Preservation

A. Introduction:

Many apartment projects that were developed in the 1970s and 1980s through the Section 236 and Section 8 programs are nearing the end of their compliance periods. Projects developed under both programs are, for the most part, modestly designed rental developments with limited amenities. They depend on government subsidies in the form of interest rate reduction payments or project-based rent subsidies for a large portion of their rental revenues. The government subsidies allow very low-income households to occupy the units. The following briefly describes the rent components of these two programs:

- The Section 8 program provides project based rental assistance for up to 100 percent of the units in a project. Under the program HUD and the owner execute a Housing Assistance Payments (HAP) Contract that specifies contract rents that the owner will receive for units occupied by low-income households who pay rents based on 30% of their incomes. HUD pays the owner the difference between the contract rents and the tenant payments.
- The Section 236 program provides interest reduction payments for loans that finance housing targeted to low households who pay rent equal to the greater of the minimum, or basic rent, and 30 percent of their adjusted income. All rents are capped at a HUD approved market rent. Some or all of the units in Section 236 projects may also receive project-based rental assistance.

In an effort to preserve these Section 8 and Section 236 properties as affordable housing rentals, many non-profit and for profit developers are using tax credit equity to renovate the properties. The conversion to a LIHTC project may alter the project’s existing rent subsidies. Some developers terminate all of the existing housing subsidies and convert the project to a 100% tax credit project that charges fixed rents to all tenants. However, most developers seek to retain the property’s project-based rental assistance by extending its Housing Assistance Payments (HAP) contract.

HUD typically makes the extensions subject to annual appropriations or program changes. Since the HAP contract extensions do not guarantee the continuation of the project-based rent subsidies through the end of the 15 year Low Income Housing Tax Credit compliance period, it is necessary to consider what rents the project can achieve without rental assistance after its renovation and conversion to a tax credit property.
B. Factors to Consider in Market Analysis of a Preservation Property

- **Market Position**: The Section 8 and 236 projects generally are Class C properties with modest designs and limited amenities that usually compete with older subsidized and market-rate developments. A limited level of renovation that is more geared toward repairing existing systems and removing signs of deferred maintenance is not likely to change a project’s market position. Improvements that significantly upgrade the project’s design appeal and amenity level can reposition the project and allow it to compete with projects in a different age and rent class.

- **Location**: The site’s adjacent land uses, neighborhood characteristics, and market area income levels affect the rents that the project could achieve without rental assistance. If the property has no adverse adjacent land uses and is in a community with incomes above the regional averages, it may be able to command significantly higher rents after renovation. However, if it is in a low income community that is dominated by deeply subsidized units and is not attracting reinvestment, the project’s chances of commanding rents above the levels paid by its tenants, as well as residents of adjoining housing projects, are minimal.

- **Comparable Projects**: Unless the renovation involves upgrades that will let the preservation project compete with newer, market rate and tax credit projects, the property is most likely to compete with rentals that are in its current age and rent class and have similar locations. Using newer LIHTC projects that have similar income restrictions, but superior locations, designs, and amenities, to determine post-rehabilitation rents can produce rent estimates that significantly exceed what the property could achieve without project-based rent subsidies.

- **Role of Housing Assistance Payments (HAP) Contract**: The initial Section 8 HAP Contract rents and the Section 236 market rents were based on the cost of building the project, rather than the rents that the project could attain in the open market. HAP Contract and Section 236 market rents are automatically adjusted annually to reflect regional changes in household income, which often differ from the rates of rent appreciation in the project’s micro-location. As a result the HAP Contract rents and Section 236 market rents often do not reflect the prices that the project could achieve if it lost its project-based rental assistance.

- **Rents Paid by Tenants**: The rents paid by the existing tenants, rather than HAP Contract or Section 8 market rents, can be a good barometer of the rents that tenants are willing to pay, especially in projects with some units that are not covered by project based rental assistance.

- **Housing Choice Vouchers**: Some projects that do not have 100% rental assistance are dependent upon tenant-based rent subsidies to fill their units. A reliance on rent subsidies to keep units fully occupied may suggest limited demand for units at non-subsidized rent levels.
History of Rental Assistance: Government funding sources often increase the level of project-based rental assistance to properties that have chronic difficulty keeping their non-assisted units fully occupied. An analysis of a project’s historic occupancy including increases in the degree of rental assistance can suggest either that the property has significant design flaws or its neighborhood has limited incomes that will not support higher rents.

C. Red Flags

- **Mixing new and renovated LIHTC projects:** Many funding sources require analysts to separately discuss market-rate and tax credit properties. If the market area contains newer tax credit projects that have better locations and/or more amenities, comparison of a preservation project to newer income restricted projects can overstate the occupancy and rent levels that the preservation property could achieve.

- **Comparison to newer projects:** Using newer projects that have similar income restrictions, but superior locations, designs, and amenities, to determine post-rehabilitation rents can produce rent estimates that significantly exceed what the property could achieve without project-based rent subsidies.

- **No differentiation between units with different subsidies:** In projects that have some units without project-based rental assistance, there can be significant differences in the occupancy levels and wait lists at the rental assistance units.

- **No discussion of achievable rents:** The absence of a discussion of the achievable rents can lead to the conclusion that the contract rents (or maximum tax credit rents) are feasible, with and without the project based rental assistance.

- **Reliance on Section 236, market rents or HAP contract rents:** Tenants seldom pay the Section 236 or HAP contract rents. Studies that use the contract rents at either the project under consideration or nearby projects can significantly overstate the rents that the property could achieve without rental assistance.

- **No demand analysis for the non-rental assistance contingency:** An analysis that assumes that the project based rental assistance will remain may use an income base ranging from $0 up to the maximum tax credit income limits. It may conceal the limited number of tenants who could qualify to live at the property without rental assistance.
D. **Recommended Practices for Analyzing Preservation Properties**

- **Role of Housing Assistance Payments (HAP) Contract:** Discuss the project’s existing financial structure, including the number of units covered by the HAP contract. Describe the terms and conditions of any post-renovation extensions to HAP contracts or other forms of project-based rental assistance.

- **Scope of Rehabilitation:** Describe the planned improvements.

- **Market Position:** Discuss the impact of the rehabilitation on the property’s market position.

- **Comparable Projects:** Use the projects that are most similar in design, age, and rent class as the basis for projecting the property’s market performance after renovation. Older projects that have been converted to tax credit properties are often the best comparables. The market analysis should place less emphasis on newer tax credit projects in determining the anticipated rents and occupancy rates of preservation projects.

- **Rent Roll Analysis:** Analyze the rents paid by the tenants of both the units that have project-based rental assistance and those that do not. Compare vacancy rates and wait lists of assisted and non-assisted units. Discuss the role of Housing Choice Vouchers in filling the units that do not have rental assistance.

- **Location:** Discuss housing prices, income levels and land uses that are adjacent to the site, as well as any planned or existing neighborhood improvements that will affect the rents that the property could achieve.

- **Attainable Rent without Rental Assistance:** Determine what tax credit rents the property could achieve after rehabilitation if it lost its project-based rental assistance.

- **Income Qualified Tenants:** Estimate how many tenants could remain at the property without rental assistance.

- **Demand Analysis:** Use the incomes needed to qualify for the project without rental assistance to estimate demand. Discuss whether the market area has a sufficient pool of income qualified tenants who could fill the units if the property no longer had project-based rental assistance.