

RAD Ownership and Control for RAD Component 1 and RAD PRAC

I. RAD Component 1 Background / Requirements

The RAD statute (Public Law 112-55 as amended by Public Laws 113-76, 113-235, 114-113, 115-31 and 115-141) has specific requirements relating to the control of a first component PHA conversion RAD project. In the first instance at deal closing (as opposed to in the event of foreclosure or certain other contingencies down the road), the RAD statute has two applicable provisions:

- “...The Secretary shall require ownership or control of assisted units by a public or non-profit entity...”
- “...[The Secretary] may allow ownership to be transferred to a for-profit entity to facilitate the use of tax credits only if the public housing agency preserves its interest in the property in a manner approved by the Secretary...”

The RAD notice (H 2019-09 and PIH 2019-23 (HA) issued September 5, 2019) provides guidance as to ownership and control requirements:

- Section 1.4 A.11 states that ownership control requirements may be satisfied for a Covered Project when a public or non-profit entity (or entities), directly or through a wholly owned affiliate ¹: “(1) holds a fee simple interest in the real property of the Covered Project; (2) is the lessor under a ground lease with the Project Owner; (3) has the direct or indirect legal authority (via contract, partnership share or agreement of an equity partnership, voting rights or otherwise) to direct the financial, and legal interests of the Project Owner with respect to the RAD units; (4) owns 51 percent or more of the general partner interests in a limited partnership; or 51 percent or more of the managing member interest in a limited liability company with all powers of a general partner or managing member, as applicable; (5) owns a lesser percentage of the general partner or managing member interests and holds certain control rights as approved by HUD; (6) owns 51 percent or more of all ownership interests in a limited partnership or limited liability company and holds certain control rights as approved by HUD; or (7) other ownership and control arrangements approved by HUD.”
- Section 1.4 A.11 further states: “HUD may allow ownership of the project to be transferred to a tax-credit entity controlled by a for-profit entity to facilitate the use of tax credits for the Covered Project, but only if HUD determined that the PHA preserves its interest in the property. Preservation of PHA’s sufficient interest in a project using tax credits could include, but not be limited to, the following, if properly structured subject to HUD’s review:
 - PHA, or an affiliate under its sole control, is the general partner or managing member;

¹ An affiliate includes a PHA affiliate as defined in 24 CFR 905.604, but does not include a PHA instrumentality as defined at 24 CFR 905.604. The public or non-profit status of a PHA instrumentality must be determined independently, on the basis of its affiliation with the PHA.

- PHA retains fee ownership and leases the real estate to the tax credit entity pursuant to a long-term ground lease;
- PHA retains control over the leasing of the Covered Project, such as extensively maintaining and administering the waiting list for the Covered Project, including performing eligibility determinations complying with the PHA Plan;
- PHA enters into a Control Agreement by which the PHA retains consent rights over certain acts of the Project Owner (including, for example, disposition of the Covered Project, leasing, selecting the management agent, setting the operating budget and making withdrawals from the reserves) and retains certain rights over the Covered Project, such as administering the waiting list; or
- Other means that HUD finds acceptable, in its sole discretion.”

In reviewing a first component PHA conversion RAD transaction, the Field Counsel must keep these requirements in mind as he or she reviews the transaction.

II. RAD Components 1 Deal structures that comply with ownership / control requirements.

A. The following structures are clearly acceptable:

- Where the PHA will continue to own the project.
- Where the PHA will transfer the ownership to an affiliate entity in which the PHA is the sole owner or member.
- Where the PHA transfers the ownership to another public or non-profit entity.

For any PHA affiliates, ensure that the HUD-required language for PHA affiliates is used.

B. The following structures are potentially acceptable, subject to review:

1. Ownership by an LIHTC entity. Where, for purposes of facilitating tax credits, the PHA transfers ownership to a tax credit entity (usually a limited partnership or limited liability company), review is necessary to ensure that the PHA has adequate control and consent rights. Review is necessary whether the PHA (or an affiliate under its sole control) is the general partner / managing member or one of multiple general partners / managing members. The Field Counsel shall:

- a. ensure that the entity is in existence for at least as long as the HAP contract; and
- b. ensure that the HUD-required provisions (attached at the end of this guidance document as Attachment 1) are included in the owner entity’s governing document (for example, Limited Partnership Agreement in the case of Limited Partnership or Operating Agreement in the case of an LLC).

2. Long-term ground lease: Where, for purposes of facilitating tax credits, the PHA transfers ownership to a tax credit entity, the PHA may also retain adequate control over the property through a long-term ground lease in which the PHA is the lessor and the project owner entity is the lessee. Review is necessary to ensure that the PHA retains adequate control and that the ground lease is not a de facto irrevocable transfer of the fee interest.

- a. The Field Counsel shall review the ground lease to ensure:
 - i. the term of the ground lease is at least as long the HAP contract; and
 - ii. the HUD-required provisions (attached at the end of this guidance document as Attachment 2) are included in the ground lease.

b. Because the HUD-required provisions include self-subordinating language, the ground lease may be recorded prior to the RAD Use Agreement.

C. The following structures cause serious concern and must be reviewed thoroughly:

1. Seller financing or other subordinate loans. A PHA may, when transferring ownership of the project to a tax credit entity propose to maintain control of the project with a subordinate mortgage, serviceable from cash flow. Although seller financing or other subordinate loans, secured by a mortgage, give the PHA a legal interest in the property, the PHA's interest is most likely very limited. A subordinate lien is terminated if a superior lien forecloses. The lien is limited to the amount of the financing. The lien terminates when the loan is due or repaid. Therefore, the PHA's interest is limited to the amount of financing it provides and can be extinguished when the loan is repaid, including if the property is refinancing in year 15, for example. For these reasons, seller financing alone is almost certainly not an adequate method to maintain PHA control. If a transaction proposes maintaining PHA control through seller financing without either an adequate ownership interest in the organizational structure or a long-term ground lease (both as described above), the Field Counsel must consult Program Counsel (Vickie Longosz) in Headquarters as to whether or not the specifics of the transaction meet the RAD statutory and notice requirements.

2. Right of first refusal. A PHA may, when transferring ownership of the project to a tax credit entity propose to maintain control of the project through a right of first refusal (ROFR) recorded against the property. An ROFR springs when the project owner receives an offer to purchase the property. This can be problematic if the ROFR requires the PHA to match a fair market valuation. If the PHA cannot meet the price set in the ROFR (which may be the fair market value), then the PHA cannot exercise the ROFR and the property may be transferred to the purchaser. Setting the price at below fair market value may cause negative tax implications for the current project owner. Even if the price is set at a value that the PHA can pay, the time period for exercising the ROFR may be limited. Even if the PHA can feasibly pay the purchase price, the PHA may not be able to garner the appropriate approvals in the time period necessary to exercise the ROFR. Once the ROFR lapses, the PHA's rights to purchase the property may be lost. In other words, if the PHA does not exercise the ROFR, it likely loses its interest in the property. For these reasons, an ROFR alone is almost certainly not an adequate

method to maintain PHA control. If a transaction proposes maintaining PHA control through an ROFR without either an adequate ownership interest in the organizational structure or a long-term ground lease (both as described above), the Field Counsel must consult Program Counsel (Vickie Longosz) in Headquarters as to whether or not the specifics of the transaction meet the RAD statutory and notice requirements.

III. RAD PRAC Ownership and Control

Section 237 of the General Provisions – Department of Housing and Urban Development in the Consolidated Appropriations Act, 2018 (Pub. L. No. 115-141) authorized RAD conversion of Project Rental Assistance Contracts (PRACs) under Section 202(c)(2) of the Housing Act of 1959. This Section provides RAD program instructions to owners of these Section 202 Housing for the Elderly Capital Advance properties with PRACs. These properties are referred to as “202 PRAC Projects” unless otherwise noted. While the Second Component of RAD does not have the broad statutory waiver authority that the First Component does, the Second Component does provide that participation is subject to “requirements established by the Secretary.” HUD has used this authority and standard regulatory waiver authority to develop alternative requirements, and to waive purely regulatory provisions where necessary in order to fulfill the purposes of the Demonstration.

Eligible Owners

A. Compliance with HUD Requirements. The Project Owner must be in good standing with HUD. If the current Project Owner is anticipated to remain in the ownership structure, the Project Owner must not have a history of non-compliance with program and contractual requirements, including maintaining units in a decent, safe, and sanitary condition. If a proposed conversion is in the context of an acquisition simultaneous with the conversion, the purchaser must provide evidence of successful experience owning and operating HUD or other multifamily housing properties. Any change in Ownership will require Form HUD-2530 Previous Participation approval as described in Attachment 4A.

B. Fair Housing and Civil Rights Compliance. A Project Owner must certify it will comply with all fair housing and civil rights requirements including but not limited to those at 24 CFR § 5.105(a). Any outstanding fair housing or civil rights matters arising prior to conversion must be resolved to HUD’s satisfaction prior to conversion, provided that all applicable legal processes have been satisfied. If HUD determines a conversion would fail to meet this standard, HUD will notify the Project Owner of its determination and any necessary actions. Fair housing or civil rights matters that arise after conversion will be addressed in accordance with applicable authorities. Additionally, a Project Owner may be required to demonstrate that its proposed activities under RAD are consistent with any applicable VCA, conciliation agreement, consent order or consent decree, final judicial ruling, or administrative ruling or decision. HUD may terminate an approval if it determines that the terms of the conversion would be inconsistent with

fair housing or civil rights laws or a fair housing or civil rights court order, settlement agreement, or VCA. Furthermore, if a project is subject to a VCA, conciliation agreement, consent order Section IV: Section 202 Project Rental Assistance Contract (PRAC) Projects 237 or consent decree, or final judicial ruling or administrative ruling or decision, it must ensure that the ownership agreement or other appropriate document makes the new Project Owner subject to the remedial provisions contained in such documents. It is the Project Owner's obligation to disclose such documents, to the prospective Project Owner. The extent of the Project Owner's responsibilities, including whether the responsibilities are appropriately limited to the development, maintenance, or operation of the particular RAD project, must be appropriately documented. The Project Owner will follow any requirements for the modification of such VCA, conciliation agreement, consent order or consent decree, or final judicial ruling or administrative ruling or decision. If HUD is a party to such document, the RAD project will not close without HUD's express approval of the transfer of obligations to the new Project Owner.

C. Ownership and Control. Through the term of the Converting Project's Capital Advance Use Agreement, HUD will require ownership or control of the Covered Project by a nonprofit entity:

1. A non-profit entity is an organization that has tax exempt status under 501(c)(3) or 501(c)(4) of the Internal Revenue Code of 1986 or that is a non-profit consumer cooperative or non-profit affiliate with a public agency .
2. Non-profit entity ownership or control may be satisfied if a non-profit entity directly or through an entity wholly owned by the non-profit entity meets one or more of the following:
 - (a) holds a fee simple interest in the real property of the Covered Project;
 - (b) is a Lessor under a Ground Lease with the Project Owner;
 - (c) has the direct or indirect legal authority (via contract, partnership share, agreement of an equity partnership, voting rights, or otherwise) to direct the financial and legal interests of the Project Owner with respect to the RAD units;
 - (d) owns 51% or more of the general partner interest in a limited partnership or 51% or more of the managing member interests in a limited liability company with all powers of a general partner or managing member, as applicable;
 - (e) owns a lesser percentage of the general partner or managing member interest and holds certain control rights as approved by HUD;
 - (f) owns 51% or more of all ownership interests in a limited partnership or limited liability company and holds certain control rights as approved by HUD ; or
 - (g) other ownership and control arrangements approved by HUD.

Note however, that prior to conversion, the Converting Project must continue to meet the ownership requirements set forth in the Housing Act of 1959, as amended.

Attachment 1

HUD-required provisions for LPA/Operating Agreement in LIHTC transactions

** for use in LIHTC deals when a PHA or non-profit maintains control of the RAD project through membership in the organizational structure*

Instructions: The following language must be inserted into the owner entity's governing organizational document (partnership agreement, operating agreement, or by-laws).

[Section #] Notwithstanding any other clause or provision in the [identify both the formation document(s) and the governing document(s)] ([LPA / Operating Agreement]) and so long as the Rental Assistance Demonstration Use Agreement dated as of substantially even date herewith, as amended from time to time ("Use Agreement") is in effect, the following provisions shall apply:

1. If any of the provisions of this [LPA / Operating Agreement] conflict with the terms of the Use Agreement, the provisions of the Use Agreement shall control.
2. The provisions in this [Section #] are required to be inserted into this [LPA / Operating Agreement] by HUD and may not be amended without HUD's prior written approval. If there is a conflict between any of these HUD-required provisions and any other provision of this Agreement, the terms of these HUD-required provisions will govern. If there is a conflict between any of the provisions in the [insert appropriate document, e.g., Articles of Organization] and these HUD-required provisions of this Agreement, these HUD-required provisions will govern. If there is a conflict between the Use Agreement or these HUD-required provisions relating to the Rental Assistance Demonstration ("RAD") and any HUD-required provisions relating to mortgage insurance provided in connection with the National Housing Act, the more restrictive provisions shall control.
3. [Name of entity controlled by PHA or non-profit] may be removed for cause by the [Investor Member/Limited Partner] pursuant to [insert relevant Section #] of this Agreement but only subject to the conditions set forth in the [if PBRA: Section 2.25(d) OR if PBV: Section 37], the "Low-Income Housing Tax Credit Provisions," of the [HAP Contract] (HAP LIHTC Provisions).
4. The [members / partners] acknowledge that provision of rental assistance to the [Project] depends on [name of entity controlled by PHA or non-profit] to be a [member / partner] in [name of owner entity] and to be controlled by [PHA or non-profit]. [Name of entity controlled by PHA or non-profit] may not transfer all or part of its interest in [name of owner entity] without prior written consent of HUD. Failure of [name of entity controlled by PHA or non-profit] to be controlled by [PHA or non-profit], except as provided above in [insert relevant Section #], shall be a violation of this Agreement and may cause termination of such rental assistance.
5. Neither the [name of ownership entity] nor any [member / partner] shall have any authority to:
 - a. Take any action in violation of the Use Agreement; or
 - b. Fail to renew the [HAP Contract] upon such terms and conditions applicable at the time of renewal when offered for renewal by the [PHA] or HUD.
6. Without the consent of [name of entity controlled by the PHA or non-profit] (and provided that the [name of entity controlled by PHA or non-profit] has not been removed for cause by

Attachment 1

HUD-required provisions for LPA/Operating Agreement in LIHTC transactions

** for use in LIHTC deals when a PHA or non-profit maintains control of the RAD project through membership in the organizational structure*

the [Investor Member/Limited Partner] in accordance with [insert relevant Section #], neither the [name of ownership entity] nor any [member / partner] shall have any authority to:

- a. Except to the extent permitted by the [HAP Contract] or Use Agreement, transfer, convey, assign, mortgage, pledge, sell, lease, sublease or otherwise dispose of, at any time, the [Project] or any part thereof; or
- b. Amend, renew or terminate the [Property Management Agreement] or enter into a new property management agreement.

Attachment 2

HUD-required provisions for Ground Lease in LIHTC transactions

**for use in LIHTC deals when the Project Owner owns the Covered Project pursuant to a ground lease interest rather than fee simple.*

Instructions: *The ground lease entered into by the PHA (or non-profit) as Lessor for the "Project" as described in the Rental Assistance Demonstration ("RAD") Use Agreement must include the following provisions.*

[Section #] In addition to entering into this [ground lease], [Lessor] and [Lessee] also contemplate the provision of rental assistance to the [Project] pursuant to a a Housing Assistance Payment Contract ("HAP Contract"). If a HAP Contract is entered into pursuant to the Rental Assistance Demonstration ("RAD"), the U.S. Department of Housing and Urban Development ("HUD") will require Lessor and Lessee to enter into a RAD Use Agreement ("Use Agreement") in connection with the provision of rental assistance to the [Project]. Notwithstanding any other clause or provision in this [ground lease], upon execution of the Use Agreement and for so long as the Use Agreement is in effect, the following provisions shall apply:

1. This [ground lease] shall in all respects be subordinate to the Use Agreement. Subordination continues in effect with respect to any future amendment, extension, renewal, or any other modification of the Use Agreement or the [ground lease].
2. If any of the provisions of this [ground lease] conflict with the terms of the Use Agreement, the provisions of the Use Agreement shall control.
3. The provisions in this [Section #] are required to be inserted into this [ground lease] by HUD and may not be amended without HUD's prior written approval.
4. Violation of the Use Agreement constitutes a default of this ground lease.
5. Notwithstanding any other contract, document or other arrangement, upon termination of this ground lease, title to the real property leased herein shall remain vested in [PHA or non-profit] and title to the buildings, fixtures, improvements, trade fixtures and equipment that belong to Lessee shall vest in [PHA or non-profit].
6. Neither the [Lessee] nor any of its [members / partners] shall have any authority to:
 - a. Take any action in violation of the Use Agreement; or
 - b. Fail to renew the [HAP Contract] upon such terms and conditions applicable at the time of renewal when offered for renewal by the [PHA] or HUD.
 - c. Except to the extent permitted by the [HAP Contract] or Use Agreement and the normal operation of the [Project], neither the [Lessee] nor any [members / partners] shall have any authority without the consent of [PHA or non-profit] to sell, transfer, convey, assign, mortgage, pledge, sublease or otherwise dispose of, at any time, the [Project] or any part thereof.

Attachment 3

HUD-required provisions when Project Owner is a PHA instrumentality or affiliate

** for use when a PHA or non-profit maintains control of the RAD project through an affiliate, whether wholly-owned or in connection with other parties.*

Instructions: *The following language must be inserted into the Project Owner's governing organizational document (by-laws or operating agreement, etc.) unless the transaction involves LIHTC.*

[Section #] Notwithstanding any other clause or provision in the [identify both the formation document(s) and the governing document(s)] ([By-laws / LPA / Operating Agreement]) and so long as the Rental Assistance Demonstration Use Agreement dated as of substantially even date herewith, as amended from time to time ("Use Agreement") is in effect, the following provisions shall apply:

7. If any of the provisions of [these By-laws OR this LPA / Operating Agreement] conflict with the terms of the Use Agreement, the provisions of the Use Agreement shall control.
8. The provisions in this [Section #] are required to be inserted into the [By-laws / LPA / Operating Agreement] by HUD and may not be amended without HUD's prior written approval. If there is a conflict between any of these HUD-required provisions and any other provision of this document, the terms of these HUD-required provisions will govern. If there is a conflict between any of the provisions in the [insert appropriate document, e.g., Articles of Organization] and these HUD-required provisions of this ([By-laws / LPA / Operating Agreement]), these HUD-required provisions will govern. If there is a conflict between the Use Agreement or these HUD-required provisions relating to the Rental Assistance Demonstration ("RAD") and any HUD-required provisions relating to mortgage insurance provided in connection with the National Housing Act, the more restrictive provisions shall control.
9. In order to provide rental assistance to the [Project] pursuant to RAD, HUD requires that [PHA or non-profit] control [name of Project Owner]. [PHA or non-profit] may not transfer all or part of its interest in [name of Project Owner] without prior written consent of HUD. Failure of [Project Owner] to be controlled by [PHA or non-profit] shall be a violation of this ([By-laws / LPA / Operating Agreement]) and may cause termination of such rental assistance.
10. Neither the [Project Owner] nor any [member / shareholder] shall have any authority to:
 - a. Take any action in violation of the Use Agreement; or
 - b. Fail to renew the [HAP Contract] upon such terms and conditions applicable at the time of renewal when offered for renewal by the [PHA] or HUD.
11. Without the consent of [PHA or non-profit], the Project Owner shall have no authority to:
 - a. Except to the extent permitted by the [HAP Contract] or Use Agreement, transfer, convey, assign, mortgage, pledge, sell, lease, sublease or otherwise dispose of, at any time, the [Project] or any part thereof; or
 - b. Amend, renew or terminate the [Property Management Agreement] or enter into a new property management agreement.