Personal Reflections on HUD's New Rental Assistance Demonstration Program

by Jaime Bordenave, President, The Communities Group

The first units of public housing were built during the mid-1930's and have grown to over 1.1 million in number today. Many of the early units catered to families with small children, as evidenced by the incorporated cornerstone cartouche shown below. Relatively few units have ever been replaced, which means that a high proportion of such housing is elderly at best and obsolete in both design and construct at worst. Since occupants were expected to pay no more than thirty percent of available income towards, the difference between rental income and operating expenses was funded solely through federal appropriations in the form of annual contribution contracts between about 3,100 local housing authorities and the U.S. Department of Housing and Urban Development (HUD). There were little public funds available for modernization or replacement of aging units, and private financing and leverage were disallowed under the rules.

Older housing deteriorated and fell into such disrepair and derelict condition that it became apparent that they could not be saved without procurement of private investment, as was eventually permitted on a small scale, limited basis.

This same private financing method will be essential if the remaining sustainable public housing real estate is to be renovated and maintained. HUD understands this fact and has been exploring a number of solutions over the past several years.

As a result, HUD recently instituted the Rental Assistance Demonstration (RAD) program, which effectively de-federalizes certain public housing and permits the local housing authority to acquire private debt to modernize, remodel and place the rental units on a replacement reserve schedule, which had historically been absent from these real estate capital computations.

Since the properties accepted under the RAD program will be exempt from a host of HUD restrictions, they will be eligible for Low Income Tax Credits (LITC) and will be able to utilize Section 8 project based subsidies as well as a percentage of certain former subsidies to secure additional debt servicing.

No doubt that one can find faults with the RAD program. We've managed to find a few ourselves (more on that later). But we've also found much to recommend it *for the right developments, with well-conceived plans.*

If you imagine a distribution of all 16,000 or so public housing developments[1], based on the cost-per-unit needed to meet project capital needs, the RAD program offers a solution for a very large percentage of them. Based on The Communities Group's prior analysis of HUD's portfolio, I estimate it to be substantially more than half.

Some projects with little need for capital improvements can be converted with "debt only," or no debt at all. Those in need of moderate rehabilitation and many in need of substantial rehabilitation can be taken care of

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1941 Public Housing Bas Relief

[1] We prefer to look at pre-AMP projects, since it avoids the problems of having projects of different ages, building and unit types in the same analysis.

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with debt plus 4% tax credit equity. Projects needing "extreme makeovers," including demolition and redevelopment, are the most challenging and the most difficult to preserve with RAD.

So the first thing "right" about RAD is that it does offer solutions for the preservation of many public housing developments. In our analysis, we compare the capital raised through debt and (primarily) 4% tax credit equity to the net present value of the capital funding for that property over the coming 20 years (assuming continued funding at the current level, which is a generous assumption). RAD generates at least three times as much funding, and as much as five times or even more. On that basis RAD is certainly better than "business as usual." In our company's market area, we have looked at potential projects in the Carolinas, Georgia, Virginia, Arkansas, Maryland, and Kentucky. On average, these projects can support from $40,000 to $60,000 per unit for substantial rehab (using debt and 4% equity). The discounted value of future capital funding is more on the order of $12,000, spread over 20 years—assuming continued capital funding at present levels—which has a major element of risk.

Second, the RAD converted projects will have their own reserves, which are structured into the operating budget. These are project reserves, and are not subject to HUD recapture.

Third, these converted projects will provide cash flow to the non-federal owner(s)—a major incentive for participation!

Fourth, an additional benefit to the RAD program is the user-friendly staff who are supporting the program at HUD. We are working directly as developer or financial advisor on ten RAD projects, with an additional seven being implemented by clients of ours, where we are not the developer. As Planning Coordinator for numerous Choice Neighborhood projects, RAD is providing very hard to come by leverage for six of these area revitalizations, and we expect to introduce it to several more.

Fifth, on the RAD website,(*www.hud.gov/rad*) there is a quantitative tool that helps with the initial screening of a local housing authority's portfolio for calculating supportable debt and equity. Recently, I used that tool, in addition to one of my own worksheets, to calculate the debt and equity that a small authority's portfolio would generate. This two-hour exercise, combined with an analysis of that authority's physical needs assessments, tells me which projects are most feasible for conversion under RAD.

Sixth, *the RAD application is amazingly simple* (especially so for those of us accustomed to working with HOPE VI and tax credit applications), and is reasonably user-friendly. Unlike HOPE VI and Choice Neighborhoods applications, the only third-party attachments are letters of interest from the lender and equity provider that are subject to their "normal underwriting" criteria, so that these are not cast in concrete.

One client's four projects in Wilson, North Carolina, that have received Commitments to enter Housing Assistance Payment from HUD (CHAP) provide a good example of the flexibility of RAD.

A small high-rise of 58 units, built in 1982, needs major plumbing upgrades, and since the authority's administration moved from the ground floor to another building, there is need to refit that floor for resident services needs.

A second project, which dates from 1962, consists of a great deal of the family units that were previously the subject of a HOPE VI plan that was not funded in the last round of that program, and which is currently the subject of a Choice Neighborhood planning grant. Many of these units are in a flood plain, and will not be included in the RAD project, and will ultimately be demolished. Separately, we hope to apply for RAD for those units, demolish them, and transfer the RAD units to a vacant historic downtown former hotel.

The third project (built in 1966) consists of family units adjacent to a recently renovated green development that was subsequently leveraged with 4% tax credits to fund a nearby 38-unit three-story elderly building.

The fourth project consists of family units from the 1970s and 1980s, with low density, adequate off-street parking, and amenities reasonably nearby.

All of these developments will include debt plus 4% tax credit equity. The next RAD phase, the hotel conversion, will likely need 9% and historic tax credits

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Derelict Housing in 1948

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to be able to afford the extensive renovations needed by this hotel.

At the end of the day, this particular local housing authority will no longer have any conventional public housing properties, which has been their goal for the past five years under their current leadership.

So, what are the drawbacks we have experienced with contemplating the RAD program as a possible preservation tool for older, distressed public housing?

As noted above, it is very difficult to use RAD as a replacement for HOPE VI, or Choice Neighborhoods—as it does not generate enough funding with a combination of debt and 4% tax credits. Also, 9% credits usually only work with smaller developments (typically less than 100 units), so any larger project would require phasing, and with the RAD program being authorized only through September 2015, that practicality limits such a project to two phases of 9% credits—neither of which is certain.

In this regard, however, we have one client with a 314-unit project already approved for RAD, with the application originally indicating debt plus 4% equity as the sources. Upon further investigation, it looks like at least some demolition and redevelopment is needed and warranted, and the RAD office is exploring alternatives that would support phasing with use of 9% credits for the first phase. It is expected that revisions to the RAD Notice are expected to be published in the Federal Register before the end of March, 2013.

Another client has a RAD approved for a small project of less than 50 units and originally planned a rehabilitation. Upon further analysis, the client determined that they may need to demolish that property. One strategy at this point is to transfer the RAD units to the acquisition of an existing tax credit property in their Choice Neighborhood target area, for which the property is nearing the end of its compliance period, and the additional revenue will help upgrade and stabilize that property.

For another client, we compared a RAD approach to the possible use of the *Capital Fund Financing program* (CFFP)—by which local housing authorities can borrow against future subsidies—and for those 170 units, RAD can generate $8 million in debt (using

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Construction of Public Housing in 1951

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HUD mortgage insurance under the 221(d)3 program), versus only $3.5 million through CFFP. RAD conversions also do not need approval from HUD's Special Applications Center (SAC) in Chicago, which can make prompt applications nearly impossible. For a larger authority, CFFP might be able to bring substantially more funds to a redevelopment project.

It is important to remember that it will be difficult for most PHAs to calculate the benefit of the RAD program for their situations. Interested PHAs should search out specialists with experience in different financing examples. Examining every option will be critical for the future viability of these properties.

RAD may not be an solution for every authority and every property of that authority, but we do believe that it might be a solution for many properties of most authorities—and it therefore merits the analysis of the benefits of the program by each authority. It is a program that will be here at least through 2015, or until the 60,000 available units are allocated out to authorities.

On balance, we find this program to be an excellent tool for most local housing authorities' portfolio preservation plans. The more options that public housing Authorities have, the better they will be able to manage their properties and address the needs of resident families.

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