

202 PRAC Rent Increase for Conversions to PBRA Conversions: FAQs

This document provides responses to frequently asked questions related to a provision in Housing Notice 2023-08/PIH Notice 2023-19 (RAD Supplemental Notice 4B) that creates the opportunity for increased contract rents (“preservation rent increase”) for certain 202 PRAC conversions to PBRA where the conversion supports long-term preservation by enhancing climate resilience, energy and water efficiency, and the design of housing appropriate for the elderly to age-in-place.

BACKGROUND

Section 4.6.D as amended by the RAD Supplemental Notice 4B states:

“HUD may provide:

- An increase of up to \$250 per unit per month (PUM) to the PRAC rent for any transaction that will undertake new construction or substantial rehabilitation (defined as hard construction costs, including general requirements, overhead and profit, and payment and performance bonds) in excess of 60% of the Housing Construction Costs as published by HUD for a given market area.^{4B-2}
- An increase of up to \$100 PUM to the PRAC rent for any transaction that will undertake rehabilitation (defined as hard construction costs, including general requirements, overhead and profit, and payment and performance bonds) in excess of 30% of the Housing Construction Costs as published by HUD for a given market area.”

Question: What converting projects are eligible for this provision?

Answer: A project, as defined in the RAD Notice and which equates to a single transaction or phase, must meet all of the following criteria. The project must:

- Be converting to a Project Based Rental Assistance (PBRA) HAP contract
- Propose new construction or rehabilitation work in the Conversion
- Demonstrate that the new construction or rehabilitation work will:
 - 1) enhance climate resilience,
 - 2) energy and water efficiency, and/or
 - 3) incorporate appropriate design for the elderly residents to age-in-place through fall prevention, integration of universal design and/or visitability features, effective use of electronic communications, and/or promotion of health and wellness
- Require the rent increase in order to achieve viability of the transaction

Question: If HUD determines my project is not eligible for the preservation rent increase can I still get a rent increase for projected tenant paid utility cost savings?

Answer: Yes. Projects need not be approved for the preservation rent increase in order to be eligible for the utility savings rent increase.

^{4B-2} Housing Construction Costs are published annually. For the most recently published Housing Construction Costs as of the Notice publication date, please see:

https://www.hud.gov/sites/dfiles/PIH/documents/TDCs_2022.pdf

Question: Does receipt of the preservation rent increase disqualify a property from using other rent flexibilities available under the RAD Notice?

Answer: No. However, the evaluation of the appropriate rent increase will take into account the final proposed rent.

Question: How is “substantial rehabilitation and rehabilitation” defined and what can be included in the RAD Scope of Work to measure against Housing Construction Costs?

Answer: Substantial rehabilitation and rehabilitation are defined here as a proposed RAD scope of work where the hard construction costs, including general requirements, overhead and profit, and payment and performance bonds, exceed 60% or 30% of the “Housing Construction Costs,” respectively. Housing Construction Costs for a given market area can be found at

https://www.hud.gov/sites/dfiles/PIH/documents/TDCs_2022.pdf

We have also developed a tool available on the RAD Resource Desk that 202 PRAC property owners can use to check to quickly assess whether the proposed rehab level meet these thresholds. For purposes of calculating aggregate construction costs vis-à-vis the 60% or 30% threshold, HUD will consider the combined construction costs of the overall development. The development may include a mixture of new construction and rehabilitation and may include other units besides the converting units (e.g., through the development of new units).

The “202 PRAC Preservation Rent Increase Eligibility Tool” can be found on the RAD Resource Desk in the RAD for Multifamily Document Library at https://www.radresource.net/mf_library.cfm

Question: For a mixed transaction of rehab of a 202 PRAC with new construction of LIHTC-only. Would the hard costs for comparison to the HCCs be the rehab only or the whole project?

Answer: The hard costs for the entire project are used for the comparison to the HCC.

Question: How will HUD determine whether the rent increase is necessary for the viability for the transaction?

Answer: 202 PRAC Owners may request a preservation rent increase to the project rents in the RAD Conversion Application on the RAD Resource Desk. Generally, HUD will take the following approach to determining whether the rent increase is necessary for the viability of the transaction:

- 1) HUD will consider the total revenue for the property, including any other revenue producing units at the site.
- 2) The transaction must utilize “hard debt,” must-pay financing (not including any identity-of-interest loans).
- 3) Using a trending rate of 2% for revenue and 3% for expenses, the transaction must maintain a debt coverage ratio that is no greater than 1.35 over a 20-year pro forma.
- 4) The transaction cannot include any cash-out financing or net acquisition proceeds to the Owner. This does not preclude a arms-length sale to an unrelated third party.

5) This rent increase is not contemplated to provide additional surplus cash to service soft debt obligations.

As a result of these tests, HUD may approve a per unit increase amount of up to \$250 or \$100 after determining the 60% or 30% HCC threshold has been met. HUD reserves the right to consider other unique factors in the analysis of individual transactions.

Question: Can my increased rents exceed 120% of FMR?

Answer: A property's initial Section 8 contract rents at conversion can exceed 120% of FMR only if the PRAC budget-based rent setting has already set the rents over 120% of FMR. When 202 PRAC owners are approved to receive a preservation rent increase, the maximum amount will be capped at 120% of FMR, less utility allowances.

Question: Is there any change to PBV rent setting?

Answer: No, the changes in the Supplemental Notice apply strictly to PBRA conversions. Only PBRA conversions can come in at over 120% FMR, and only PBRA conversions would be eligible for the preservation rent increase.

Section 4.5.H of the RAD Notice concerning Initial Contract Rent Setting for PBV conversions remains unchanged.

Question: Is the rent increase only for preservation 202s, or would new construction 202s be eligible as well?

Answer: Newly constructed 202 capital advance projects are eligible to apply for the preservation rent increase.

Question: When may a 202 PRAC Owner make the request and how will HUD document approval?

Answer: Owners may make an initial request for the rent increase up to six months prior to submission of the full Conversion Plan, at which point HUD will reserve the funding for the preservation rent increase, and the Owner will make the final request when the complete Conversion Plan is submitted. Owners can make the initial request by completing the "Preservation Rent Increase" section of the conversion application on the RAD Resource Desk.

The Owner's submission should affirm that the project:

- Is converting to a Project Based Rental Assistance (PBRA) HAP contract;
- Will be newly constructed or rehabilitated;
- Will include work to enhance climate resilience, energy and water efficiency, or incorporate appropriate design for the elderly residents to age-in-place through fall prevention, integration of universal design and/or visitability features, effective use of electronic communications, and/or promotion of health and wellness; and

- Requires the rent increase in order to achieve viability of the transaction

Unless the project is not converting to PBRA or if it does not meet eligibility requirements, HUD will issue a comfort letter that will provide an estimated rent increase amount conditioned on 1) submission of a complete and acceptable Conversion Plan within six months of the date of the letter and 2) HUD's verification at the time of Conversion Plan that the transaction meets the criteria for the rent increase as described above. The Owner can use the comfort letter to support lender and investor underwriting. If a complete and acceptable Conversion Plan is not submitted within six months of the date of the comfort letter is issued, the conditioned approval will expire. HUD will not provide extensions. The Owner may submit a subsequent request for the rent increase, which HUD will consider subject to the availability of funding.

In reviewing the Conversion Plan, HUD will confirm that the project meets all criteria to be eligible for the increase and confirm that the amount of the rent increase is necessary for the viability of the transaction. Once confirmed, HUD will include the rent boost amount in the RAD Conversion Approval Letter attachment, the HAP Term Sheet to document final HUD approval of the increased rents.

Question: Does receipt of a comfort letter for a preservation rent increase impact the budget-based rent increase that a property owner can request prior to conversion?

Answer: No. Owners can continue to request budget-based rent adjustments prior to conversion, including to adjust replacement reserves based on a Capital Needs Assessment, and such requests will be processed in the same manner.

Question: How much funding does HUD have available for these rent increases?

Answer: As of July 2023, Congress has provided HUD up to \$6 million from the FY 22 Appropriations Act and up to \$6 million from the FY 23 Appropriations Act.

Question: For the Section 202 rent bump, does the \$12 million go to the first year of the HAP? In following years, will it add to the renewal baseline cost?

Answer: Yes, Congress authorized \$12M to support the increase of 202 PRAC contract rents at conversion for properties converting to a Multifamily Project Based Rental Assistance (PBRA) contract. Properties are eligible for an increase to the contract rents of up to \$250 per unit per month. This funding will be applied to the HAP contract for months in the year of conversion plus the first full year after conversion. Beginning with the second full year after conversion, the HAP contract is funded with Section 8 renewal funds.

Note that the scope of work must enhance climate resilience, energy or water efficiency, or incorporate design for the elderly to age in place to qualify. The owner must also demonstrate that the transaction would not otherwise be feasible without the increased funding.

See Section 4.6.D on Initial Contract Rent Setting for 202 PRAC conversions to PBRA in the revised Notice for more information on the preservation rent increase.