RAD Underwriting Considerations for Existing Mixed Finance[1] Projects

At the heart of RAD is the requirement that, prior to conversion, a project can reasonably demonstrate that it has the resources to meet the 20-year capital needs identified in the Capital Needs Assessment (CNA). Often, public housing mixed-finance projects were developed in conjunction with low-income housing tax credits and, therefore, involve outside investors, owners, and lenders. Unlike traditional public housing projects, existing public housing mixed-finance projects can find it impractical to refinance the property, or to re-size the annual deposit to replacement reserves, prior to the end of the tax credit compliance period. As such, the Office of Recapitalization has adopted the below alternative underwriting criteria for mixed-finance projects who are unable to meet the 20-year capital needs identified in the CNA at the time of conversion.

Reminders Regarding Existing Underwriting Criteria

1) If the Mixed Finance project was constructed or substantially rehabbed in the past five years, the project is exempt from CNA requirements except for completing the RPCA Tool or CNA e-tool in order to produce the 20 Year Reserve Schedule and Utility Consumption Baseline (UCB).

2) If the assisted units at the Mixed Finance project represent less than 20% of the total units at the project, the project is exempt from CNA requirements.

3) Any mixed-finance project that is not taking on new debt as part of the RAD conversion is considered a "non-leveraged" transaction and, as such, HUD applies the underwriting standard of no less than $12 per unit per month in stabilized cash flow for purposes of the Feasibility Benchmarks under Attachment 1A, Section I.5.i in the RAD Notice.

Alternative Underwriting Criteria

1. *The replacement reserve balance may show a negative balance after 10 years provided that the negative balance does not exceed 50% of the principal amortization*.

   This provision, which is the standard used in the MAP Guide for FHA-insured projects, only applies if (1) there is (or will be) a permanent loan and (2) the negative balance begins after 10 years of loan maturity (either the existing loan or the proposed loan). In other words, a project can carry a projected negative balance in its replacement reserve account only if it can be shown that the principal amortization is twice the negative balance. The assumption here is that, if the project meets this test, the project has sufficient resources to refinance, when necessary.

2. *The project can demonstrate that it has the capacity to refinance (and meet all 20-year needs) once the initial 15 year LIHTC compliance period ends.*

   In demonstrating the capacity to refinance, the Office of Recapitalization will use the following minimum underwriting assumptions:

   - The proposed loan must be able to pay off all existing hard debt, all associated financing and third-party costs, and all identified capital needs, including any (then) immediate repairs, any Initial Deposit Reserve for Replacements, or annual reserve deposits. Note: Given the uncertainty of receiving a future allocation of either 4% or 9% LIHTCs in many

[1] A "mixed-finance" public housing project is one that was developed pursuant to 24 CFR 906.604

states, as well as the uncertainty related to possible tax reform legislation, a future refinancing cannot assume LIHTCs as a source of funds.

- Loan term: not more than 40 years.
- Interest rate of not less than 5.5% (the Department reserves the right to modify this rate as markets change).
- A debt coverage ratio (DCR) of not less than 1.11.
- Operating Expenses: Audited financial statements for the past three years must be examined to determine if Year 1 expenses are appropriate. Any variances greater than 15% need to be explained and justified.
- Vacancy and Bad Debt: An assumption of 3% vacancy and 2% bad debt should be used. Any deviation from this must be approved by HUD.
- Origination/financing fees must be included in the development budget that are consistent with the loan program being proposed
- Typical lender legal fees, borrower legal fees, and lender third-party costs must be included in the development budget.
- New loan must be sufficient to pay off all debt that comes due within the term of the loan being proposed.
- No balloon payments prior to year 18 without HUD approval.

Submission Requirements for Future Refinance Scenarios

For any future refinance scenario (where the refinancing will not be part of the initial RAD closing), the PHA must submit, via uploading to the “Other Documents” section of its Financing Plan on the RAD Resource Desk, the following documents:

1. Cover letter summarizing the request and the reasons the property cannot refinance at this time, including the date of the end of the 15-year LIHTC compliance;
2. Development budget depicting the future refinance;
3. 20-year Operating Pro-forma depicting the future refinance;
4. Information on all existing debt (source, original loan amount, rate/terms, outstanding balance, etc.);
5. Letter from the PHA confirming its willingness to re-structure any PHA debt to accommodate the new loan financing; and
6. Three years of the most recent annual financial statements for the project.