



Affordable Housing Alert

Developments in affordable housing law

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HUD's policy on the conversion of efficiencies into one-bedroom units

By Randall Kelly

On February 1, 2008, acting deputy assistant secretary for Multifamily Housing Programs, John L. Garvin, issued HUD's "Policy and Procedures on the Conversion of Efficiencies into One-Bedroom Units" in a memorandum to all multifamily hub directors and their staff.

The policy outlined in this long-awaited memorandum (the "Memo") applies to many properties seeking to complete preservation transactions, but are not feasible because they need to convert efficiency units into one-bedroom units, including Sections 202, 811, 236 (insured and non-insured), and 221(d)(3) properties, to name a few. The Memo also applies to properties with project-based Section 8 HAP contracts, with or without an accompanying FHA-insured mortgage loan.

The new policy outlines seven programmatic requirements that any application to convert efficiencies into one-bedroom units must satisfy. Among the criteria are the requirements that (i) the average vacancy in the efficiency units be at least 25% for at least 24 months of the preceding 36-month period; (ii) on completion of the unit conversion, the project debt service coverage ratio must be 1.1 or greater; (iii) the proposed conversion must only involve units of the same subsidy type; and (iv) the proposal must not result in an increase in the amount of existing budget authority available to the subject property.

The new policy outlines additional program-specific requirements whose applicability depends on the type of subsidy available at the subject property. For example, in the case of a property with a project-based Section 8 HAP contract, postconversion rents must be established at the lesser of (i) the current one-bedroom rent or (ii) the combined unit rents of the two converted efficiency units. Future rent setting pursuant to MAHRA may be based on the new unit size. In addition, the Memo states that if low-income housing tax credits (LIHTCs) are used in the proposed financing, rents may not exceed the lesser of LIHTC rents or comparable market rents. This Section 8 rent cap marks a dramatic change in HUD's Section 8 rent-setting policy and is at odds with MAHRA.

Section 236 properties are also singled out for special treatment under this new policy. The Memo requires that in the case of a Section 236 property that receives interest reduction payment (IRP) subsidy, the IRP must be reduced in a manner proportional to the reduction in units, but the reduction does not take into account unit size, which will have an adverse impact on properties with

larger-sized units. The Memo notes that whether the IRP must be reduced depends on the requirements in the original Section 236 mortgage.

Finally, the new policy requires that owners submit a conversion request application, in accordance with the requirements set forth in the Memo, including evidence of a notice, a comment period provided to residents, a sources and uses statement, and evidence of local government support.

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