across the country.

While we are committed to working with HUD and the affordable housing field to ensure feasibility of RAD as a tool for preservation as described, we also recognize the overarching policy adjustments needed throughout HUD program administration, including support for ongoing property maintenance, capital needs, and operational funding, to avoid the need to rely on RAD to begin with. Additionally, while we commend HUD's team for successfully designing and implementing the RAD program to date, a number of policies in the current RAD for 202 PRAC program hinder HUD's preservation goals, and in fact recreate the physical condition issues and financial infeasibility constraints that necessitated the RAD conversion in the first place.

As HUD implements new RAD provisions for the 811 portfolio, we urge the agency to utilize this regulatory opportunity, and to make use of its waiver authority granted by the RAD statute, to make improvements to RAD for 202 PRACs with the goal of improving conversion feasibility and enhancing the condition of the country's affordable housing stock over the long-term.

Building Feasibility

While some properties have been able to navigate the RAD for PRAC conversion process in its current structure, we caution against continuing and replicating policies for converting 202 and 811 PRACs that create infeasibilities and ultimately limit the ability for deserving communities to participate in the preservation process.

From our members' experiences, these areas are ripe for improvement:

- **Rent Adjustments for Continuing Marketability and Preservation:** The "Second Component" of the RAD Statute, as last amended in 2022, reads that properties converting to Project-Based Rental Assistance (PBRA) enter into initial 20-year project-based subsidy contracts "with rent adjustments only by an operating cost factor established by the Secretary."[2]

  The RAD Notice implements this process by locking the initial contract into Operating Cost Adjustment Factor (OCAF)-adjusted rents, with Rent Comparability Studies only accessed to justify OCAF-adjusted rents that are higher than 120% of Fair Market Rents (FMR).[3] Non-RAD project-based Section 8 contracts, by contrast, have access to a Rent Comparability Study (RCS) every 5 years (in

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[2] Ramseyer for the "Rental Assistance Demonstration" as set forth in the Consolidated and Further Continuing Appropriations Act, 20121 Approved November 18, 2011 (P.L. 112-552 as amended by P.L. 113-76, P.L. 113-235, P.L. 114-113, P.L. 115-31, and P.L. 115-141), provision 22 (https://www.hud.gov/sites/dfiles/Housing/documents/RAD_112-55_Comprehensive_Ramseyer_3-15-22.pdf)

[3] Implemented for the Second Component in the fourth revision of RAD Notice, lines 743-754

addition to OCAFs), as well as other contract rent re-negotiation avenues, that help keep property budgets in step with market rents when HUD's operating cost factors lag behind and in and of themselves act as a preservation mechanism for HUD's Multifamily Housing portfolio.

Entering into a 20-year OCAF-only contract with no opportunities for budget adjustments or set intervals to bring rents to market levels is extremely risky for non-profits, and is deterring or barring properties in need of preservation from participating in RAD. The lack of access to a Rent Comparability Study (RCS) also heightens the importance of the initial rent-setting at the beginning of the new 20-year contract post conversion, because each year thereafter is able to be adjusted only minimally: Historically, OCAF adjustments have been in the 3% range, far below recent double-digit cost increases occurring nationally due to inflation and sharp rises in localized housing markets.

Because the OCAF-only 20-year contract is a legal requirement under the RAD statute, we urge HUD to work with Congress to adjust this requirement, or to utilize waiver authorities to provide alternative process for properties undergoing conversion. This will be necessary both for properties that have already converted – and now find themselves in a cashflow bind, unable to fully preserve the physical property (replicating the original motivation for converting through RAD) – and for properties positioning for a conversion and mapping out the financial feasibility over the long-term.

- **Initial Rent-Setting for Long-Term Feasibility:** Because of the restricted access to contract rent adjustments for converted properties, improving initial rent-setting should be HUD's primary goal to create more financial feasibility for converting properties and to avoid the conditions that necessitated RAD-accessed recapitalization to begin with.

  Currently, the RAD Notice, Rev-4, sets out a "lesser of" test[4] to establish initial contract rents for Second Component PBRA conversions: "The initial contract rents will be the lower of (a) the approved PRAC rents or (b) 120% of the applicable [Fair Market Rent].[5] While the general cap or "ceiling" on rents is a market-driven threshold set through HUD's Fair Market Rent calculation process, the current "lesser than" rent-setting approach sets a rent "floor" that relies not on the market or on HUD-analyzed datasets, but on HUD's annual budget-based adjustment process for PRACs, as requested by property staff and approved by HUD field staff on a property-by-property basis.

  The reliance on regular PRAC rents sets properties up to fail because of strong pushback from local HUD staff to increase PRAC budgets annually, originating in part from limited funds in the Section 202 account. In many cases, properties spend years inching property budgets upwards at less than 4% until they reach a rent level at which they can reasonably convert under RAD, keeping in mind that at the point of conversion they are locked into OCAF adjustments for 20 years. During the years of attempted budget-based increases, interest rates, costs, and capital needs often climb in proportion to the minimal budget-based rent increases, once again limiting access to RAD as a much-needed preservation tool.

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[4] RAD Notice, lines 714-716

[5] The 2022 amendment of the RAD Statute allows HUD to waive or alter the rent limit set through separate statute[5] at 120% of Fair Market Rent, allowing properties to go higher than 120% of comparable market rents in certain scenarios; we look forward to HUD's implementation of the new waiver authority to create rents that go above 120% of FMR to preserve a property's access to supportive services or to avoid a reduction in current subsidy, leading to better preservation over the long-term.

We strongly urge HUD to utilize waiver authorities to shift instead to an initial rent-setting process that considers comparable market rents, rather than relying on approved PRAC budgets alone. A similar authority was established through the amended RAD Notice for certain projects in high cost areas. For example, the current requirement could be adjusted to set initial contract rents at "the lower of (a) the approved PRAC rents, *not lesser than 100% of FMR*, or (b) 120% of the applicable FMR." In addition, lines 736 and 737 of the RAD Notice should be amended to read that HUD may "modify the PRAC Rents separate from the annual contract renewal process and prior to conversion, given the project budget, and subject to the availability of funding in the Housing for the Elderly account, *to adjust the rents to a minimum of 100% of FMR.*"

To further improve the initial rent-setting, and to incentivize the implementation of energy efficiencies at converting properties (discussed further below), HUD could add an additional rent-setting threshold of no less than 110% of FMR for properties utilizing proven energy efficiency strategies in their rehabilitation plans or projecting a minimum 20% energy utilization reduction, as demonstrated through energy audits, over a determined timeframe.

Alternately, HUD could waive the PRAC budget-setting process and establish an entirely separate, market-driven process for converting properties to access rent levels that are financially feasible over 20 years (this is already indicated by lines 736-741 of the Rad Notice, which carves out space for HUD to seek out off-cycle PRAC budget adjustments). It is our understanding that HUD is separately considering a market-driven budget approach for all PRACs; in the meantime, HUD should implement an alternative approach for RAD-converting properties so as to improve feasibility for many of the properties that would otherwise be excellent candidates for the preservation tool, and to avoid recreating the capital needs and cash flow binds that created the need for RAD to begin with.

Lastly, regarding rent-setting, HUD should, in its updates to the RAD Notice, reflect HUD's recent implementation of five-year PRAC renewals[6], compared to the previous annual renewal process. For example, Section 4.4 (G) of the Notice currently reads: "Owners of 202 PRAC Projects are required to submit a project budget and any accompanying request for a Budget Based Rent Increase annually for renewal of the PRAC."[7] With HUD's shift to five-year PRAC renewals, owners will no longer be *required* to submit budget adjustment information annually to HUD; although properties retain the ability to adjust rents annually, the lack of the annual renewal requirements will lead to fewer owners requesting budget increases annually and will result in lower rents overall across the portfolio. This serves as yet another reason for HUD to set a market-driven initial rent setting process or floor for RAD-converting PRACs.

- **Feasibility Benchmarks for PRAC Conversions.** Like HUD, we are invested in setting properties up for preservation success. To that end, HUD has established operating pro forma for all FHA transactions or conversation using equity sources of finances. For all other conversions, HUD has established "feasibility benchmarks" for which the Pro Forma applies, including for revenue and expense projection.

[6] NOTICE H 2022-05
[7] RAD Notice, Revision 4, lines 133-136

Currently, for revenue, the RAD Notice requires a projection of vacancy loss of no less than the greater of the average over the past three years or three percent. Similarly, bad debt calculations should not be less than the greater of the average over the past three years or two percent. On the expense side, the projections require the debt-coverage ratio to be not less than 1.11 over a ten-year period using two percent growth in revenue and three percent growth in expenses.[8]

We urge HUD to reconsider, or allow requests for exceptions, to the current vacancy threshold and debt ratio trends. Many RAD-positioning properties find the projections out of step with actual ledgers that still reflect financially healthy properties. In addition, the use of a calculation that relies on historical averages requires exceptions due to the impact of the Public Health Emergency on occupancy rates across the portfolio.

- **Capital Needs Assessment Time Limits.** Owners spend a great deal of time reviewing their draft Project Capital Needs Assessments (PCNAs) given that this is their one chance to increase their annual Reserve for Replacement (R4R) deposit to support renovation work. It is very easy for these to expire, especially since HUD Recap has changed the expiry date from 12 months to 6 months. Owners are frequently incurring additional fees for desk updates and/or brand-new reports. We therefore encourage HUD to change the recognized expiration date back to the 12-month limit.

- **Capital Needs and Reserve for Replacement Planning.** Reserve deposit calculations are a crucial tool for owners to set up budgets that will support the property over 20 years, both for needed capital repairs and to create cashflow in the approved budget. In fact, in many cases, adequate reserve deposit amounts counter the inadequate rents based on initial rent setting. However, HUD applies an overly-restrictive “lesser of” test related to the projection of capital needs planning and Reserve for Replacement (R4R) account deposits. HUD’s current lesser of 5- or 20-year Reserve for Replacement annual deposit formula does not adequately fund projects’ R4R accounts for the term of the new 20 year, OCAF-only HAP contract. It also forces properties to alter the projected timeline for capital projects in order to achieve a financially feasibly project and asset preservation. We recommend that the formula be changed to reflect the full 20 years or, better yet, the greater of 5 or 20 years.

Improving the Preserved Portfolio

In addition to the feasibility measures recommended above, we also urge HUD to consider policies to improve the portfolio, even as its preserved.

- **Rent Bundling between 811 and 202 Properties.** Currently, the RAD Notice allows rent bundling between multiple simultaneously converting Section 202 properties.[9] This allows rents to be adjusted and spread across separate properties; bundling has proven to be an effective tool to increase preservation feasibility for smaller properties or properties with diverse financial, asset, and population needs. Moving forward, we recommend that HUD allow rent bundling for 811 PRACs, as well as between 811 and 202 PRACs.

[8] RAD Notice, lines 1335-1364
[9] RAD Notice, lines 722-734

- **Process Improvements.** RAD conversions require a strong partnership between housing professionals and HUD, and the Office of Recapitalization has successfully helped properties navigate the conversion process. We commend the HUD team for their work in this area, and we recommend that HUD continue to make owners aware of options available throughout the conversion process. For example, we applaud HUD for waiving the $15 Supportive Services Fee cap per unit per month (PUPM) for PRACs, replacing it with $27 PUPM for converting properties;[10] however, some properties are unaware of this option (both converting properties and non-converting properties). We therefore encourage HUD to adjust its processes, both internally with other HUD offices involved in PRAC budget setting and externally with housing property stakeholders, to achieve early implementation of the Supportive Services Fee.

  Similarly, we encourage HUD to improve processes that support owners in including certain future-facing needs in the Capital Needs Assessment (CNA) process, which then informs the Reserve for Replacement deposit schedules: Property CNAs should include digital infrastructure needs assessments at the property and schedule reserves for internet installation, as well as climate and energy needs.

- **Energy Efficiency.** We share HUD's renewed commitment to improving energy efficiency, climate resilience, and environmental justice, and we believe that recapitalization is the prime opportunity to elevate climate priorities throughout the portfolio. With roughly 20% of HUD's rental assistance accounts currently going to utility costs, HUD urgently needs solutions for energy efficiency. Further, more than 80% of HUD's MFH stock was built prior to 1990, with most properties built prior to 1980; U.S. Census data shows that older multifamily housing buildings consume double the amount of energy per square foot and have 50% greater energy costs compared to buildings built after 2000.[11] Using RAD, many of HUD's inefficient or climate-vulnerable buildings are positioning to exist for another 50 or 100 years – at the same time as climate-driven disasters worsen and increase, making energy and climate solutions a crucial part of affordable housing portfolio preservation. Lastly, the costs of inefficient energy and climate vulnerability are disproportionately shouldered by poor people, older adults, and people of color.[12]

  RAD presents HUD with both a responsibility and an opportunity to achieve environmental equity and energy efficiency. Currently, the RAD Notice steers converting properties toward energy efficiencies, but falls short of providing stronger incentives to achieving energy efficiency. For example, HUD asks properties to include in their operating Pro Forma a description of, and inclusion in the projected budget calculation, any energy and water efficiencies and associated expense-savings anticipated as a result of conversion-related rehab and construction.[13]

  Separately in the Notice, HUD states: "Project Owners are strongly encouraged, for all Converting Projects, to scope rehabilitation and ongoing replacements that utilize the components that the CNA indicates will improve indoor air quality, prepare the property for known or anticipated natural

[10] RAD Notice, lines 510-513
[11] U.S. Census data as reported by HUD; "Scaling the Nationwide Energy Retrofit of Affordable Multifamily Housing: Innovations and Policy Recommendations;" Lori Bamberger, December 2010
[12] "The Impact of Climate Change: Why Older Adults are Vulnerable," LeadingAge LTSS Center at UMass Boston, February 2022
[13] RAD Notice, lines 1326-1329

hazards, generate utility cost savings for residents or common areas, and/or reduce overall environmental impact, where those components are determined to be cost-effective and consistent with healthy housing and energy efficiency principles and best practices."[14]

While we commend HUD for encouraging owners toward energy efficiency, the current policies could do more to require, support, and incentivize owners to implement environmental efficiencies. HUD should take several steps to improve RAD as tool for environmental justice: First, HUD should adjust the RAD Notice's operating Pro Forma language to require the property to demonstrate even a minimum threshold level of energy and water efficiencies over time, to undergo energy auditing, and/or to utilize additional rehab approaches with proven energy efficiencies, while backing off the current emphasis on cost-effectiveness related to energy efficiency measures. HUD could also create financial incentives for properties by boosting the initial rent-setting for energy-efficient properties to a minimum of 110% of FMR (as described above), and by allowing energy cost savings to exist outside of the operating Pro Forma, allowing owners to reinvest savings and to pass along benefits to tenants.

We are mindful of the potential cost impacts of environmental threshold requirements, and we encourage HUD to elevate incentives over requirements. In addition, because of the financial constraints on converting properties, and we encourage the Office of Recapitalization to allow converting properties to incorporate forthcoming Green and Resilient Retrofit Program (GRRP) funding into the rehab capital stack for RAD-converting properties.

- **Design for Independent Aging.** We agree with HUD that, per the RAD Notice, "quality housing is a platform for health and wellness," and we support HUD's policy as stated in the Notice: "the Department strongly encourages Project Owners to incorporate design standards that address fall prevention, visitability, universal design, and electronic communication mechanisms when developing or rehabilitating housing and community facilities." [15]

  However, similar to the RAD Notice's approach to energy efficiency, HUD's current approach to design elements in converting properties is to encourage, but not require, support, or financially incentivize, proven designs that optimize aging in community. We encourage HUD to consider implementing additional incentives to steer preserved properties toward elements that will allow older adults to age independently in housing that is affordable and accessible.

Again, thank you for the opportunity to provide input on improving RAD for PRACs. Preserving and expanding the affordable housing access is critical to the Administration's goal of addressing equitable housing access, and we look forward to working together to advance affordable, service-enriched housing options for older adults. Please address any questions to Juliana Bilowich (jbilowich@leadingage.org).

Sincerely,

Juliana Bilowich
Director, Housing Operations and Policy

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[14] RAD Notice, lines 246-251
[15] RAD Notice, lines 223-224; 232-235