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RAD Collaborative

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Thomas R. Davis
Director
Office of Recapitalization
Department of Housing and Urban Development
451 7th Street, SW
Washington DC

RE: Follow-up Comments on RAD Closing Process

Dear Tom,

Thank you for the invitation to the Listening Session on March 29th to discuss the RAD closing process and how HUD and stakeholders could make the closing process more efficient and encourage more deals to close earlier in the year. Several of our members and representatives attended the listening session, but we also wanted to memorialize our comments in writing for your convenience. Overall we believe HUD is to be commended on the RAD program and its quick development – we are often surprised that there are not even more issues in this brand new program. We also appreciate the chance to discuss what improvements may be made to the overall process. Below are our primary suggestions and observations on the closing process from the past two years and how to help avoid the end of the year bottleneck.

1. <u>Provide incentives to close earlier in the year</u>. Given that the subsidy cannot be converted until the first full calendar year after conversion, public housing authorities ("PHAs") have every incentive to close in October or November so that they can avoid the funding shortfalls in the first year following conversion. This will be a particular issue again this year given the projected proration for 2016 and 2017.

   While the amount of operating subsidy in a given year is not impacted by the funding conversion, there is a disconnect between (1) the CHAP and HAP rents which are based on prior year appropriations as increased by annual OCAF increases and (2) the subsidy available to the housing authority at the time of conversion, which is based on actual appropriations for the year of the conversion, as reduced by proration of public housing subsidies. This difference means that the CHAP and HAP rents are often significantly higher than the actual subsidy available to the PHA in the year of the RAD conversion. While the new HAP Contract forms do not make this first year funding gap the direct obligation of the PHA any longer by acknowledging that the first year funding may be less than the amounts recited in the CHAP and HAP, investors and lenders are often unwilling to modify their underwriting to reflect this difference. Additionally, PHAs that are serving as the general partner or developer or guarantor of a tax credit transaction will nevertheless be required to fill these gaps by their financing partners. As a result, PHAs have a number of financial incentives to close late in the year to minimize this period of time when they no longer own the public housing project but are still obligated to support it financially.

Additionally, questions surrounding the availability of Capital Funds likewise incentivize PHAs to close their RAD conversions in October or November. There is significant confusion about when HUD determines that PHAs are eligible for Capital Funds for particular units (based on PIC reporting dates, ACC Amendment dates, etc), and when those funds are then fully available for disbursement to the RAD project. Similar questions surround the PHA's ability to contribute Capital Funds for the RAD units that the PHA receives after the RAD conversion occurs. This confusion encourages PHAs to close later in the calendar year to ensure that they optimize their receipt of Capital Funds for their projects. Finally, we understand that PHAs find this stub year difficult from an administrative perspective, and so PHAs are again incentivized to close in October or November to reduce these administrative burdens.

We encourage HUD to investigate incentives that could be offered to encourage closing earlier in the year such as:

- Whether HUD has existing PHA funding that HUD would be willing to reallocate to offset gaps created by closing earlier in the year. For example, Capital Funds that are used as incentives for high performing agencies or other discretionary funds that could be freed up to use as a financial incentive for PHAs to close earlier in the year.

- Formalize the process for PHAs and owners to provide additional funds to closed projects through a streamlined approval process. For example, many state agencies and Federal Home Loan Banks approve awards in October and November, and many PHAs wait until these awards are announced to close. If HUD could publicize a streamlined process for adding these funds to a deal after closing, PHAs who plan to fill their funding gap with deferred developer fee if they do not receive these awards could then close before the awards are announced.

- Incentives or priorities given to PHAs that close before 9/31 for future deals or applications on the RAD waiting list.

- Streamlined approval processes for subsequent deals for PHAs that close on schedule.

- Investigate whether the reallocations of funds from Section 9 to Section 8 in connection with RAD closings could occur twice a year rather than just on January 1.

- Allow PHAs to convert, but to allow HAP Contract effective dates to be delayed a few months. However, note that this option should be further evaluated to determine when the conversion actually happens (at closing, or at the effective date of the HAP Contract) and whether Section 8 or Section 9 requirements apply between the closing and the effective date of the HAP. This option may be most helpful for straight conversion projects, where essentially HUD and the PHA process and agree to documents and the conversion is approved, but the effectiveness of the conversion is delayed a few months. We also understand that this option is available for new construction deals, perhaps the new construction delayed HAP option could be made available for in-place rehabilitation projects as well.

- Allow RAD approval to occur prior to financial closing. The RAD team and HUD could review and approve a transaction and sign documents before the deal is ready to go to financial closing. The signed documents could be held in escrow by either the title company or the field office until the rest of the deal is ready to close.

- Hold additional conversations with PHAs that have converted to ascertain and discuss the administrative difficulties in the first year and what waiver authority or assistance could be utilized to ease any burdens caused by continuing to administer the subsidy in the initial year following conversion.

2. Increased Transparency. Deals would be greatly benefited by increased transparency in the RAD review and approval process, particularly leading up to taking the deal to committee and issuance of the RCC. In the mixed finance process, PHAs and their partners draft and submit the Development Proposal (formerly the Rental Term Sheet) and Mixed Finance ACC for the HUD grant manager and development panel's review and approval. This allows the people with the most detailed knowledge about the deal to explain the deal clearly and concisely and allow the HUD personnel to ask questions and receive answers. It ensures that the PHA and the HUD personnel are looking at the same information and are on the same page with respect to the details that HUD is concerned about.

   In our experience in the RAD process, the transaction mangers draft and submit all information regarding the deal to the RAD committee. Often the PHA is not aware of a perceived weakness or misunderstanding until after the deal has gone to the committee and either been rejected or tabled. This can add several weeks to the closing timeline to then respond to the RAD committees concerns and get the deal back on track. We encourage HUD to look to the mixed-finance closing process as a model for creating a transparent process for reviewing and approving transactions.

   Below are a few more suggestions to that would increase the transparency of the RAD process and encourage more efficient closings:

- Formalize and publicize the process to gain RAD approvals, including forms of what is to be submitted and reviewed by the RAD Committee. Allow PHAs to assist in the drafting of any material that is reviewed by the RAD Committee and to the extent possible answer any questions the RAD Committee has in advance of the meeting.

- Provide realistic timeframes and paths forward when issues are raised by the RAD Committee so that deals can quickly remedy any concerns and move forward.

- Provide feedback in the form of written minutes or questions from the RAD committee so that questions can be answered comprehensively.

- Provide clarity on which reviews happen at which point so that the PHAs can follow the roadmap to approval.

- Create and publish a comprehensive checklist to be used by the Transaction Managers and the PHAs of all necessary approvals, when those approvals are needed and who at HUD grants the approvals.

- Update and publish HUD organizational charts with respect to the RAD program and the various approvals needed.

3. Establish Processes and Firm Timelines for External HUD Reviews. It seems as though different departments of HUD are able to step in and review the projects at multiple points which creates uncertainty for PHAs about whether issues that have been raised are fully resolved. For example, FHEO does an initial review of the transaction, but then also re-reviews the transaction before closing to satisfy special conditions listed in the RCC (many of these issues are the ones described in Item 4 below). In our experience, this gives HUD multiple opportunities to review the same issues and to re-open issues that PHAs and their partners believed were resolved. This in turn creates delays for PHAs that assumed that the first review and response satisfied any outlying concerns. By streamlining when and how other HUD offices review the transactions, HUD will allow PHAs to move more efficiently to closing.

4. Upfront Feasibility Reviews. HUD should consider establishing a more comprehensive upfront review of a project after the RPCA is completed to identify threshold feasibility concerns before the transaction proceeds to financing plan and RCC issuance. Transaction managers should perform an initial substantive review of the larger issues that confront RAD transactions – FHEO, relocation, site and neighborhood standards, RPCA and financial needs before the financing plan is submitted to spot large issues that will take significant time or work to resolve. To the extent necessary, the transaction managers should incorporate any other necessary offices of HUD, who should then provide their approval for the transaction to proceed. Once HUD has given these threshold approvals, PHAs and their partners should be able to rely on the finality of the approvals. Another option may be to at least begin the review of the RPCA internally or by an outside contractor before the review of the financing plan. The feasibility of the deal rests on

the RPCA so it is in everyone's best interest that these issues are identified early so that time is not spent reviewing other aspects of a deal that does not work because of the RPCA.

5. Streamline Aspects of the Closing Process. There are several aspects of the closing process that could be streamlined in order to reduce the burden on both HUD and PHA staff. Suggestions for streamlining are as follows:

    - Sign RCCs and other documents more than once a week and/or delegate this authority more broadly. At the very least authority to sign documents should be delegated for those deals that fit within prescribed parameters and are not required to go through the Committee approval process. Having more occasions and individuals to sign documents will provide flexibility to deals to close faster. The delay in the receipt of these documents then causes a ripple effect in the ability for the remainder of the deal to move forward. For instance, it can often take several weeks to get an RCC signed after RAD committee approval has been received, which then hinders the ability to make timely submissions to move to closing.

    - Issue the RCC in draft form first to allow a chance to review and catch mistakes or inaccuracies. Alternatively, establish a process to easily amend the RCC at closing. We currently amend the majority of our RCCs at closing, and the process to amend the RCC ranges from simple to complex, and has frequently been done in a panic at closing. We hope the new form documents will eliminate the need for some of our most common amendments

    - Eliminate the requirement for a PILOT opinion. The PILOT opinion is not required by statute and any property tax issues should be considered as an element of the operating pro forma review without the need for a formal and costly legal opinion.

    - Eliminate the need to submit all financing documents and instead have a rider that includes all the RAD requirements (particularly for loan, bond, and equity documents) that is submitted for approval in lieu of the package of financing documents. This will help reduce the volume of documents submitted for HUD's review, yet which do not affect HUD's interests in the transaction.

    - Clarify how permanent financing should be treated in the RCC and initial closing process. In many transactions permanent financing is not entered into at the time of closing, but rather at the time of conversion. Currently there is confusion surrounding how this source should be shown on the RCC and what should be submitted with the closing package. Since these documents are often not ready for the initial closing, getting drafts from permanent lenders can be very difficult and time consuming. However, there is also no clear path to receiving approval on these documents and sources at the time of conversion. We believe that this could be simplified by showing the permanent sources consistently in the RCC and essentially pre-approving the execution of the permanent financing. In lieu of requiring permanent financing documents be submitted, HUD could require the use of a RAD rider (as suggested above) and an executed permanent financing commitment that acknowledges the RAD program and subordination to the RAD Use Agreement.

- Create and/or publish a checklist or form for PHAs to complete prior to RAD Committee review to allow the PHA to have greater ability to review the information and facts submitted to the RAD committee.

- Allow subsequent phases to have a streamlined submission that focuses only on items that are specific or different from the first phase. Additionally, all efforts should be made to assign the same closing coordinators and counsel to all phases of a multiple phase transaction.

- With respect to FHA deals, encourage the transaction managers to work with FHA underwriters before the completion of all FHA underwriting to ensure the RAD and FHA process run on the same timeline. We have often see examples where the transaction manager does not start reviewing the financing plan submissions until the FHA underwriting is complete and ready to go to committee for issuance of the Firm Commitment. This, combined with delays encountered because RAD committee and RCCs are only signed once a week, can lead to a several -week delay in getting the Firm Commitment and RCC, which then can lead to the FHA underwriting becoming a bit stale.

6. Early Starts. Allowing early start of construction and or a transfer of site control in advance of closing can allow PHAs and owners to meet tax credit requirements regarding carryover and placed-in-service deadlines while allowing HUD additional time to review by pushing closing into the next year or a subsequent financial quarter. R&C was able to negotiate such approvals in one of our transactions last year, and we believe this deal could be a model for future deals.

   As in our approved early start, the PHA and its partners could be responsible for identifying a particular scope of work, obtaining lien waivers from the contractors involved, and ensuring that the development parties secured funds to pay for the work. Additionally, site control could be transferred to the new owner via a ground lease, subject to the existing Declaration of Trust, as long as the ground lease contains unwind provisions that would automatically revert the property back to the PHA in the event RAD approval was not achieved.

   We understand that there is still some concern about this idea, particularly regarding the possibility of liens being filed against the RAD property. However, we believe that this is a surmountable issue, and one that the mixed finance program has gotten comfortable with and that the regulations at 24 CFR 905 already address. We are happy to discuss this with you further to provide additional comfort to OGC or Recap on why any concerns regarding liens should be addressed through lien waivers and title insurance.

7. Self-financed Transactions. Conversions that do not involve outside financing are often the ones that can move the most quickly through the RAD process. HUD should require PHAs to identify counsel at the financing plan stage so that the legal and closing process can run more smoothly. HUD could create a streamlined set of instructions for Self-Financed deals (which do not need to meet many of the other requirements of the Financing Plan) and assign one Branch Manager to handle all self-financed transactions. PHAs doing self-financing, especially smaller PHAs, have very different needs from the mid and large sized PHAs. These PHAs need someone who understands the issues and can shepherd them through the process.

8. Relocation. PHAs care profoundly about relocation and the impacts of RAD conversions on residents, but some aspects of HUD policy that are not consistent with the URA and the RAD statute needlessly compromise the process, often to the detriment of residents and PHAs alike. PHAs should be permitted to respect the autonomy of their residents when possible by allowing those residents to control the timing of their moves as permitted under the Uniform Relocation Act. We encourage HUD to continue looking at these issues to find ways for relocation to happen earlier in the conversion process, particularly transfers that are consistent with the public housing ACOP.

9. Acknowledgement of differing levels of complexity. Deals that have more complex financing and multiple stakeholders should be given more flexibility to get to closing and work with HUD to set realistic schedules. While it is usually the intent of the parties to get to closing as quickly as possible, when multiple agencies and financing parties are involved unforeseen events often occur, requiring the participants to work together to preserve a complex deal.

Thank you for opening this dialogue regarding the RAD closing process and taking the time to consider these comments. Please do not hesitate to reach out to any of us to discuss these in more detail.

Sincerely,

Sunia Zaterman
Sarah Molseed
Patrick M. Costigan

Sunia Zaterman	Sarah Molseed	Patrick Costigan
Executive Director	Member	Strategic Advisor
CLPHA	Reno & Cavanaugh, PLLC	RAD Collaborative