Recapitalization: How to Finance the Rehab of Affordable Housing

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National Housing Law Project
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What is recapitalization & why does it matter?

• 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

<table>
<thead>
<tr>
<th>Capital Funds</th>
<th>Rental Assistance Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Low Income Housing Tax Credits</td>
<td>• Mark Up to Market</td>
</tr>
<tr>
<td>• State and local resources (National Housing Trust Fund, CDBG, HOME)</td>
<td>• Mark to Market</td>
</tr>
<tr>
<td>• New mortgages (Section 223(f), Section 221(d)(4))</td>
<td>• Project-Based Vouchers</td>
</tr>
<tr>
<td>• Bonds (cheaper debt)</td>
<td>• Rental Assistance Demonstration (RAD)</td>
</tr>
<tr>
<td></td>
<td>• Project-Based Vouchers or project-based rental assistance</td>
</tr>
</tbody>
</table>
Low Income Housing Tax Credits

• 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

1. IRS allocates tax credits to each state based on population.
2. State allocating agency adopts a Qualified Allocation Plan (QAP) which reflects the state's priorities for housing development.
3. Developers submit proposals to the allocating agency.
4. Allocating agency awards tax credits to some developers, in accordance with priorities set in the QAP.
5. Investors purchase a share in the development, providing the equity needed to fund the project.
6. Developer builds and operates the housing.
7. The developer submits compliance reports to the allocating agency.

The Basic Structure of a Low-Income Housing Tax Credit Deal

RHLG - Regional Housing Legal Services
www.rhls.org
HUD “Mark Up to Market” Program

• 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

• 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

<table>
<thead>
<tr>
<th>Uses</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisition</td>
<td>$12,000,000</td>
</tr>
<tr>
<td>Rehabilitation</td>
<td>$3,000,000</td>
</tr>
<tr>
<td>Transaction Costs</td>
<td>$600,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$15,600,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sources</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Phase One Acquisition</td>
<td></td>
</tr>
<tr>
<td>OHA Loan</td>
<td>$12,500,000</td>
</tr>
<tr>
<td>Phase Two Permanent Financing</td>
<td></td>
</tr>
<tr>
<td>LIHTC Equity (if @4%)</td>
<td>$3,000,000</td>
</tr>
<tr>
<td>Below-market Loans</td>
<td>$8,600,000</td>
</tr>
<tr>
<td>OHA Deferred Loan</td>
<td>$4,000,000</td>
</tr>
<tr>
<td>OR</td>
<td></td>
</tr>
<tr>
<td>LIHTC Equity (if @9%)</td>
<td>$6,000,000</td>
</tr>
<tr>
<td>Below-market Loans</td>
<td>$8,600,000</td>
</tr>
<tr>
<td>OHA Deferred Loan</td>
<td>$1,000,000</td>
</tr>
</tbody>
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Key Considerations
Key Considerations in Recaps

• 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?
Thank you!