LeadingAge

The mission of LeadingAge is to expand the world of possibilities for aging. Our membership touches 4 million lives every day and includes 6,000 not-for-profit organizations representing the entire field of aging services, 39 state partners, hundreds of businesses, consumer groups, foundations and research partners. LeadingAge is also a part of the International Association of Homes and Services for the Aging, whose membership spans 30 countries. LeadingAge is a 501(c)(3) tax-exempt charitable organization focused on education, advocacy and applied research.

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Executive Summary:

The earliest Section 202 capital advance properties with project rental assistance contracts (PRAC) are now more than 20 years old. Many of these properties already have capital needs outstripping available capital resources, and newer properties risk going down the same path. As capital needs grow with the age of the property, it has proven difficult for owners to build up enough reserves through modest rent increases to adequately fund the reserves for big-ticket replacements. As the country ages and the affordable housing stock is already inadequate for the rapidly growing population of low-income seniors, preservation of existing housing becomes all the more critical.

A recent survey of the entire portfolio of 2,875 Section 202 PRAC properties indicates that many of these buildings will need major systems updates, energy saving upgrades, and up-to-date accessibility features, but lack the resources to address them. Therefore, strategic steps should be taken now to ensure adequate build-up of reserves to sustain the newer portfolio, as well as to address the current gaps in resources in the older cohort.

One not-for-profit sponsor found that 37 communities in their Section 202 PRAC portfolio had an average per property need of $973,264, but Reserve for Replacement (RfR or reserves) totaling less than half of that. However, the nature of the capital advance (being a government-held forgivable grant) does not allow a 202 PRAC property or its sponsors to take on debt or leverage external financing to meet capital needs like other types of HUD-funded properties.

We have a unique opportunity to address this issue now, sooner rather than later, and avoid burdening this critical resource with a growing capital needs backlog that will only be aggravated in years to come.

Because each PRAC is different in age, in the way it was constructed, in the property's size, and in the geographic location and sponsor characteristics, more than one approach or solution is likely to be necessary. As such, any of the multiple solutions should be flexible enough that HUD and/or Congress can address varied needs across the portfolio in the short and long term.

Our recommended solutions to the problem are three-fold:

- Allow and facilitate older PRACs with current shortfalls and/or demonstrable capital needs to be able to leverage new financing by converting the existing annual PRAC rental assistance contract to a long-term subsidy. If Congress were to expand the existing Rental Assistance Demonstration (RAD) program to include PRACs, some properties could use the program to convert the PRAC subsidy to long-term project-based vouchers (PBV) or project-based rental assistance (PBRA), making it possible to leverage new financing;

- Ensure that the PRAC budgeting processes going forward will adequately fund reserve for replacement (reserve) accounts, and allow access to residual receipts account to offset repair needs. Establishing proactive processes to monitor both capital needs and reserve spend-down rates, and having clear guidance to make necessary adjustments to reserve account funding will ensure that the newer PRACs will have funds available for improvements when the time arrives; and

- Address critical repair needs of properties lacking the time to build up adequate reserves or the ability to recapitalize by ensuring funds are made available each year through the existing Section 202 line item for emergency capital repairs.
HUD is aware of the specific limitations regarding the PRAC program prohibiting secondary financing or other debt. HUD specifically included in the Secretary’s fiscal year 2017 budget proposal a request to include PRAC in the Rental Assistance Demonstration (RAD) program, along with up to $50 million to facilitate preservation of public housing and PRAC properties. The key here is the conversion of short-term subsidy contracts to long-term subsidy contracts. The longer term contracts make new financing more possible, thereby facilitating the ability of PRACs with current shortfalls and/or demonstrable capital needs to leverage new capital.
Statement of Need

The earliest Section 202 capital advance properties are now more than 20 years old and, while Section 202 properties are typically the most highly rated properties according to REAC physical inspection results, many properties in the Section 202 PRAC portfolio face substantial challenges in building up project reserve accounts to address their accruing capital needs.

In fact, a survey of PRAC providers indicates that capital needs outstrip capital resources in many situations where reserve for replacement accounts have not been growing at a sufficient rate to sustain the property for the long-term. How we got to this point can be better understood by reviewing the unique design of the program.

Background on the Section 202 PRAC Program

The Section 202 PRAC portfolio is a small and unique cohort of properties owned/operated by not-for-profit organizations. The program was introduced in 1990 and developed as a forgivable capital advance grant*, provided the property complies with its affordable use requirements for 40 years. Project Rental Assistance Contracts (PRAC)* obligate the Secretary to make monthly payments to cover any part of the costs attributed to units occupied by very low-income elderly that is not covered by tenant rent (which is 30% of adjusted income, similar to the Section 8 program).

To allow for greater leveraging of diminishing public funds for new construction and increase the number of low-income elderly units that can be produced from each Section 202 dollar, Congress in 2000 expanded Section 202 ownership and financing structures to include tax-credit partnerships with a not-for-profit controlled general partner.

Each capital advance has an executed 40-year mortgage note. This note bears no interest and repayment is not required so long as the housing remains available for very low-income persons. The note may not be prepaid prior to the maturity date without prior written approval of HUD. Provided the housing has remained available for occupancy by eligible families until the maturity date of the note (and the note has not otherwise become due and payable by reason of defaults of the note, mortgage, or regulatory agreement), the note shall be deemed to be paid and discharged. If default is made by the Owner, the entire principal sum shall at once become due and payable without notice. Interest per annum at a set rate shall be payable on demand with respect to the payment of principal upon default.

However, the nature of the capital advance (being a government-held forgivable grant, as described above) does not allow the property or its sponsors to take on secondary financing or other capital debt on behalf of the property.

In the earliest years of the program, initial PRAC contracts were for 20 years and covered 100% of operating costs. But early on in the program, in conjunction with legislative efforts to restrict new federal obligations for the long-term, the contracts were reduced to five years and only covered 75% of operating costs. Contract terms thereafter fluctuated between three and seven years, and remained at the 75% level. Contract renewals are now limited to a one year term subject to annual appropriations.

Though HUD has been quite proactive in recent years in working toward the preservation of the existing multifamily housing stock, HUD has not developed a program or policy to address the long-term sustainability needs of the aging Section 202 PRAC portfolio. And policies regarding PRAC contract renewal are several years
old (the last one published is Notice H 02-17). Policies concerning budget-based rent adjustments (HUD Handbook 4350.1, Chapter 7) predate the existence of any operating PRAC properties. So, in too many cases project reserves are not growing at a sufficient rate to meet long-term sustainability needs.

Further exacerbating the gap between capital needs and capital resources, not-for-profit sponsors have counted on having access to the residual receipts* account to offset project needs, expecting cash flow surpluses to be able to be transferred into the reserve accounts. Because 202 PRAC sponsors and controlling general partners are exclusively not-for-profit, all cash flow derived from the property is ultimately kept with the property; distributions for the gain of investors or sponsors are not allowed. By regulatory agreement, all funds received and placed in reserves and/or residuals accounts must be used for the property and/or for the benefit of the residents, and may only be accessed with permission from HUD.

However, in late FY2015, as LeadingAge was still in its preliminary stages of exploring the question of PRAC portfolio needs, HUD issued a directive to 202/PRAC providers recalling all residual receipts in excess of $250/unit at the time of the next PRAC contract renewal and on the anniversary dates after initial expiration. As a result, the residual receipts account that so many had depended on for project needs was eliminated as a source available to owners.

**National Survey Findings:**

2,875 Section 202 PRAC projects have been built since 1990. According to a LeadingAge's nationwide survey conducted in 2015, many of these buildings need major systems updates, energy saving upgrades, and up-to-date accessibility features.

In an effort to identify the key issues, needs and trends of the portfolio, LeadingAge's PRAC Preservation Task Force developed a survey that was sent out to all PRAC properties nationwide in 2015. More than 300 individual site-specific survey responses were received and provided important information about the levels of reserves, access to residual receipts for repairs and improvements, experience upon requesting a budget increase to enhance reserves, interest in refinancing and/or consolidated refinancing, and the type of capital needs.

**Reserve Shortfalls Most Common for Highest Cost Items**

Respondents indicated that the following high cost items resulted in the most common reason for reserve shortfalls:

- HVAC systems;
- Site work
- Roofs
- Windows & doors
- Kitchen cabinets/counters
- Bathrooms upgrades
- Accessibility upgrades
Less commonly, shortfalls were noted for:

- Plumbing systems
- Life safety systems (sprinklers, alarms)
- Elevators

Electrical system needs were among the items least indicated as a capital need.

**Marketability Concerns Greatest in the Short Term**

Climate control and marketability-type upgrades featured most prominently among the responses to "needs in the next 5 years for which insufficient reserve for replacement" were expected to be available:

- General refurbishment (50)
- HVAC systems (45)
- Site Work (46)
- Kitchens (30)
- After that came:
  - Roofs (25)
  - Windows/doors (24)
  - Bathrooms (20)
  - 504/accessibility (20)
  - Life safety (17)
  - Elevators (12)
  - Plumbing
Infrastructure and Envelope Concerns Greatest in the Long Term

Funding shortfalls for major systems and building envelope issues took precedence as the capital needs and code compliance upgrades needed “in the next 6 - 10 years for which insufficient reserve for replacement funds” were expected, including:

- HVAC (37)
- Roof (35)
- Windows & doors (30)
- Elevator (25)
- Life Safety (22)
- Plumbing systems (18)

NOTE: General refurbishment was still the highest (37) overall issue, with kitchens (36) and bathrooms (28) close behind

CNAs Demonstrate Real Gaps Between 10-year Needs and Reserves

Capital Needs Assessments (CNAs) from more than 70 properties (age range 5 – 25 years) provide a sample of the needs that exist nation-wide for a variety of PRAC communities. Third-party commissioned reports indicate the following:

- Average 10-year capital need per property is over $1 million
- Average current reserves per property are at about half of the documented need
- Average capital need per unit over $25,000

Altogether, this represents an average 10 year need of $1,380,542 per property and $27,047 per unit – with the older PRACs built in 2000 or earlier averaging projected needs of about $1M and the later PRACs averaging projected needs of about $1.5M – and an estimated $1,014,376 of unmet financial resources per PRAC property or $19,873 per unit.
Trends in this sample show that the oldest properties have a somewhat higher 10-year capital needs projection. Yet newer properties find themselves with the greatest gap between projected needs and funding. If steps are not taken now to adjust budgets and build up reserves to ensure sustainability, the gap between needs and resources will grow even wider.

Additionally, notable outlier cases show substantially larger gaps between resources and needs. For example, one property has documented need which is more than triple the average ($4 million) and resources inversely less available (approx. $1 million). Therefore, strategic steps should be taken now to ensure adequate build-up of reserves to sustain the newer portfolio, as well as addressing the current gaps in the older cohort.

Conflicting Priorities Impact Efforts to Increase Reserves, Access Funding

Unfortunately, other survey results indicated significant concerns with current processes and policies that contribute to the expected shortfalls.

Survey respondents indicated both opportunities for and frustrations in their efforts to address the long-term sustainability of their properties, specifically:

- 41.5% indicated that their project needs improvements to reduce energy consumption;
- 35% indicated they had been denied a request to increase deposits to Replacement for Reserves;
- Over 60% indicated they had been unable to access residual receipts for capital repairs and improvements (While 43% indicated they did not have any residual receipts, we are unclear if this was due to the recent sweeps, or already tight budgeting); and
- 33% indicated they would be interested in consolidated refinancing, which is combining a number of smaller properties into one refinancing transaction – though the question did not define whether this might comprise combining two or three commonly-owned sister or co-located properties, or something as vast as regional properties not owned by the same sponsor, potentially for a tax exempt bond issuance.

As stated earlier, as capital needs grow with the age of the property it has proven difficult for owners to build up enough reserves through modest rent increases to adequately fund the reserves for big-ticket replacements. In fact, many owners fear they can never catch up and may delay needed improvements while prioritizing other repairs or while waiting for their reserve for replacement account to grow.

One Problem Requiring Flexible Solutions

Solutions to the problem need to address the unique concerns of the individual properties, and should be flexible enough to incorporate opportunities and address challenges depending on the exigence of the need in the short term, the length of time available to build-up reserves for sustainability, and the size/scope of need among properties held by a single sponsor. Following are some scenarios that illustrate the fact that no single solution will work for all:

First: When a property has substantial needs, lacks sufficient resources, and has sufficient time to complete a refinancing, recapitalization may be a very effective solution. A recapitalization is characterized by leveraging new capital funds to be used to catch-up with the more expensive and complicated capital repairs, and to adequately fund the reserve account for the future.
However, as pointed out earlier, the nature of the capital advance (being a government-held forgivable grant) does not allow a 202 PRAC property or its sponsors to take on debt or leverage external financing to meet capital needs like other types of HUD-funded properties. **Legislative changes are required to enable this preservation financing option.**

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**Notable Progress in This Area Has Already Been Made:**

Successful engagement of HUD and support by the current administration is evidenced by proposals made in February 2016 in the administration’s budget request for FY 17. The budget request included a recommendation to expand the Rental Assistance Demonstration (RAD) to include the PRAC program, and requested up to $50 million to facilitate PRAC and public housing participation.

The Senate subsequently passed an FY17 HUD appropriation bill that includes the RAD for PRAC proposal, but includes only up to $4 million to facilitate PRAC preservation efforts.

Under a broadened RAD initiative, PRACs could seek to convert their subsidy to the Section 8 platform, and thereafter leverage external financing to meet capital needs like other HUD portfolios can and have done.

As discussed further below (see *Modeling as Evidence*), it may be challenging to attract and secure funding from the private markets, due to the small size of the typical stand-alone PRAC property, without substantial increases to the current break-even rents. Without a change in the nature of the “break-even” operations, there is effectively no Net Operating Income (NOI) available to pay for new debt service.

A critical variable to preserve and understand is the inclusion of Service Coordinators in the current PRAC budgets. Legislative changes to the program in 2010 made provision of a service coordinator a selection criterion for a new Section 202 application. If “market rents” are used in any way in a RAD conversion of PRAC contracts, the value of the Service Coordinators must be included in those market rent calculations, and/or a separate grant must be provided to cover the Service Coordinator expense, which is so vital to the successful operation of these properties.

In addition, regulations and policies may need to be developed beyond legislative authority in order to enable bundling of project assets and financing for the purpose of a “scattered site” transaction. The bundling can work to increase the operational efficiency of many smaller properties, and it can attract new debt when one property would be too small for a new loan.

Second: For newer PRACs and/or single-site or smaller portfolio sponsors that need not, or cannot, participate in a portfolio consolidation, HUD should establish proactive policies to address the adequacy of reserve for replacement accounts for long-term sustainability. Now is the opportune time to establish clear and consistent policies regarding PRAC asset management/oversight and budget adjustment processes.

Timely action now on the regulatory front could enable newer, less at-risk properties to build up project reserve accounts sufficient to address accruing capital needs and to sustain the property for the long-term. However, **HUD would need to develop clear operational guidance, including proactive oversight and budgeting practices**, with a goal of preservation and sustainability in order to affect a portfolio-wide change.
Best practices suggest that conducting periodic reviews of 202 PRAC capital needs and reserve account spend-downs, and promoting proactive policies to assure adequate growth of reserve accounts over time can help a substantial portion of the portfolio to be sustainable for the long term. Working together, stakeholders including HUD staff, property owners and agents, and preservation-minded (or real estate/asset management) specialists can further explore options and create the necessary policies and comprehensive guidance, though it may take Congressional action to require HUD to take this step.

**Third: When a property has imminent, extensive and/or sudden significant needs and lacks adequate reserves, emergency funding should be made available.** This is vital for single asset properties that lack sufficient resources, particularly where there is not enough time or any real opportunity to pursue recapitalization.

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Should debt leveraging become an option, not all properties will be able to access private capital resources. Some properties are too small, or are not able to take advantage of consolidating the property into a larger portfolio. Yet some of these properties are already on the threshold of having critical repair needs. These properties could benefit from existing Section 202 statutory authority to issue Emergency Capital Repair grant funds, but **Congress would need to act to appropriate new funds for this urgent need.**

Therefore, in summary, our recommended solutions to the problem are three-fold:

- Allow and facilitate older PRACs with current shortfalls and/or demonstrable capital needs to be able to leverage new financing by converting the existing annual PRAC rental assistance contract to a long-term subsidy. If Congress were to expand the existing Rental Assistance Demonstration (RAD) program to include PRACs, some properties could use the program to convert the PRAC subsidy to long-term project-based vouchers (PBV) or project-based rental assistance (PBRA), making it possible to leverage new financing;

- Ensure that the PRAC budgeting processes going forward will adequately fund reserve for replacement (reserve) accounts, and allow access to residual receipts account to offset repair needs. Establishing proactive processes to monitor both capital needs and reserve spend-down rates, and having clear guidance to make necessary adjustments to reserve account funding will ensure that the newer PRACs will have funds available for improvements when the time arrives; and

- Address critical repair needs of properties lacking the time to build up adequate reserves or the ability to recapitalize by ensuring funds are made available each year through the existing Section 202 line item for emergency capital repairs.

**Modeling as Evidence**

LeadingAge worked with a team of members and financing professionals to produce financial models for six PRAC properties. These six properties represent the range of typical PRAC deals in terms of property size, geography, and whether or not the “rents” are below, at or above the local fair market rent. The modeling assumes current rents and a separate funding of the Service Coordinator expense.

The models indicated that for this range of PRAC properties, a solution set of multiple options needs to be developed. No one solution will work for every PRAC property.

Some key findings from the modeling exercises are:

1. Below a certain size of property (30-40 units), even with rent increases, the size of loan that might be leveraged is much smaller than most lenders would accept. Possible solutions:
a. “Bundling” with other small PRACs into one loan, tax exempt bond and/or LIHTC transaction;

b. Might these be a good fit for the “small loan” risk share program being developed?

c. Grants

2. An increase in rent or a separate source of funds that accounts for the value of the extra services and service coordination that these properties offer will leverage additional needed capital, depending on the size of the property (see #1 above).

3. It is important to “right size” PRAC budgets to address adequate reserve funding for long-term capital needs of the project. In many cases, properties are too small to be able to afford the transactional cost of new debt, so adequate funding of reserves may be the only way to ensure their sustainability for the long term.

**A Fundamental Challenge**

As noted above (see 202 Background), the operational costs associated with the inclusion of a service coordinator and other initiatives aimed at facilitating better access to health and related services critical to aging successfully in community is a consideration that is specifically embedded in the programmatic requirements of PRACs. In the modeling, this cost almost always results in these properties having per-unit operating costs that translate to needed rents that are in excess of Fair Market Rent (FMR), and likely in excess of market comparables.

However, as is well documented and understood, integrating health care and other services with housing has the desirable effect of helping to improve health outcomes for older adults, reducing the cost that would otherwise be borne by the health care system, and enabling the fortunate residents of this uniquely designed and valuable, but insufficiently funded, housing stock to age with options instead of too often or too early being forced into higher cost restrictive care setting.

Existing multifamily housing preservation models include allowing rent increases up to the lower of RCS market rents and some factor of the Fair Market Rent (FMR). This however may not work for many PRACs. Various methods should be explored, but a solution must be found in order to protect the enhanced services aspect of the 202 program. Some ideas on how this could potentially be addressed include:

- Separating out, then adding back in, the cost of services (i.e., service coordination), if RCS market rent is used.
- Creating policy for a rent increase above FMR and/or RCS rents exclusively for PRACs that values the inclusion of services in these projects.

The exclusion of the cost of the service coordinator expense from the underwritten operating expense budget will make the refinancing potential of these properties more feasible and will net higher loan proceeds. However, in most cases, the damage it would do to the opportunities for the individuals living in the property, and to the core elements of the program, are abhorrent to the not-for-profit owners and sponsors. Eliminating these services would be a wrong-headed choice, subverting the original purposes of the program and undermining the unique and under-appreciated value of the program. As such, LeadingAge and its members are adamant that specific provisions must be made so that enhanced services are guaranteed to remain at these properties.
Next Steps

Legislation

LeadingAge is continuing to work with HUD to explore common ground on the range of options that may be necessary to meet the varied needs of the aging portfolio of Section 202 PRAC properties, including:

- RAD for PRAC - Allow current PRAC subsidy to be converted to a PBRA contract or a PBV contract through a RAD-like transaction. Longer-term Section 8 subsidy can then be used to attract financing;
- Support HUD and Senate requests for additional funding for rent adjustments to facilitate PRAC conversions; and
- Develop new policies to increase rents to cover cost of the new debt of the capital loan and or the cost of the service coordination expenses.

FHA program modification

LeadingAge should work with HUD to explore the ability to:

- Address special FHA underwriting criteria for PRAC deals:
  - Underwrite to 3% vacancy when supported.
  - Convert high reserve account deposits into cash available for debt service when supported by the repairs to be accomplished through the refinance.
  - As one solution to address Service Coordination expenses, place these expenses “below the line” for underwriting, which would require the owner to agree to pay for the SC from surplus cash.
  - Underwrite to the typical 202 Direct Loan standards: 90% LTV for (f) and (d)4 deals, and 1.11 DSC.

Regulation

- Work with HUD to create proactive policy and guidance on “right-sizing” PRAC budgets to address adequate Reserve for Replacement account funding for upcoming repairs and long-term capital needs of the project.
  - Current concerns include:
    - lack of consistency between offices,
    - apparent efforts to constrain budget adjustments despite requested increases specific to reserves, resulting in opposition to or deferral of requests to increase funding of replacement reserves,
    - substantial delays in processing of PRAC budget budgets (reports indicate problems of delays of 6 months to more than 1 year, especially since the beginning of the multifamily transformation and may, at least in part, be due to new instructions regarding and/or
discomfort with elements of the budget related to service coordination), failure to timely process R4R releases, and

- not communicating who the Account Executives are for the communities.

  o Explore ability to expand Service Coordinator grant program to include PRACs so that SCs aren’t being paid for through budgetary cash flow.

We look forward to working with HUD to engage in a collaborative dialogue to identify best practices for assessing current and long-term capital needs, providing adequate documentation/justification for budget adjustment requests, and addressing training and/or new policy creation as HUD transforms its business processes.
Glossary of Terms

**Capital Advance** – Through the Section 202/PRAC program, the Department of Housing and Urban Development (HUD) provides interest-free capital advances (similar to loans) to private, nonprofit sponsors to finance the development of supportive housing for the elderly. Capital advances may be used to finance the construction, rehabilitation or acquisition with or without rehabilitation of structures that will serve as supportive housing for very low-income elderly persons, including the frail elderly. The capital advance does not have to be repaid as long as the project serves very low-income elderly persons for at least 40 years.

The Capital Advance note may not be prepaid prior to the maturity date without prior written approval of HUD. Provided the housing has remained available for occupancy by eligible families until the maturity date of the note (and the note has not otherwise become due and payable by reason of defaults of the note, mortgage, or regulatory agreement), the note shall be deemed to be paid and discharged. If default is made by the owner, the entire principal sum shall at once become due and payable without notes. Interest per annum at a set rate shall be payable on demand with respect to the payment of principal upon default. Statute, regulation, and related information provided by HUD fact sheet: [http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/progdesc/eld202](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/progdesc/eld202)

**Emergency Repairs Grants** – Section 202b of the Housing Act of 1959 authorizes grants for the substantial capital repair of elderly housing or the conversion of elderly housing to assisted living facilities (the Assisted Living Conversion program). HUD may provide grants to non-profit sponsors of multifamily projects with elderly tenants that are needed to rehabilitate, modernize, or retrofit aging structures, common areas or individual dwelling units. The capital repair needs must relate to items that present an immediate threat to the health, safety, and quality of life of the tenants. The intent of these grants is to provide one-time assistance for emergency items that could not be absorbed within the project’s operating budget, and where the tenants’ continued occupancy in the immediate future would be called into question by a delay in initiating the proposed cure. Additional information provided by HUD fact sheet: [http://portal.hud.gov/hudportal/HUD?src=/hudprograms/ecrp](http://portal.hud.gov/hudportal/HUD?src=/hudprograms/ecrp)

**Enhanced PRAC (e-PRAC)** – As part of proposed rules [http://www.gpo.gov/fdsys/pkg/FR-2014-10-07/pdf/2014-23276.pdf](http://www.gpo.gov/fdsys/pkg/FR-2014-10-07/pdf/2014-23276.pdf) to implement amendments to the Section 202 PRAC program, HUD proposed in October, 2014 the Enhanced PRAC (ePRAC) program for both the Section 202 senior housing and the Section 811 housing for persons with disabilities. As described by Section 891.190 of the proposed rule, an ePRAC is available to a sponsor or owner under the Section 811 program or Section 202 program, accessing private capital, to fund the construction or provide permanent financing for supportive housing units for the elderly or persons with disabilities. The ePRAC would be available to sponsors that can provide evidence of a committed funding source from a lender for the construction or permanent financing of the Section 202 or Section 811 supportive housing units covered by the ePRAC. These 20-year contracts would allow, among other things, for the inclusion of debt service for units covered by the ePRAC as a project expense. The enhanced project rental assistance contract (ePRAC) would allow operating subsidies to pay debt service under specific circumstances.

**Fair Market Rents (FMR)** - Section 8(c)(1) of the United States Housing Act of 1937 (USHA) requires the Secretary to publish FMRs periodically, but not less than annually, adjusted to be effective on October 1 of each year. The primary uses of FMRs are to determine payment standards for the Housing Choice Voucher (HCV) program, to determine initial renewal rents for some expiring project-based Section 8 contracts, to determine initial rents for housing assistance payment contracts in the Moderate Rehabilitation Single Room Occupancy program, and to serve as rent ceilings for rental assistance units in the HOME Investment Partnerships program. FMRs are used in the calculation of maximum award amounts for Continuum of Care grantees and are
also used in the calculation of flat rents in Public Housing units. Additional information on FMR provided by HUD notice for FY2016 FMRs: https://www.federalregister.gov/articles/2015/09/08/2015-22023/proposed-fair-market-rents-for-the-housing-choice-voucher-program-moderate-rehabilitation-single

**Housing Assistance Payments (HAP) Contracts** - Section 8 Housing Assistance Payments Contracts (HAP Contracts) provide that the resident pays a portion of the contract rent (the resident’s portion is limited to a percentage of the resident’s income), with the remainder of the Contract Rent being paid under the HAP Contract as a Housing Assistance Payment. The HAP contract is a written agreement between the Public Housing Authority (PHA) and the owner of a unit occupied by a housing choice voucher program participant. The HAP contract must be in the form prescribed by HUD. Under the HAP contract, the PHA agrees to make housing assistance payments to the owner on behalf of a specific family leasing a specific unit. The PHA uses its payment standard schedule to calculate the monthly HAP payment to the owner. HUD provides HAP guidelines in chapter 11 of the choice voucher handbook 7420.10G: http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_11755.pdf

**Low-income Housing tax credits** - The Low Income Housing Tax Credit (LIHTC) program was established within Section 42 of the Internal Revenue Code in 1986 to provide private owners with an incentive to create and maintain affordable housing. The Internal Revenue Service (IRS) allocates funds on a per capita basis to each state. Each state has a housing finance or other agency (HFA) that assumes responsibility for allocating tax credits to developers. The process by which the HFA allocates the credits is competitive and uses criteria enumerated in the state’s Qualified Allocation Plan. Investors buy income tax credits in qualified properties that have received state allocation, creating cash equity for owners that reduces project development debt burden. In exchange, the owner agrees to rent a specific number of units to qualified tenants at specified rents, usually below-market. Two levels of tax credits are available: one at 9% of depreciable basis, competitively allocated; the other, at 4% of depreciable basis, comes with state bond financing, which is capped and allocated by a state agency, which may or may not be very competitive. Additional information on LIHTC available at HUD: http://portal.hud.gov/hudportal/HUD?src=/program_offices/fair_housing_equal_opp/lihtcmou or National Housing Law Project: https://nhlp.org/lihtcoverview

**Project based rental assistance (PBRA)** – A Section 8 HAP contract is project-based if the rental assistance remains with the property when a tenant moves. The Section 8 Program was authorized by Congress in 1974 and developed by HUD to provide rental subsidies for eligible tenant families (including single persons) residing in newly constructed, rehabilitated and existing rental and cooperative apartment projects. The rents of some of the residential units are subsidized by HUD under the Section 8 New Construction (New Construction), Substantial Rehabilitation (Substantial Rehabilitation) and/or Loan Management Set-Aside (LMSA) Programs. All such assistance is project-based, i.e.; the subsidy is committed by HUD for the assisted units of a particular Mortgaged Property for a contractually determined period. http://portal.hud.gov/hudportal/HUD?src=/recovery/programs/project

**Project based vouchers** - Project-based vouchers are a component of a public housing agencies (PHAs) housing choice voucher program. A PHA can attach up to 20 percent of its voucher assistance to specific housing units if the owner agrees to either rehabilitate or construct the units, or the owner agrees to set-aside a portion of the units in an existing development. http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/programs/hcv/project Key features of the program include the following: A PHA may provide project-based assistance for existing housing that does not need rehabilitation, as well as for newly constructed or rehabilitated housing. Except for units designated for families that are elderly, disabled, and/or receiving supportive services, no more than 25 percent of units in a multifamily project may have project-based voucher assistance. The PHA may enter into a HAP contract with an owner for an initial term of up to 15 years and an extension of the initial term of up to 15 years. Both the initial contract term and any contract extension
Project Rental Assistance Contracts - PRAC – Project rental assistance contract funds are provided by HUD to post-1990 awardees of Section 202 Supportive Housing for the Elderly projects (and Section 811 for persons with disabilities) to cover the difference between the HUD-approved operating cost for the project and the tenants' contribution towards rent. Project rental assistance contracts are approved initially for 3 years and are renewable based on the availability of funds. As described in the HUD handbook (4571.3, 1-6, B) any contract amounts not used by a project in any year shall remain available to the project until the expiration of the contract. The Secretary may adjust the annual amount if the sum of the project income and the amount of assistance payments available are inadequate to provide for reasonable HUD-approved operating costs. The HUD-approved operating costs may include an allowance (not to exceed $15 per unit per month) for services limited to the frail and “at risk” elderly.


Recapitalization – As defined by HUD for real estate, recapitalization is a process whereby the type, amount, income, return, or priority of a loan, ownership interest, or other securities of a property are adjusted, restructured, or replaced. With regard to preservation of HUD-assisted multifamily housing, recapitalization refers to refinancing or restructuring of FHA-insured outstanding mortgages or other financing. Additional information on recapitalization is available at the HUD Office of Recapitalization: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/hsgmfbus/abouthp

Rent Comparability Study – As a requirement for renewal under Section 524(a) of Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA), most project owners with expiring Section 8 project-based contracts must submit a RCS at initial renewal to demonstrate that current rents are at or below comparable market rents. Beginning with the date of the initial renewal of the expiring Section 8 project-based contract, the RCS will start a maximum five-year “life cycle” before a new RCS is required. In general, any contract that renews during the five year life cycle can only be renewed for a term that does not exceed the remaining life of the RCS. An exception is when the owner submits a new RCS when requesting permission to mark rents up to market. The RCS must be completed by a certified general appraiser, licensed and in good standing in the state where the property is located. Chapter 9 of Section 8 policy changes guidebook provides additional RCS information: http://www.hud.gov/offices/hsg/mfh/exp/guide/s8renew.pdf

Rental Assistance Demonstration (RAD) and RAD 2 – As described by HUD, the Rental Assistance Demonstration (RAD) allows public housing agencies (PHAs) and owners of other HUD-assisted properties to convert units from their original sources of HUD financing to project-based Section 8 contracts. The primary benefit of RAD is that properties that convert under this process are no longer restricted from securing private sources of capital financing, and the owners are therefore able to address deferred maintenance issues that have caused Public Housing and other HUD rental stock to deteriorate nationwide. Under the First Component of RAD, properties that are currently funded under the Public Housing and Section 8 Mod Rehab programs convert their assistance to long-term, project-based Section 8 contracts. Under the Second Component of RAD, the owners of projects funded under HUD’s legacy programs (Rental Supplement, Rental Assistance Payment, and Moderate Rehabilitation) can convert the unit subsidy funding to Section 8 project-based vouchers. RAD was authorized by Congress under the FY12 HUD appropriations act (PL112-55) http://portal.hud.gov/hudportal/documents/huddoc?id=HR-2112-RAD-Language.pdf

Reserve for replacement – As stated in HUD Handbook 4350.3 REV 1, the regulatory agreement for FHA-insured multifamily properties specifies that the borrower must establish and maintain a Reserve for Replacement account, with a specified monthly amount to be deposited, for defraying certain costs of replacing major structural elements and mechanical equipment of the insured property, and for other purposes. The balance in the account is a restricted asset; disbursements can only be made with HUD’s consent. As stated in the HUD handbook 4350.1 http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_35335.pdf A Reserve Fund for Replacements exists for most projects (including) HUD-insured, HUD-held mortgages, and Section 202. The Reserve Fund is generally used to help defray the costs of replacing a project’s capital items. Title 24 of the Code of Federal Regulations provides, at Section 207.19(f)(3)(i), “In all projects, except those involving rehabilitation where the mortgage does not exceed $200,000, a fund for replacements shall be established and maintained with the mortgagee. The amount and type of such fund and the conditions under which it shall be accumulated, replenished, and used, shall be specified in the charter, trust agreement, or regulatory agreement.” Additional information on HUD guidelines for RR available at: http://portal.hud.gov/hudportal/HUD?src=/states/shared/working/r8/mf/reserveguidelines/14

Residual Receipts – Residual receipts refer to certain funds held by borrowers whose mortgages are insured or held by HUD. Residual receipts are calculated after first determining the amount of surplus cash. Certain borrowers then may make any distributions permitted under the regulatory agreement and other program obligations. As described in Chapter 25 of the HUD 4350.1 handbook http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_35309.pdf, the requirement for a Residual Receipts Account is established by a Regulatory Agreement or a project-based subsidy contract such as Section 8 Housing Assistance Payments. During the life of the mortgage (except for certain Section 8 projects), Residual Receipts are an asset of the mortgagor held under HUD control. Amounts received by the facility through subsidy payments which are over the gross unit rent, typically required to be deposited into a separate project-specific account and may be authorized to access them for HUD approved expenditures which may include funding for CNA’s, service coordinators, etc. In June, 2015 HUD issued a Notice to recapture of residual receipts - http://www.leadingage.org/uploadedFiles/Content/Members/Provider_Types/Housing/HUD_Regulatory_Compliance/PRAC_residual_receipts_DAS_Memo_2015.pdf

Section 202 Supportive Housing for the Elderly – The Section 202 program was created in 1959 to provide direct government loans to nonprofits for the purpose of developing affordable rental housing for the elderly, and also for persons with disabilities under subsequent authorizations. The program currently provides interest-free capital advances to finance the construction, rehabilitation, or acquisition (with or without rehabilitation) of structures that will serve as supportive housing for very low-income elderly persons. The program also provides rental assistance subsidies for these properties. As summarized by a recent Congressional Research Service document, “Section 202 and Other HUD Rental Housing Programs for Low-Income Elderly Residents”, http://congressionalresearch.com/RL33508/document.php the Section 202 has been modified several times since it was first established as part (Section 202) of the Housing Act of 1959; and has evolved essentially in three phases based on its financial structure and income eligibility:

- direct loan (1959-1974) – HUD provided long-term (50 years) low-interest (3%) loans to non-profit organizations to provide non-subsidized affordable housing for moderate-income older persons (90% of the area median income -AMI). In the FY1970 budget, the Nixon Administration imposed a moratorium on the
program over concerns with budget outlays – not calculating repayments (elderly housing eligible under a new Section 236 program used during this moratorium).

- **direct loan with Section 8 rent subsidy (1974-1990)** – Among major changes made were the attachment of project-based Section 8 rent subsidies (20 year); lowered eligibility to low income (80% of AMI), rent based on income (30%); some units for non-elderly persons with disabilities; and later cost-containment policies that reduced size and quality of buildings;

- **Capital Advance with Project Rental Assistance Contracts** - (1990 to present) – Major changes included: funds provided (Capital Advance) that do not need to be repaid as long as the property remains available for very low-income (50% of AMI) for at least 40 years; a new project-based rental assistance (PRAC); staffing of service coordinators, and eligibility exclusively for seniors (a new Section 811 program was established for non-elderly persons with disabilities.

The Section 202 Supportive Housing for the Elderly Program is authorized by section 202 of the Housing Act of 1959 (12 U.S.C. 1701q), as amended. Program regulations are found 24 CFR Part 891. More information about the Section 202 program, can be found in HUD Handbooks 4571.3, Supportive Housing for the Elderly and 4571.5, Supportive Housing for the Elderly--Conditional Commitment; HUD Notices H96-102 REV 00-23, H2009-10 and H2011-18.