









# ACCOUNTING FOR THE RENTAL ASSISTANCE DEMONSTRATION PROGRAM

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PIH Real Estate Assessment Center  
Quality Assurance Sub-system

# Attractiveness of RAD Program

Before RAD	After RAD
 <p>Properties are typically not funded at 100% in Public Housing</p>	 <p>Properties are placed on a more stable Section 8 funding platform</p>
 <p>In Public Housing, PHAs cannot borrow money to perform necessary repairs</p>	 <p>PHAs and owners can more easily borrow money and perform rehabilitation work</p>
 <p>The funding fails to keep up with the deteriorating living conditions of residents</p>	 <p>The living conditions of residents are improved</p>
 <p>Residents cannot choose to move without losing housing assistance</p>	 <p>Residents may receive a tenant-based voucher, or similar assistance, and move after 1 year in PBV and 2 years in PBRA</p>

- The RAD program has fundamentally changed public housing, likely forever
  - Converts revenue stream from Sec. 9 funding to Sec. 8 PBV and/or PBRA
  - Cap raised from 225,000 units (2017) to 455,000 units (by 2024)
    - Current cap will result in approximately a 38% reduction of PH portfolio in terms of units

*Based on current funding levels and political climate, we generally agree that a well-planned and executed RAD conversion for some or all PHA projects puts the PHA in a better position to provide low income housing*

# Impact of RAD on PHA

- RAD conversions are usually complex from both a legal and financial view
- Proper financial reporting is based on underlying legal documents that may be difficult to interpret
- Many PHAs are converting projects without a full understanding of the deal and impact on the PHA, including financial reporting
- Possible Impacts and Risks
  - PHAs, accountants, and auditors may not be fully aware of certain financial management implications
  - Inconsistent financial reporting of transactions and diversion of application of accounting
  - Increased solvency risk to participating PHAs
  - PHAs may struggle in new PBV / PBRA environment as they may not be as knowledgeable about these programs
    - PBV: Improper reporting in VMS can result in funding issues
    - PBRA: Problems with TRACS and FASS-MF filings

# Purpose of Session

- Openly discuss some specific topics around RAD conversions that seem to be misunderstood / misreported with the goal of:
  - Updating Accounting Brief #22 (*Financial Data Schedule (FDS) Reporting Requirements for Projects Converting Under the Rental Assistance Demonstration Program*), as needed
  - Providing new financial reporting and management guidance related to RAD for topics not currently covered in Accounting Brief #22
  - Providing more information in a manner that allows all interested parties to more fully understand the impact of a RAD conversion to a PHA and available options
- Today's session
  - Is simply to facilitate a discussion around areas of concern related to financial management and reporting around RAD and possible solutions and options
  - Introduces some key documents that affect financial reporting
  - This session is not intended to make policy or provide reporting requirements
  - This session does not reflect any official position of HUD

# Topic 1 - Pre-Development Costs

## Concept, Context, and Citations

- Timeframe between (1) Conception of RAD Conversion and (2) RAD Conversion Commitment (RCC)
- PHA may use Public Housing funds to support predevelopment costs
- PHA may use up to \$100,000 in Capital Funds on material and services related to development and pre-development work (Capital Fund Guidebook, page 128)
- Headquarter approval of RCC constitutes approval for the PHA to expend additional capital funds on pre-development costs

# Topic 1 - Pre-Development Costs

## Financial Management and Reporting Concerns

- Should the \$100,000 of pre-development costs be reported on the sources and use statement?
  - If CFP was used to cover pre-development costs but was not shown as a source, and later the PHA received funds at closing to cover these costs, does the PHA need to repay the CFP grant?
- Should all other pre-development costs be reported on the sources and use statement?
- Can CFP funds be loaned to the owner entity or developer to cover pre-development costs?

# Understanding Legal Documents & Agreements



- Correct financial reporting is determined by applying proper GAAP to the underlying legal documents and agreements
- PHA accountants and auditors must read and understand the underlying documents as each RAD conversion is unique
- Examples in this session are for a typical RAD conversion (i.e., be careful not to apply accounting treatment from one RAD conversion to another without understanding the underlying documents)
- Impact on PHA
  - Release of Declaration of Trust
  - RAD Use Agreement
  - Lease Agreement

# Topic 2 - Release of Declaration of Trust

## Concept, Context and Citations

- Removes HUD's 1<sup>st</sup> position lien on the property
- Property is no longer part of the Public Housing program
- Instrument perfected on specific date (e.g., 12/31/2015)
- Declaration of Trust still in effect for properties not covered by this instrument

Return after recording to:  
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### PARTIAL RELEASE FROM DECLARATION OF TRUST

#### Heritage View Homes IV

The Cuyahoga Metropolitan Housing Authority ("**Authority**"), a public body corporate and politic, duly created and organized pursuant to and in accordance with the provisions of the laws of the State of Ohio and the United States of America ("**Government**") pursuant to the United States Housing Act of 1937, as amended (42 U.S.C. 1401, et. Seq.), acting by and through the Department of Housing and Urban Development ("**HUD**") have previously entered into an Annual Contributions Contract ("**ACC**") providing for a loan and for annual contributions to be made by the Government to assist the Local Authority to finance and operate one or more low-rent housing projects.

HUD is the beneficiary of a certain Declarations of Trust by which the Authority placed in trust for the benefit of HUD and granted certain rights and restrictions for the benefit of HUD, certain real property owned by the Authority, together with improvements to be constructed thereon, situated in the City of Cleveland, County of Cuyahoga, State of Ohio.

The date and the record information of said Declarations of Trust (collectively, the "**Existing Instrument**") is as follows:

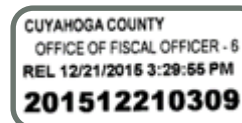
Declaration of Trust filed for record in Volume 90-5559, Page 43 on September 13, 1990 of Cuyahoga County Records

Declaration of Trust filed for record in Volume 91-2204, Page 52 on April 23, 1991 of Cuyahoga County Records

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# Topic 3 - RAD Use Agreement



## Concept, Context and Citations

- Replaces the Declaration of Trust
- Identifies parties
- Places restrictions on the property
- Provides for HUD approval of the conversion
- Provides HUD with a continuing interest in the property, that is not subordinate to other liens
- Runs concurrent with the HAP agreement
- Automatically renews when the HAP contract renews
- Provides date of perfection

(See RAD Use Agreement Handout)

**Rental Assistance Demonstration  
Use Agreement**

**U.S. Department of Housing  
and Urban Development**  
Office of Housing  
Office of Public and Indian Housing

OMB Approval No.  
2577-0276 (Exp.  
02/29/16)

**Public reporting burden** for this collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to the Reports Management Officer, Paperwork Reduction Project (2577-0276), Office of Information Technology, U.S. Department of Housing and Urban Development, Washington, D.C. 20410-3600. This agency may not collect this information, and you are not required to complete this form, unless it displays a currently valid OMB control number.

**This Rental Assistance Demonstration Use Agreement** (hereinafter called the "Agreement") made the \_\_\_\_\_ 17 \_\_\_\_\_ day of December, 2015, by and between the United States of America, Secretary of Housing and Urban Development (hereinafter called "HUD"), Garden Valley Housing Partnership IV, L.P., (hereinafter called the "Owner"), and Cuyahoga Metropolitan Housing Authority (hereinafter called the "Ground Lessor") provides as follows:

**Whereas**, Rental Assistance Demonstration (hereinafter called "RAD") provides the opportunity to test the conversion of public housing and other HUD-assisted properties to long-term, project-based Section 8 rental assistance to achieve certain goals, including the preservation and improvement of these properties through access by Owners to private debt and equity to address immediate and long-term capital needs.

**Whereas**, Projects funded under the public housing programs may under RAD convert their assistance to long-term, project-based Section 8 rental assistance contracts. Under this component of RAD, Owners may choose between two forms of Section 8 Housing Assistance Payment (HAP) contracts: project-based vouchers (PBVs) or project-based rental assistance (PBRA). No incremental funds are authorized for this component. Owners will convert their assistance at current subsidy levels.

**Whereas**, Projects shall have a RAD Use Agreement that will be recorded superior to other liens on the property, run for the same term as the initial term of the HAP contract, automatically renew upon each extension or renewal of the HAP contract for a term that runs with each renewal term of the HAP contract, and remain in effect even in the case of abatement or termination of the HAP contract (for the term the HAP contract would have run, absent the abatement or termination).

**Whereas**, HUD has approved the conversion of the "Project" identified as Heritage View Homes IV and covering real property as described in Exhibit "A" attached hereto; and that this approval is evidenced by and through the terms of the RAD Conversion Commitment as described in Exhibit "B" attached hereto; and that was previously subject to a public housing Declaration of Trust filed for record in Volume 90-5559, Page 43 on September 13, 1990 of Cuyahoga County Records; Declaration of Trust filed for record in Volume 91-2204, Page 52 on April 23, 1991 of Cuyahoga County Records; and Declaration of Trust as filed for record in Instrument No. 20090150340 on January 5, 2009 of Cuyahoga County Records.

# Topic 3 - RAD Use Agreement

## Other RAD Use Agreement Language

- 2. Term Language
  - Provide for initial agreement term (e.g., 20 years)
  - Agreement will survive HAP abatement or termination of the HAP contract
- 3. Use Restriction and Tenant Income Language
  - Project will be used solely for low income housing
- 4. Subordination Language
  - Any mortgage liens will be subject to this agreement
  - Agreement will survive foreclosure and bankruptcy
- 7. Transfer of the Agreement Language
  - HUD is granted and possess an interest in the project
  - Owner and ground lessor must refrain from transferring, conveying, encumbering.....without the release of said covenant by HUD

# Topic 3 - RAD Use Agreement

## Other Agreement Language

- 9. Enforcement
  - In the event of a breach of the agreement, HUD may take legal action to enforce performance and recover damages
- 12. Execution of Other Agreements
  - The owner agrees that it will not execute any other agreements with provisions that are contradictory to this agreement
  - Agreement is controlling and supersedes any other conflicting requirements
- 14. No Negotiation
  - The agreement is not subject to negotiation by the owner or any lender

(Note: There are many other terms of conditions in the exhibits to the main RAD Use Agreement)

# Topic 3 - RAD Use Agreement

## Financial Management and Reporting Concerns

- Perfection date triggers the release of the project from the Public Housing program
  - Where are the assets and liabilities of the project now reported?
  - Where is the land reported?
    - If prior to a conversion RAD the land was recorded as a part of public housing (i.e., a federal program), should the land continue to be recorded under a federal CFDA number due to the restriction of the RAD use agreement and since the land was purchased with Federal funds?
  - What is the valuation of these assets?
  - Are there any needed note disclosures?
- Does REAC's Accounting Brief #22 - Financial Data Schedule (FDS) Reporting Requirements for Projects Converting Under the Rental Assistance Demonstration Program include proper reporting guidance for moving the project out of public housing?
- Are there other related topics that should be covered in the accounting brief?

# Topic 3 - RAD Use Agreement

## Concept, Context, and Citations

- After the DOT is removed and the project is under a HAP contract, the project is no longer public housing
- Project asset and liabilities should not be reported as public housing in the FDS

(Example of improper reporting after project conversion in AMP balance sheet of FDS)

FDS Line Description		12/31/2014	12/31/2015	Change
161	Land	\$2,795,243	\$2,795,243	\$0
162	Buildings	\$16,313,565	\$17,229,557	\$915,992
163	Furniture, Equipment & Machinery - Dwelling	\$1,432,418	\$1,434,398	\$1,980
166	Accumulated Depreciation	(\$13,854,735)	(\$14,389,073)	(\$534,338)
167	Construction in Progress	<u>\$1,679,254</u>	<u>\$1,006,311</u>	<u>(\$672,943)</u>
160	Total Capital Assets, Net of Accumulated Depreciation	\$8,365,745	\$8,076,436	(\$289,309)

# Topic 4 - Lease Agreement

- Concept, Context, and Citations
- Identifies parties (PHA and ownership entity)
- PHA will continue to own the land (not the ownership entity)
- Creates (ground) lease between parties for a number of years (this example: 70 years)
- PHA will own the land (not the ownership entity)

Note: Ground leasing creates two sets of owners – an owner of the land and a separate owner of the physical residential structure that sits on the land. This bifurcation of ownership allows the land owner to develop various affordability controls that govern the use of the land for residential purposes over a timeframe that can stretch from long-term to technically permanent affordability.

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This Instrument Prepared by:  
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Washington, DC 20001  
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## MEMORANDUM OF LEASE

**THIS MEMORANDUM OF LEASE** is dated December 17, 2015 and made effective as of December 17, 2015, by and between the **CUYAHOGA METROPOLITAN HOUSING AUTHORITY**, a public body corporate and politic organized under the laws of the State of Ohio ("**Landlord**"), whose address is 8120 Kinsman Road, Cleveland, Ohio 44104 and **GARDEN VALLEY HOUSING PARTNERSHIP IV, L.P.**, an Ohio limited partnership whose address is c/o Pennrose Properties, LLC, 230 Wyoming Avenue, Kingston, Pennsylvania 18704 ("**Tenant**"). The following is a correct statement of information with respect to the lease described below:

1. Landlord and Tenant have entered into a certain Lease Agreement dated as of December 17, 2015 ("Lease") to which this Memorandum pertains.
2. The name of the lessor in the Lease is the Cuyahoga Metropolitan Housing Authority
3. The name of the lessee in the Lease is Garden Valley Housing Partnership IV, L.P.
4. The address of Landlord and Tenant set forth in the Lease are the same as those for such parties set forth above.

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Order No. 190513-3

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# Topic 4 - Lease Agreement

## Financial Management and Reporting Concerns

- Where should the lease be reported on the FDS?
- What is the correct GAAP to apply from the PHAs and ownership entity perspective?
- What should be the value of the lease?
- What if lease payments are not made or expected to be made?

# Topic 5 - Program Income

## Concept, Context, and Citations

- 2 CFR 200 defines program income
- Depending on the deal, federal funding / program income may have been used to support the conversion
- While HUD approves the deal, thereby approving the use of federal funding and program income in the conversion, HUD has provided limited guidance on the use of such funds coming back to the PHA (is there a restriction on their use?)



# Topic 5 - Program Income

## Concept, Context, and Citations

- From Exhibit B - RAD Conversion Commitment
10. **Tax, Financial, and Legal Consequences.** HUD has not provided, nor shall it provide, any opinions, representations, warranties, or covenants regarding any federal, state and/or local tax consequences, financial consequences, or legal consequences relative to the Transaction. The Owner and all other parties to, or affected by the Transaction are advised by HUD to consult with their own legal counsel and tax advisers with respect to all such matters. The Owner agrees that it is relying on its own independent determination regarding the tax, financial and legal matters related to this Transaction and not upon any representation made by any other party to this Transaction or any other party's agent or employee. Under no circumstances shall the reliance or performance of the Owner on matters—including but not limited to the tax, or financial or legal matters—result in obligations, duties, or liabilities for HUD.

# Topic 5 - Program Income

## Examples of Program Income Situations

- 1. PHA loans replacement housing factor funds and operating reserves to the ownership entity as part of the conversion, and is now receiving payments
- 2. PHA enters into a ground lease between the PHA and ownership entity, and is now receiving payments

# Topic 5 - Program Income

## Examples of Program Income Situations

- 3. Surplus cash distribution from PBRA back to PHA
  - What are terms and conditions for distribution (i.e., waterfall language)?

E. Distributions. Covered Projects will not be subject to any limitation on distributions of surplus cash, contingent on the availability of surplus cash as determined by year-end audited or certified financial statements. To implement this provision, HUD will not apply 24 CFR § 880.205, which, among other provisions, establishes certain limitations on distributions for profit-motivated owners and authorizes HUD to require not-for-profit and certain for-profit owners to establish a residual receipts account. Note: Although the PBRA contract will have no limits on distributions, owners will still be subject to any limits on distributions that are established in other governing documents at the project (e.g. a 236(e)(2) Use Agreement). (Notice PIH-2012-32 addresses the use of surplus cash (page 187))

# Topic 5 - Program Income

## Financial Management and Reporting Concerns

- What constitutes program income?
- If the funds are considered program income, what can they be used for?
- How should program income and/or loans be reported on the FDS, so that these funds do not lose their identity as restricted / program income?
- If funds are loaned, but the expectation of repayment is unlikely or limited, should an allowance for the receivable be booked?

# Topic 6 - Right of First Refusal

## Concept, Context, and Citations

- Provides opportunity to purchase the property (normally by the PHA)
- Right to purchase property normally provided to PHAs after the end of compliance period
- Seen most often in transaction involving 9% LIHTC
  - Extra points awarded for ROFR
- Provides a minimum price, which might exceed fair market value

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### RIGHT OF FIRST REFUSAL AGREEMENT

THIS RIGHT OF FIRST REFUSAL AGREEMENT (this "*Agreement*"), dated and effective as of the 20<sup>th</sup> day of December, 2015, is made by and between Garden Valley Housing Partnership IV, L.P., a limited partnership formed under the laws of the state of Ohio (the "*Partnership*") and Western Reserve Revitalization and Management Company, Inc., an Ohio corporation (the "*Purchaser*"), and the Cuyahoga Metropolitan Housing Authority, a public body corporate and politic duly organized and validly existing under the laws of the State of Ohio (together with Western Reserve Revitalization and Management Company, the "*Purchaser*").

### Recitals

The Partnership was formed for the purpose of developing, constructing, leasing, managing, operating, and, if appropriate or desirable, selling or otherwise disposing of a sixty

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# Topic 6 - Right of First Refusal

## Right of First Refusal

- IRC § 42(i)(7)(A): after close of compliance period, project will not lose federal tax benefit with respect to any qualified low-income building by reason of a ROFR held by tenants, management corporation or qualified nonprofit or government agency that purchases the property for a *defined minimum price*
- Minimum price = sum of the principal amount of outstanding indebtedness secured by the building (other than any indebtedness incurred within the five year period ending on the date of the sale to the tenants), plus all federal, state and local taxes attributable to the sale (i.e. exit taxes) (IRC §42(i)(7)(B))

# Topic 6 - Right of First Refusal

## Financial Management and Reporting Concerns

### *PHA Strategy*

- What is the PHA intent on this provision going into the deal?
- What is the physical and financial condition of the property at the time of possible sale and how is the PHA managing its interest in the property?
- If PHA will purchase property, what funds are available to the PHA?
- What happens to a property if PHA does not purchase?

### *Financial Reporting*

- Any Impact on Note Disclosures?
- Does ROFR Affect Component Unit Decision Tree?

# Questions and Comments

