



CERTIFIED PUBLIC ACCOUNTANTS

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HUD'S RENTAL ASSISTANCE DEMONSTRATION PROGRAM (RAD)

The Rental Assistance Demonstration (RAD) is a voluntary program of HUD intended to preserve public housing by providing Public Housing Agencies (PHAs) with access to more stable funding to make needed improvements to properties. Public housing units across the country need more than \$26 billion in repairs. HUD refers to these repair costs as capital needs. Congress has not provided enough funding for PHAs to keep up with capital needs. As a result, PHAs have had to make difficult choices between things like repairing roofs and replacing plumbing—or worse, demolishing public housing. RAD provides PHAs a way to rehabilitate or repair units without depending on additional money from Congress. RAD allows a housing authority to manage its property under either a Section 8 project-based voucher program (PBV) or Section 8 rental assistance (PBRA); thereby replacing the traditional public funding of annual operating subsidies and capital grants. As part of this change, HUD would relinquish its Declaration of Trust on the public housing property, thereby making it possible for PHAs to borrow make the necessary improvements to preserve its housing stock. These borrowings may come either through conventional financing programs or the use of low income housing tax credits. It is important to note that tenants will not lose housing assistance and will not be rescreened because of a RAD conversion – the program will not result in rent increases to residents. As part of the RAD conversion, a housing authority must perform a detailed physical inspection to determine both its short-term rehabilitation needs and long-term capital needs to obtain HUD approval of the conversion.

To ensure that its projects are managed most effectively, the management team has undertaken the task of analyzing whether it would be possible and beneficial to convert to RAD financing under a scenario where 4% tax credits are utilized to rehabilitate the properties by completing the improvements identified in its Capital Needs Assessment.

OVERVIEW OF THE LOW-INCOME HOUSING TAX CREDIT PROGRAM (LIHTC)

The low-income housing tax credit (LIHTC) was created as part of the 1986 Tax Reform Act as an incentive for the development and rehabilitation of affordable rental housing. LIHTC addresses a major market failure—the lack of quality affordable housing in low-income communities. The program's goal is to give private-sector business incentives to develop, manage, and maintain affordable housing for lower-income tenants.

One of the criticisms of the LIHTC is that the federal subsidy per unit of new construction is higher than it should be because of the various intermediaries involved in financing these projects—organizers, syndicators, general partners, managers, and investors—each of whom are compensated for their participation. As a result, a significant part of the federal tax subsidy does not go directly into the creation of new rental housing stock. Another criticism is that LIHTC projects are concentrated in low-income communities where they have historically been segregated and where economic opportunities may be limited. Finally, while the LIHTC helps in the construction of new affordable housing, maintaining that affordability is challenging once the required compliance periods are over.

The federal government issues tax credits to state and territorial governments. State housing agencies then award the credits to private developers of affordable rental housing projects through a competitive process. Developers generally sell the credits to private investors to obtain funding. Once the housing project is placed in service (essentially, made available to tenants), investors can claim the LIHTC over a 10-year period.

COMPUTING THE CREDIT

Two types of LIHTC's are available depending on the nature of the construction project. The 9% credit is generally awarded to new construction projects, while the 4% credit is typically used for rehabilitation projects. Each year, for 10 years, a tax credit equal to roughly 4% or 9% of a project's qualified basis (cost of construction) is claimed. The applicable credit rates have historically not actually been 4% and 9%. Instead, the credit rates have fluctuated in response to market interest movements so that the program has delivered a subsidy equal to 30% of the present value of a project's qualified basis in the case of the 4% credit, and 70% in the case of the 9% credit. The qualified basis equals the fraction of the cost of the housing project rented to tenants meeting the income tests. In our case, the goal is to rent 100 percent of the units to qualifying tenants.

Developers sell the tax credits to investors, who may be better able to use the tax credits and other tax benefits of the housing project (e.g., depreciation, interest paid, net operating losses). Investors also contribute equity, often through a syndication or partnership. The investors or limited partners usually play a passive role, receiving the tax benefits associated with the project but not participating in day-to-day management and oversight.

Most investors in LIHTC projects are corporations that have sufficient income tax liability to fully use nonrefundable tax credits. Financial institutions traditionally have been major investors, because they have substantial income tax liabilities, have a long planning horizon, and often receive Community Reinvestment Act credit from their regulators for such investments. Taxpaying investors cannot claim credits until the project is placed into service. Typically, investors do not expect their equity investment in a project to produce income. Instead, investors look to the credits, which will be used to offset their

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income tax liabilities, as their return on investment. The return investors receive is determined in part by the market price of the tax credits. The market price of tax credits fluctuates, but in normal economic conditions the price typically ranges from the mid-\$0.80s to low-\$0.90s per \$1.00 tax credit. The larger the difference between the market price of the credits and their face value (\$1.00), the larger the return to investors. The investor can also receive tax benefits related to any tax losses generated through the project's operating costs, interest on its debt, and deductions such as depreciation.

ASSESSING THE VIABILITY OF USING 4% TAX CREDITS TO REDEVELOP OUR PROJECTS UNDER A RAD CONVERSION

Management has assessed the viability of a RAD conversion utilizing 4% tax credits as follows:

- We have determined the total construction cost of rehabilitating each property by performing a capital needs assessment (CNA). That assessment and estimate of costs was performed by an outside architectural consultant. To those construction costs, we added the costs of financing the project, including construction period interest and taxes, the pay-off of existing loans and syndication costs associated with selling the tax credits. Other soft costs such as attorney, accounting and title recording fees were included in the estimate of total rehabilitation costs.
- We then estimated the sources funds that would be available under each conversion, which include the maximum supportable mortgage, seller take-back financing and tax credit investor equity.
 - The maximum supportable mortgage was estimated using the estimated cash flow of the property after conversion.
 - Seller take-back financing represents the mortgage that would be taken by the housing authority for the sale of its property to the tax credit partnership. Since the sales price of the property is included both as a cost of the project and a source of funds, it has no impact on the computation of the shortfall funding required for the conversion.
 - We estimated the amount of tax credit equity that could reasonably expected for the project by applying the credit rate to the eligible basis. The pricing of the credits was estimated at 92% based on the current market.
- By comparing the total project costs to the total available funds, we determined the amount of shortfall funds that would need to be raised from other sources. Typically, these funds are raised from other sources, such as unspent capital funds of the housing authority, HOME grants, CDBG grants, the FHLB Affordable Housing Program and various other government programs.
- The projected sources and uses of funds are detailed on the attached schedule.

CONCLUSION

- Based on the significant shortfall computed, it does not appear that the housing authority could raise these funds from the sources noted above. Therefore, it is our opinion that the RAD conversion should not be undertaken at this point. We will continue to closely monitor all programs made available by HUD that would provide us the opportunity to secure funds necessary to rehabilitate our properties.

MILLVILLE, WILDWOOD AND SALEM HOUSING AUTHORITIES
 ANALYSIS OF SOURCES AND USES OF FUNDS
 RAD CONVERSION IN CONJUNCTION WITH 4% LIHTC

	PROJECTED TOTAL COSTS	MAXIMUM SUPPORTABLE MORTGAGE	SELLER TAKE-BACK FINANCING	TAX CREDIT INVESTOR EQUITY	TOTAL SOURCES OF FUNDS	SHORTFALL FINANCING REQUIRED
MILLVILLE HA						
HBC	\$ 7,221,505	\$ 1,395,800	\$ 1,463,587	\$ 2,056,019	\$ 4,915,406	\$ 2,306,099
CVC & FER	\$ 12,943,966	\$ 3,134,900	\$ 3,286,990	\$ 3,671,314	\$ 10,093,204	\$ 2,850,762
RVW	\$ 14,995,560	\$ 3,721,500	\$ 3,902,016	\$ 1,896,447	\$ 9,519,963	\$ 5,475,597
RVE	\$ 13,386,970	\$ 3,529,300	\$ 3,700,529	\$ 3,639,903	\$ 10,869,732	\$ 2,517,238
JCP	\$ 11,805,533	\$ 3,125,600	\$ 3,277,257	\$ 3,302,051	\$ 9,704,908	\$ 2,100,625
MVP	\$ 9,085,078	\$ 1,506,000	\$ 1,579,063	\$ 2,606,891	\$ 5,691,954	\$ 3,393,124
WILDWOOD HA						
CC	\$ 9,658,292	\$ 2,283,000	\$ 2,393,753	\$ 2,752,233	\$ 7,428,986	\$ 2,229,306
ST	\$ 11,114,135	\$ 3,112,400	\$ 3,263,472	\$ 3,147,225	\$ 9,523,097	\$ 1,591,038
SALEM HA						
WSC	\$ 10,388,597	\$ 2,549,200	\$ 2,672,868	\$ 2,871,154	\$ 8,093,222	\$ 2,295,375

