Public Housing Notice 2022-21

To: Local Housing Authorities with Section 8 New Construction/Substantial Rehab Developments

Fr: Ben Stone, Director Division of Public Housing & Acting Director, Division of Rental Assistance

Re: Preservation & Modernization Resources for LHA-owned Section 8 NC/SR Developments

Date: October 12, 2022

WHAT YOU NEED TO KNOW – KEY POINTS:

1. LHAs can maximize existing non-state resources for their Section 8 NC/SR Properties
2. This PHN serves to supplement PHN 2022-19 NCSR Recapitalization NOFA

Purpose

This Public Housing Notice ("PHN") offers LHAs guidance on maximizing existing and new non-state-public housing resources to preserve Section 8 NC/SR Program properties.

Potential Financial Resources for Development Preservation

Maximizing financial resources. There are new and existing resources available to LHAs to increase operating revenues and obtain capital specifically for these Developments: as of early 2021, DHCD estimated that the portfolio was in position to capture an **additional $9 million annually through increased rents**. Through higher, federally-subsidized rents, LHAs may attract private debt, e.g., a first mortgage, as well as equity in form of low-income housing tax credits, to finance improvements to take care of "backlog" capital needs and to help ensure adequate reserves for future replacements of systems and equipment.

1. Maximizing HUD-allowed Subsidy through upward Rent Adjustments

- *Mark Up to Market (Option 1B in Section 8 Contract Renewal Policy Guidebook)* LHAs with *eligible* Developments are urged to apply for HUD's Mark-Up-to-Market ("MUTM") Section 8

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Renewal Option 1-B. Though this option is approved at HUD's discretion, the principal benefit of MUTM is the ability for LHAs to obtain market rents right away, rather than waiting five years.

DHCD's data as of early 2021 shows that, on average, market rents are 30% higher than current Contract Rents portfolio-wide. LHAs may pursue MUTM *on, or after* their *initial* HAP Contract renewal. Tenant participation is required prior to seeking this type of rent adjustment. **Attachment A** illustrates MUTM's impact in more detail.

- *Budget-Based Rent Adjustments (See Section 8 Contract Renewal Policy Guidebook)* This option generally allows owners to restructure their operating budget based on actual, justified expenses to ensure efficient management and continued financial viability. This option also has the potential to add or increase line items for debt service for capital improvements, management fees, and reserves. Budget-based Rent Adjustments cannot exceed comparable market rents and rents *may be reduced* if expenses are not substantiated or reasonable.

- *Operating Cost Adjustment Factor (Option 2 in Section 8 Contract Renewal Policy Guidebook)* Under this option, if the Development's aggregate current rents are at or below comparable market rents, the Development's rent is adjusted annually by the HUD-published Operating Cost Adjustment Factor (OCAF) – the 10-year average OCAF is 2.5%. Rents are then subject to fifth-year adjustment to market comparables, as shown in the example below. Option 2 is straight forward, but LHAs are waiting another five years to capture market rents.

Renewal Type	**Current Rent (PUM)**	**Year 1 (Renewal Year)**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**… Year 10**
OCAF (Option 2)	$700	OCAF	OCAF	OCAF	OCAF	Market	OCAF	Market

2. Earning a HUD Management Fee

LHAs may be able to obtain a fee for managing their Development. The current HUD-published acceptable residential fee range is $50 - $76 per unit per month (PUM). The fee is derived from a percentage of project income collected by management. HUD Handbook 4381.5 explains the requirements in greater detail. Your Contract Administrator can provide further guidance on management fee requirements.

- *How are these fees treated for salary / proration purposes?* For DHCD budget proration purposes, prorate any salary taken from the management fee on the federal side of the LHA's HAFIS budget. For LHA executive director and employee salary purposes, the approved management fee will be considered fees received from a management services contract. LHAs may pay additional executive director salary up to the limits imposed in DHCD's Executive Director Salary and Qualifications Schedule then in effect.

3. Pursuing Bank Mortgages Underwritten by Section 8 Rents for Large-Scale Improvements

MGL Chapter 121B Section 11(h) authorizes LHAs to mortgage property under their ownership. DHCD estimated as of early 2021 that increased rental income from maximizing Contract Rents would position the portfolio to leverage approximately $100 million in loan financing. When used in tandem with MUTM or a Budget-Based Rent Adjustment, which may give LHAs sufficient net operating income *sooner,* this approach gives LHAs access to a mortgage to finance major, necessary capital improvements at the Development.

- *Pursuing this pathway*. Each LHA should fully consider whether mortgage financing is right for them. DHCD must review and approve all proposals prior to execution, pursuant to the requirements in 760 CMR 4.15. Some initial questions LHAs should consider include:
    - What are the overall capital needs costs compared to the Development's existing resources?
    - What is the financial strength of the Development and of the LHA?
    - Are there any restrictions on the property title?
    - What kind of property ownership structure will a lender require?
    - Are there any unusual environmental or site considerations (i.e., wetlands, easements)?
    - What size loan can the Development comfortably afford?
    - How is the LHA complying with public procurement, design, and construction laws?
    - What is the LHA's capacity to undertake a large capital project with private financing?

- *Public Procurement and Construction*. LHAs are reminded that they must adhere to MGL c. 30B, MGL c. 7C, and MGL c. 149. Most lenders will require that the development be owned by a single-asset entity, which is common in commercial lending, as opposed to lending to the LHA itself. This means that the LHA would have to dispose of the development to a wholly-owned, single-asset entity to receive favorable financing.

- *Mixed Finance.* DHCD must review documents associated with outside financing prior to a construction closing and will consider LHA-requested waiver(s) to state public housing regulations to the extent necessary to finance improvements at the development for the direct benefit of eligible households. If considering a mixed-finance redevelopment, please contact DHCD to discuss the process for such projects and the applicable regulations.

- *Technical Assistance.* If the LHA is pursuing any mixed financing for large capital projects DHCD recommends that LHAs consider procuring their own project management consultant to supplement MHP technical assistance.

4. Existing Reserves and Bond Debt Savings

Developments have – or will soon have through HAP Renewal Contracts – additional income to maintain healthy reserve levels. Additionally, the Development's original bond debt service paid to the Commonwealth is retired around the same time the original HAP Contract expires. LHAs are encouraged to apply these savings toward the Development's reserve levels to meet long-term capital needs.

5. Ways to Improve Income ***before*** HAP Contract Renewal

Similar to how DHCD publishes an ANUEL, HUD publishes rent increases on an annual basis. However, unlike ANUEL increases, LHAs have to make the request to their Contract Administrator in order to receive HUD-approved rent increases. LHAs with original HAP Contracts are reminded that they must request the rent increase in writing ninety (90) days prior to their HAP Contract's anniversary date.

LHAs are also reminded of their ability to submit special claims for vacancy loss, unpaid rent, tenant damages and other charges. Special claims are submitted to the LHA's Contract Administrator.

DHCD Special Grant Initiative for Certain Developments

DHCD recognizes that not all Developments can cover capital needs with reserves, nor the cost of mortgage loan financing or local funds alone. For this reason, DHCD, in its discretion, will provide Special Awards to LHAs specifically for Developments that have the following:

- Identified critical capital needs, supported by Capital Needs Assessment;
- Insufficient reserves to cover costs of improvements and maintain a reasonable reserve level; and
- Are unable to maximize existing Contract Rents sufficient to make those critical repairs.

Please see PHN 2022-19 for details regarding this special grant initiative, supported by Moving to Work Funds.

DHCD Technical Assistance

If you have any questions regarding this Public Housing Notice, please call or email Edward Chien, Real Estate and Redevelopment Specialist, at edward.chien@mass.gov or (617) 573-1289.

ATTACHMENT A
MARK UP TO MARKET

MUTM works by adjusting the contract rent up to market, based on a third-party rent comparability study of unsubsidized projects in the area. By comparison, Option 2 - OCAF described further below annually adjusts the current contract rent by the HUD-published OCAF. In both scenarios, rents adjust by the OCAF after the first year, and adjust again to the market every 5th year.

What is the impact to residents? Currently, a tenant is expected to pay the Total Tenant Payment ("TTP") as certified by both the resident and the LHA, capped at Contract Rent. According to HUD Handbook 4350.3, Total Tenant Payment is the greater of: 30% monthly adjusted income; 10% monthly gross income; welfare rent; and a $25 minimum rent. Most tenants should not experience a rent increase. High-income tenants could see a rent increase after MUTM, but *never to exceed* their Total Tenant Payment, capped at Contract Rent. In the event that TTP exceeds Contract Rent, the tenant would pay that new Contract Rent. LHAs must always provide 30-day notices to tenants before charging a higher rent.

EXAMPLE. A resident's monthly TTP is $400. The previous Contract Rent was $700. The MUTM-adjusted Contract Rent is $1,000. There will be no impact to tenant rent because the monthly Total Tenant Payment of $400 is less than MUTM-adjusted Contract Rent of $1,000. The LHA will receive a $600 HUD assistance payment to cover the difference between the MUTM-adjusted contract rent and TTP.

Scenario 2: TTP = $400	Contract Rent	Total Tenant Payment	Assistance Payment
Before MUTM	$ 700	$ 400	$ 300
After MUTM	$ 1,000	$ 400	$ 600

Another resident's monthly TTP is $800. The previous Contract Rent was $700. The tenant would have been expected to pay $700, since their ability to pay exceeded Contract Rent. The MUTM-adjusted Contract Rent is $1,000. The tenant will now be expected to pay $800. The LHA will receive a monthly $200 HUD assistance payment to cover the difference between the Contract Rent and the TTP.

Scenario 2: TTP = $800	Contract Rent	Total Tenant Payment	Assistance Payment
Before MUTM	$ 700	$ 700	$ -
After MUTM	$ 1,000	$ 800	$ 200

EXAMPLE. This fictional 20-unit c. 667 development with contract rent lower than that of comparable, market-rent properties has the potential to receive $113,185 more income over five years if the LHA chooses Option 1B over Option 2 - OCAF.

Renewal Type	Current Rent (PUM)	Year 1 (Renewal Year)	Year 2	Year 3	Year 4	Year 5	Year 6	… Year 10
MUTM (Option 1B)	$ 700	Market	OCAF	OCAF	OCAF	Market	OCAF	Market
OCAF (Option 2)	$ 700	OCAF	OCAF	OCAF	OCAF	Market	OCAF	Market

Renewal Type	Current Rent (PUM)	Year 1 (Renewal Year)	Year 2	Year 3	Year 4	Year 5	Year 6	… Year 10
MUTM (Option 1B)	$ 700	$ 1,000	$ 1,025	$ 1,051	$ 1,077	$1,104	$1,131	Market
OCAF (Option 2)	$ 700	$ 718	$ 735	$ 754	$ 773	$1,104	$1,131	Market

Additional MUTM Rent Potential		Year 1 (Renewal Year)	Year 2	Year 3	Year 4	Year 5	Year 6	… Year 10
PUM	$ -	$ 283	$ 290	$ 297	$ 304	$ -	$ -	$ -
Annual	$ -	$ 67,800	$69,495	$71,232	$73,013	$ -	$ -	$ -

5-Year Total Increase	**$ 281,541**
Net Present Value	*$ 229,674*