# TENTH ANNUAL PUBLIC HOUSING

BY ROD SOLOMON

OVER THE PAST decade, there have been significant bright spots in our nation's efforts to preserve, improve or replace where necessary the public housing that serves over one million of our nation's low-income families:

- Appropriation of $4 billion in public housing capital funding under the 2009 American Reinvestment and Recovery Act (ARRA);
- Increase in the amount of financing for capital improvements approved by the United States Department of Housing and Urban Development (HUD) under the Capital Fund Financing Program (CFFP), in which public housing authorities (PHAs) borrow against future appropriations of capital funds, from $600 million to $3.8 billion;
- Substantial continued use by PHAs of Low-Income Housing Tax Credits (Tax Credits), to supplement public housing capital appropriations;
- Substantial increase in approved energy performance contracting (EPC) volume of leveraged investment to over $800 million, in which PHAs finance energy conservation measures based on future savings in operating costs;
- Innovative uses of other funding sources, including Project-Based Vouchers (PBV), Department of Energy grants, Federal Home Loan Bank Affordable Housing Program grants, state and local sources such as housing trust funds and tax increment financing, and historic, solar and new markets tax credits, as well as the flexibility provided by participation in the Moving to Work demonstration for some PHAs, to supplement these resources.
- Enactment last year of the Rental Assistance Demonstration, the potential of which is discussed below.

While some of these resources have facilitated the replacement of public housing or its preservation under other subsidy programs, others including the ARRA and CFFP investments have reduced the backlog of capital needs in the remaining public housing stock. They contributed to the finding in last year's update, based on HUD-funded studies by Abt Associates in 1998 and 2010, that per-unit capital needs of the public housing stock dropped somewhat (from $32,850 to $27,550 on average, after reasonable adjustments to promote apples-to-apples comparison) from 1998 to 2010.

Because those numbers are on a per-unit basis, they ignore the decrease in public housing units during that time by roughly 9% or almost 100,000 units. The lost units often would have been among the highest-needs units in 1998 and not viable, and a significant percentage of them have been replaced by newly acquired, built or renovated units, but the shrinkage nonetheless is also an important part of the overall picture.

## Bleak Appropriations Outlook

The amount of money appropriated to address the public housing backlog in the late 1990s and early 2000s was in the $3 billion to $3.5 billion range, including modernization and HOPE VI funding. The comparable figure, for fiscal year 2012, is approximately $2 billion. The appropriation for the public housing Capital Fund (Capital Fund), $1.875 billion, is the lowest annual appropriation since 1989. A further cut of approximately 8.2% could result from the implementation of the Budget Control Act of

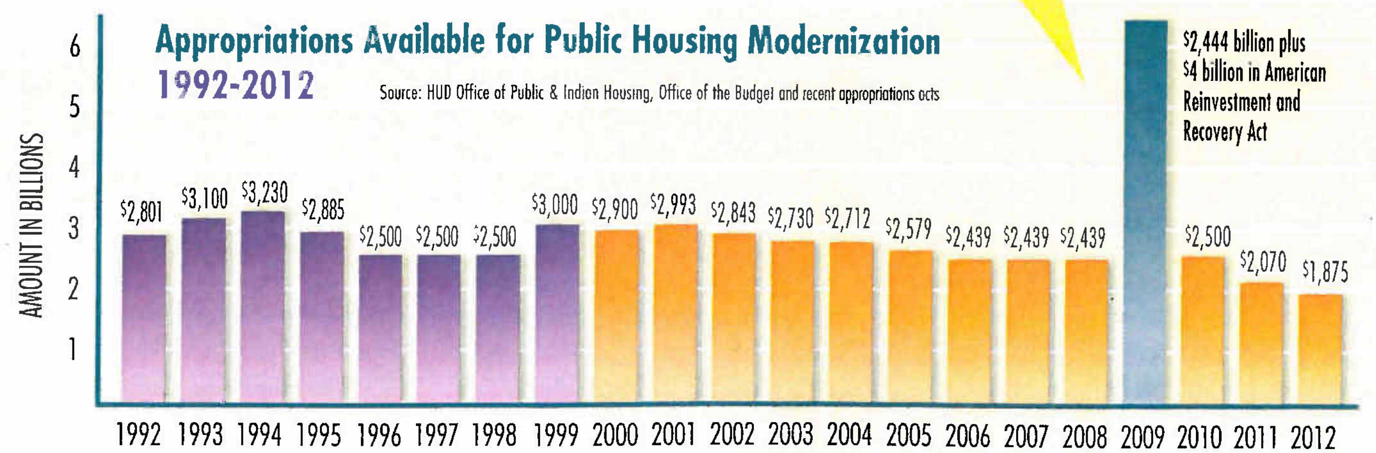

2011's "sequestration" provisions, if Congress does not take action to avert this mandated action in January 2013.

The current level of annual appropriations must be contrasted with the finding of the 2010 Abt study that in addition to amounts needed to address the $26 billion capital backlog, over $3 billion is needed annually just to address new "accrual" needs as current units age and systems need replacing. This means that without significant additional revenues to address capital needs from other sources, under current appropriations levels the public housing capital backlog will grow and public housing conditions will worsen.

## Is RAD the Answer?

The most significant event during the past year with respect to public housing investments was the passage of the Rental Assistance Demonstration (RAD) as part of the HUD appropriations act for 2012. This new law allows up to 60,000 public housing units to be converted to long-term Section 8 contracts subject to annual appropriations, either to the PBV program under which PHAs contract with private owners or themselves in some cases, or the project-based assistance (PBA) program under which HUD contracts directly with owners. The Administration advocated for this legislation as a means of placing public housing under stable long-term contracts so that financing for renovations could be raised by borrowing against the properties' rental income, as is routine for other rental housing. The RAD proposal to allow this type of

These numbers are the amounts appropriated for public housing modernization through the Comprehensive Improvement Assistance Program, the Comprehensive Grant Program and the Major Reconstruction of Obsolete Projects Program, through fiscal 1999; and the Capital Fund Program thereafter. Depending on the years in question, these funds also could be used for operating expenses, management improvements and/or for fiscal years commencing with fiscal 1996, public housing development. Congress has included various set-asides in these appropriations and thus they do not fully represent amounts available to PHAs. Nevertheless, they show the trend in available modernization resources. The chart does not include HOPE VI/Choice Neighborhoods funding substantially to replace obsolete public housing, which has been cut by several hundred million dollars on an annual basis.



financing for the public housing stock has had a number of antecedents, including proposals by the Harvard University Graduate School of Design's 2001 "Public Housing Operating Cost Study" ("Harvard Study"), the Millennial Commission in 2002, and HUD's "Public Housing Reinvestment Initiative" in 2002 and 2003. A similar proposal was backed by the "Public Housing Summit," a broad-based group of public housing experts, in 2008.

In 2010, the Administration proposed a very broad version of the RAD legislation, which encompassed housing assistance programs other than public housing and addressed numerous issues in great detail. The legislation enacted last year condenses the word count dramatically, concentrates on public housing, limits the initiative to 60,000 units and leaves considerable authority to HUD.

In addition, Congress made a fundamental structural change last year with respect to funding. The Administration had proposed $300 million in its 2010 version and $200 million in its 2011 version, to cover the difference in costs between the level of public housing operating and capital subsidies that PHAs receive and the subsidy levels that would be needed to fund PBV or PBA at the difference between market rent and Section 8 tenant rent levels. The enacted legislation instead limits subsidy to the levels of public housing operating and capital subsidies currently received by the PHAs.

Given the budget deficit controversy and Congressional pyrotechnics over the debt limit increase in 2011, RAD only could be enacted with such a funding limitation. The Administration decided to support the legislation with that limitation, despite the impact that the limitation will have on the usefulness of RAD for addressing the public housing capital backlog, so that implementation could begin and the backlog could be addressed at least to some degree.

The impact of this cost limitation on PHAs' ability to raise capital funds through RAD will be very substantial. To simplify enormously, if PHAs need the current level of operating funding provided through tenant rents and operating subsidies to operate their developments, the annual operating income potentially available is the Capital Fund appropriation–for 2012, roughly $1,700 per unit. But that much may not be available if the PHA has been using Capital Funds to cover shortfalls resulting from appropriations prorations (this year's 95% pro-ration left the average unit about $200 short of the formula's estimated need) or otherwise or for essential management improvements, and cannot count on operational savings resulting from renovations or other efficiencies to cover the gap. In addition, the amount available to make debt service payments for capital improvements would be reduced further to cover annual capital replacement reserves (HUD's default number has been $500 per unit) and underwriting adjustments such as for projected vacancy losses that largely would be funded in the public housing funding system with respect to vacancies up to 3% (about $285 if the adjustments equaled 3% of HUD's projected public housing funding-based RAD rent for the average unit). A lender's required debt service coverage of at least 1.11, depending on the lender and loan program, would reduce the available amount further.

Such deductions are only illustrative, but indicate that the amount available for debt service on an average unit very plausibly could be in the $650 range ($1,700 minus $200 minus $500 minus $285 equals $715, divided by 1.1 equals $650). Federal Housing Administration (FHA)-insured loans in particular now offer extraordinarily low rates and thus great opportunities. Even with a favorable assumed 3% rate and 40-year term, however, $650 in available debt service would finance slightly over $15,000—considerable but well short of the average per-unit capital backlog. PHAs should run the numbers for each development contemplated for RAD and results will vary widely, but overall it is clear that RAD is important but needs additional leveraging or funding to reach more of the public housing capital backlog.

Consistent with that conclusion, a study prepared for the principal public housing industry groups by Recap Real Estate Advisors (Recap Advisors) found that at fiscal 2010 public housing funding levels, which were substantially higher than fiscal 2012 levels, 37% of the public housing units studied could finance their entire capital backlog. By contrast, if Section 8 could be funded at 100% of fair market rents, 70% of units could finance their entire capital backlog.

Congress could strengthen RAD in the future by providing some funding to cover the gap between public housing and typical PBV or PBA funding amounts. The House of Representatives Financial Services Committee's Section 8 reform bill, the Affordable Housing and Self-Sufficiency Act of 2012, reauthorizes RAD and authorizes $30 million annually for this purpose. This relatively small amount, because it is gap funding, would increase RAD's potential impact substantially.

## RAD Implementation Issues

A great advantage of moving forward despite RAD's funding limit, however, is the ability to work out the details of a RAD initiative—

including addressing a multitude of issues involving funding calculations, rent-setting, financing rules, HUD processing, treatment of residents, replacement housing and other subjects. Thus, HUD published a draft implementing notice for public comment that contained about 100 pages concerning the public housing initiative (as opposed to some other aspects of the legislation), received extensive comments and published its final notice inviting proposals and material addressing the extensive comments received in late July of 2012. HUD

**Given the budget deficit controversy and Congressional pyrotechnics over the debt limit increase in 2011, RAD only could be enacted with such a funding limitation.**

also undertook an impressive technical assistance effort to assure that PHAs would know the potential of RAD, including an Internet tool to calculate potential borrowing capacity for individual developments and conferences with HUD staff and potential lenders and investors.

While many of the public comments addressed the details of funding and financing, some addressed Administration's basic program element of "Choice-Mobility." Choice-Mobility allows residents of the converted developments after an initial occupancy period to receive priority for a tenant-based voucher from a PHA's previously existing voucher allocation (the PBV or PBA contract for the original unit would remain in place). There is precedent for this approach in the PBV program, which requires that PBV residents receive such a priority after one year of occupancy.

Nevertheless, the proposal has been controversial. The Administration argued that Choice-Mobility is important for poverty deconcentration and to allow families more flexibility to live near jobs or support systems or otherwise where they choose, and would be a discipline on project management by allowing residents to "vote with their feet" if they are dissatisfied with the current project. Skeptics argued that because the proposal does not create new tenant-based vouchers, this requirement necessarily would take away a voucher from a family on the waiting list; families living in converted developments already are advantaged by having a housing subsidy (only one of four eligible families has one); the requirement could turn the developments into partial way-stations for families who mostly want tenant-based vouchers; the additional resident turnover would increase management expenses and could undermine development viability; and on the other hand, the extent to which management discipline is fostered is mitigated by long waiting lists for subsidized housing and thus the likelihood that there always be a family who would like to move in.

Congress largely avoided this issue by including no statutory language and instead indicating in the Senate Appropriations Committee Report that Choice-Mobility should be an element of the demonstration. HUD's final implementing notice keeps the Choice-Mobility element, but provides some limitations for PBA conversions by postponing applicability to two years after the later of the beginning of the contract or the family's move-in date; allowing PHAs to limit the number of families who can take advantage of the preference to 15% of a development's families in any year; and allowing PHAs to limit their annual commitment of turnover vouchers for this purpose to one third. The notice also provides in the RAD competition for up to 10% of units to be exempt from the Choice-Mobility requirement (e.g., for a PHA that only administers public housing).

Another key aspect of the RAD legislation is its treatment of the threat of foreclosure that accompanies any borrowing secured by the underlying property. Concern that public housing units might be lost by foreclosure was a substantial impediment to the progress of the Administration's proposal in 2011. The RAD statute addresses this concern by requiring that Section 8 subsidies and property use restrictions continue after foreclosure and that properties generally remain

under the control of PHAs or other public entities. HUD's implementing notice does not elaborate much on these provisions.

While this resolution of the foreclosure risk issue allowed RAD to move forward, its impact on the availability of private lending is one of RAD outcomes to be tracked carefully. Recap Advisors as part of its study conducted a survey of lenders, with optimistic conclusions substantially based on lenders' likely reliance on insurance from the Federal Housing Administration (FHA).

The RAD implementing notice sets up an initial application period in the fall of 2012. Because of the subsidy limitation, the demand for this program is very uncertain. PHAs that want to take at least some of their portfolio out of the heavily regulated public housing program with poor funding prospects may apply for RAD without trying to finance much or any rehabilitation. Other PHAs will be able to obtain financing to address relatively low levels of capital needs, or may be able to combine other resources to augment what RAD otherwise could finance.

The Administration hopes that 4% Tax Credits, which unlike 9% Tax Credits are readily available in most states, will be a valuable supplemental funding source for RAD. For this to occur, PHAs will have to be able to leverage RAD or use other funding contributions to meet the 4% Tax Credit requirement that tax-exempt bonds essentially equal to half of the investors' Tax Credit basis must be issued and thus repaid; some but not all of the funds for such repayments might come from Tax Credit syndication proceeds. Because the Administration has structured the process so that it will make awards after receiving applications for one month ending October 24, there will be a prompt indication of the nature and extent of the demand for RAD at current public housing funding levels.

## Ongoing Efforts: PBV, Capital Fund, CFFP, Tax Credits, Public Housing Operating Reserves

During the past several years a number of PHAs, such as the Boulder (Colo.) Housing Partners, Housing Authority of the County of Santa Clara (Calif.) and King County Housing Authority (Wash.), have been able to finance improvements to their former public housing stock by obtaining HUD approval for public housing disposition, retaining control of the properties, project-basing replacement vouchers that HUD had awarded them to the sites, and financing against the rental income streams. The approach has depended upon the availability of replacement vouchers. This innovative approach has been undertaken both with and without use of 4% Tax Credits, and these transactions both could be a source of "lessons learned" as RAD moves forward and illustrate the potential of a more fully-funded RAD.

HUD, however, issued a notice in February of 2012, severely limiting PHAs' ability to use this mechanism in the future. HUD's notice among other things states that generally PHAs have "alternative resources" to address their capital and operating funding needs. That premise would not seem to apply in many instances, including to a significant number of developments with capital needs beyond the reach of 4% Tax Credits coupled with public housing funding, and no realistic prospect of receiving CFFP, 9% Tax Credit or Choice Neighborhoods funds.

Largely because of the spend-out of $4 billion in ARRA funds, the substantial cutbacks in Capital Fund appropriations (from $2.5 billion in fiscal 2010 to $1.875 billion in fiscal 2012) will take awhile to be fully felt. But the impact of the cutbacks will be severe, if sustained.

The use of CFFP during the past year again was modest; approximately $49.6 million, of which $31.4 million was committed to transactions completed by the Charlotte, Lucas County (Ohio), and Hartford PHAs. Because PHAs only can leverage their future capital funding to the level that allows them to retain 3-1 debt service coverage relative to projected annual Capital Funds, the demand for CFFP substantially may have run its course — even though several large PHAs never have used this initiative. In view of the cut in Capital Fund appropriations, some PHAs with existing CFFP loans were trying to find resources to reduce or eliminate those loans so that the need to use future Capital

**There will be a prompt indication of the nature and extent of demand for RAD at current public housing funding levels.**

Funds to pay debt service rather than for renovations could be reduced. The Denver Housing Authority used approximately $7 million in operating reserves for this purpose.

The Administration's fiscal 2012 proposal to require PHAs to use operating reserves to offset new operating subsidy appropriations spurred PHA interest in using such reserves to address capital needs, rather than leaving the reserves vulnerable to future offsets. The Administration initially ruled that the reserves legally could not be used for capital improvements, but that they could be used to repay debt service on "Operating Fund Financing Program" (OFFP) loans made to finance such improvements. PHAs then began to develop proposals for such OFFP loans. The largest approved OFFP loan was approximately $8.7 million for the Houston Housing Authority.

Congress clarified in the 2012 appropriations act that operating reserves could be used for capital improvements other than "large modernization projects" at least during fiscal 2012, thus curtailing the need for OFFP loans. In any event, the remaining level of operating reserves limits this potential source of addressing the capital backlog to not more than several billion dollars at the most.

The Tax Credit market continued to recover during 2012 and Tax Credits again were a viable resource (after shrinking drastically in 2008 and 2009) to supplement public housing funding. The HOPE VI program for replacing severely distressed public housing at one time had been a substantial source of funding to be complemented with Tax Credit investments. The Choice Neighborhoods program, the replacement program for HOPE VI, only received funding for five implementation grants awarded in fiscal year 2011, one of which was related to a distressed PBA project rather than public housing. HUD also awarded 13 more Choice Neighborhoods Planning grants, bringing the total to 30 planning grants from fiscal 2010 and 2011 appropriations. These awards will demand PHA creativity to achieve their promise, because most PHAs receiving them will not see Choice Neighborhoods implementation grants for years, if ever, unless appropriations are increased dramatically.

## The Next Steps

In the immediate future, we will be able to determine more about the potential of RAD and the virtually certain need to strongly advocate gap funding to build upon that initiative. More generally, PHAs have been resourceful in finding many sources to address the capital needs of the public housing stock. HUD has promoted these efforts in many ways and could undertake additional tracking and promotion of the most promising resources, in addition to continued advocacy in support of these resources' availability (such as Tax Credits as Congress considers comprehensive tax changes). But the biggest determinant of the next decade's success is likely to be the degree of governmental support for public housing preservation in a climate of severe budget retrenchment and how that translates to funding. The upcoming election will set a tone in that regard for at least the next several years. ■