Recapitalization: How to Finance the Rehab of Affordable Housing

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What is recapitalization & why does it matter?

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- Recapitalization = bringing in new funds to preserve and improve affordable housing
- Why?
  - **Rehabilitation**: affordable homes need new funds as they age to make repairs and re-position property for long-term preservation
  - If sale, need to support any **higher acquisition price**, beyond current debt
  - Capital funding is especially needed to address high rehab needs in troubled properties & for purchase prices of higher-value properties

Capital and Operating Funds

- Capital Funds: One-time expenditures for rehab & acquisition costs; can be either equity or debt
- Operating funds: Primarily the rental income needed to support the ongoing operating expenses of the property
  - In properties with rental assistance (e.g., HUD PBRA), rental income consists of the Housing Assistance Payments (HAP) & the tenants’ 30% contribution
  - Operating expenses = e.g., maintenance, management, and debt service
- Any monthly debt service payments are a line item in the operating budget, so cheap (low-interest, deferred interest) or free $$ is best!

Key Funding Sources for Recap

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Capital Funds

- Low Income Housing Tax Credits
- State and local resources (National Housing Trust Fund, CDBG, HOME)
- New mortgages (Section 223(f), Section 221(d)(4))
- Bonds (cheaper debt)

Rental Assistance Funds

- Mark Up to Market
- Mark to Market
- Project-Based Vouchers
- Rental Assistance Demonstration (RAD)
  - Project-Based Vouchers or project-based rental assistance

Low Income Housing Tax Credits

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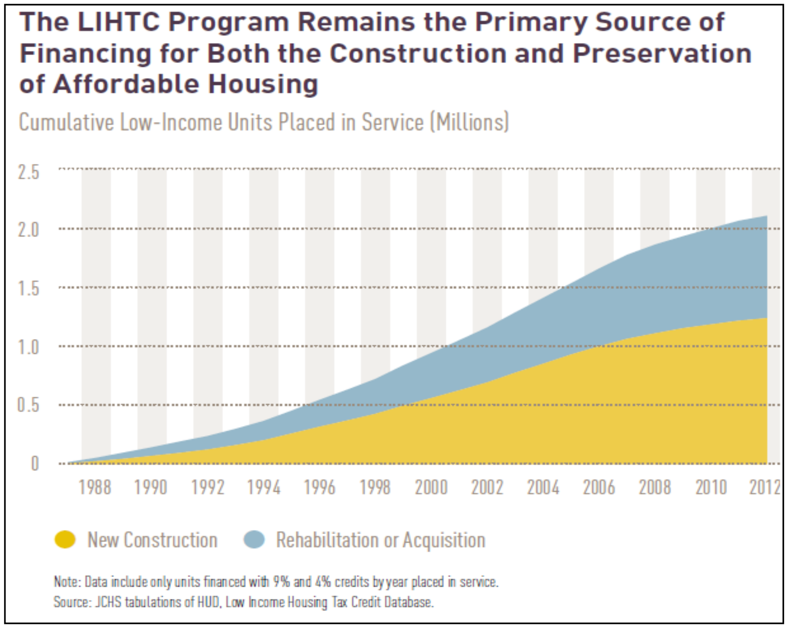
- Provides tax incentives to encourage developers to build and repair affordable housing (IRS program)
  - Provided to each state based on population
  - Distributed to the state's designated tax credit allocating agency, which then distribute the tax credits based on the state's affordable housing needs (Qualified Allocation Plan (QAP) process)
- Two kinds of credits (9% very competitive; 4% not competitive)
  - 9% = ~70% of repair/acq'n costs
  - 4% = ~30% of repair/acq'n costs
- Tenants' rights are less and different than HUD programs



Low Income Housing Tax Credits

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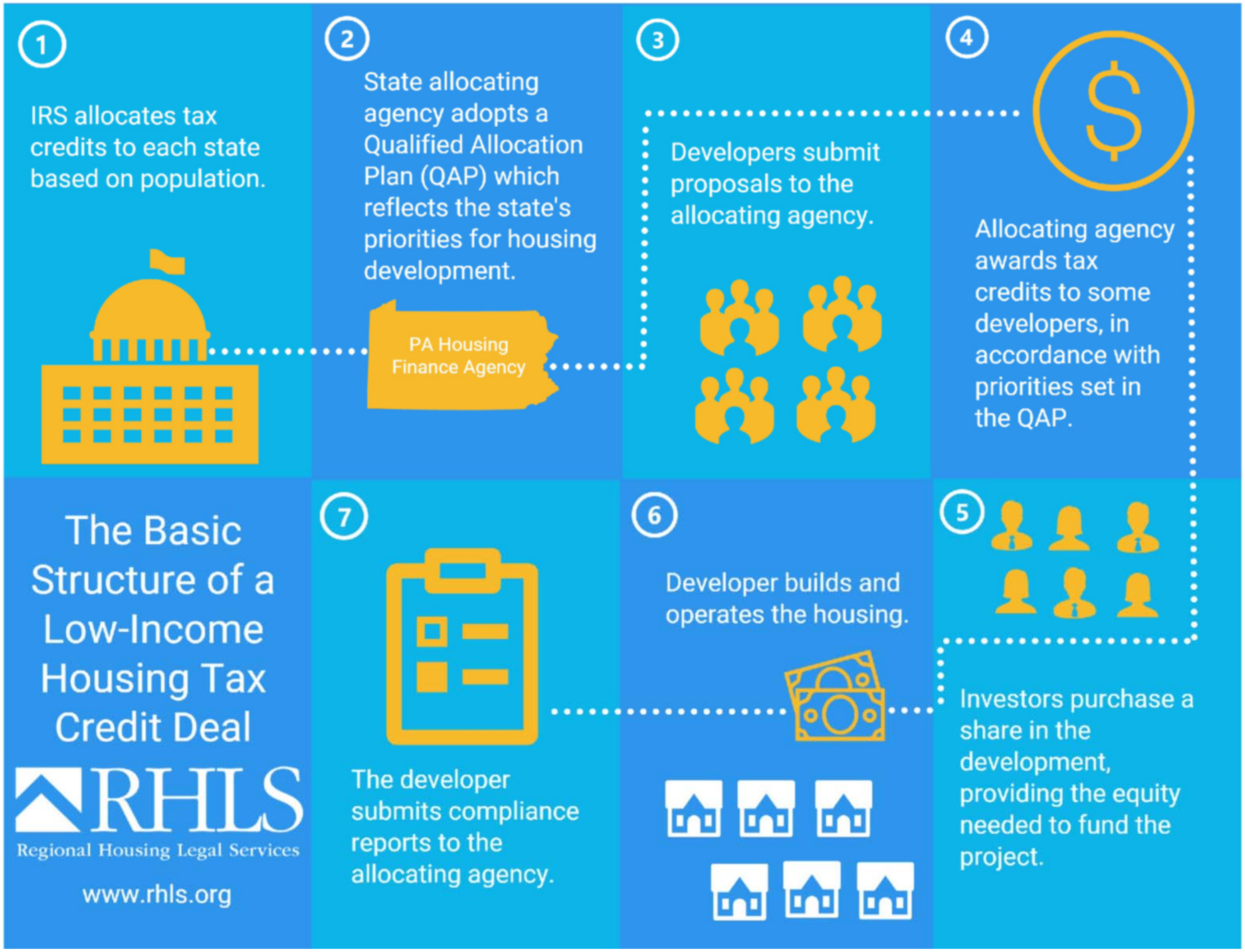

HUD "Mark Up to Market" Program

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- For projects with existing PBRA contracts: *increases contract rents* to owners, UP TO comparable market level
- Requirements:
  - Rents less than market; no use restrictions
  - REAC physical inspection score of 60+ or HUD waiver (fix-up plan), and
  - Management and Occupancy Review (MOR) rating of "satisfactory" or above
- Owner can access Mark Up to Market at any time during the contract (not just at contract expiration), by terminating old contract and executing new contract for 20 years + unexpired term
- During new contract term, rents adjusted by OCAF

➡ Long-term contract providing more rental $$ can support rehab debt

Project-Based Vouchers

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- PHA uses part of its (tenant-based) voucher funds to attach rental assistance to particular units
- For recaps:
  - HAP Contract between PHA and owner for 15 (now 20) years
  - Contract rents generally limited to 110% of FMR; can support some new debt
  - Ordinary per project & program caps on % of PBVs no longer a problem for recaps of existing subsidized units due to HOTMA
- Mobility feature: after 12 months, Tenant can request move w/ tenant-based voucher & PBV assistance remains w/ unit

Sources and Uses Example

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Uses:

Acquisition	$12,000,000
Rehabilitation	$ 3,000,000
Transaction Costs	$ 600,000
TOTAL	$15,600,000

Sources:

Phase One Acquisition	
OHA Loan	$12,500,000
Phase Two Permanent Financing	
LIHTC Equity (if @4%)	$ 3,000,000
Below-market Loans	$ 8,600,000
OHA Deferred Loan	$ 4,000,000
OR	
LIHTC Equity (if @9%)	$ 6,000,000
Below-market Loans	$ 8,600,000
OHA Deferred Loan	$ 1,000,000

Key Considerations

Key Considerations in Recaps

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- New rent/affordability and use restrictions?
  - Challenges with partial PBRA properties
- Disruption &/or Relocation during rehab?
- Right to return, rescreening?
- Change in ownership & management?
- Different tenant rights? (HUD PBRA carries through)

- Tenant engagement is key
- Attorney role? Get help.

Questions?

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Thank you!