

The 2013 Public Housing Investment Update

BY ROD SOLOMON

THERE WERE SOME bright spots during the past year for preservation or replacement of the \$100 billion public housing stock—the invigorating launching of the Rental Assistance Demonstration (RAD), a very large Capital Fund financing for the New York City Housing Authority (NYCHA), awards of large Choice Neighborhoods grants to the housing authorities of San Antonio (Tex.), Seattle (Wash.) and Tampa (Fla.), and continued contribution of low-income housing tax credits (Tax Credits). The abject failure of Congress to provide adequate funding for low-income and particularly public housing, however, counteracts the accomplishments.

Appropriations Drop Impedes Progress

Last year's report highlighted a substantial drop in public housing capital appropriations over the past 20-plus years, largely interrupted only by the \$4 billion injection of American Reinvestment and

Recovery Act stimulus funds in 2009. A total meltdown has been avoided and important progress made only as a result of funding for replacement with mixed-income communities through over \$6 billion from the HOPE VI program and over \$10 billion of associated Tax Credit and other leveraging; leveraging of other funds including substantial additional dollars through Tax Credits; large-scale voucher funding that agencies participating in the Moving to Work demonstration (MTW agencies) including Atlanta, Chicago, Philadelphia, Washington, D.C. and others used for public housing revitalization or replacement; and \$4 billion raised through the Capital Fund Financing Program (CFFP) to accelerate the impact of future Capital Fund appropriations.

While the 2013 appropriation of approximately \$1.875 billion is the lowest since 1989, the 2014 appropriation could be the same or worse: the Senate proposes an increase to \$2 billion, but the House proposes a cut to \$1.5 billion. The July 2013 implosion on

the House floor of a Transportation/HUD spending bill with draconian further spending cuts gives hope that further steep cuts will be avoided. Nevertheless, given that a 2010 report for HUD estimated a \$26 billion capital backlog for 1.1 million public housing units and annual new capital needs of \$3.4 billion, reliance on future public housing appropriations is clearly not a viable strategy.

Impact of Appropriations Meltdown on Leveraging

The public housing leveraging tool tied most closely to these appropriations, the CFFP, generated little new funding apart from the NYCHA transaction. CFFP allows public housing authorities (PHAs) to borrow capital for public housing by pledging typically up to one third of their future annual Capital Fund formula grants. Cuts in appropriations thus mean less money available to leverage bor-



rowing and to address other annual capital needs with funds remaining after debt service payments. Further Capital Fund cuts after a CFFP borrowing all would come from those remaining funds, because the obligation to pay debt service must be met irrespective of such cuts.

In the 12 months ending June 2013, HUD approved under \$6 million in new CFFP borrowings. Some of the reduced demand is a result of PHAs already having used their borrowing capacity, but reduced appropriations also forced PHAs to think harder whether they should obligate themselves to long-term CFFP borrowing.

Lower interest rates relative to those of outstanding borrowings, increased funding pressure on shrinking annual Capital Fund allocations and in some cases expiration of prepayment “locks” or

penalties built into the original financings caused several PHAs to consider refinancing of current CFFP obligations. Refinancing could reduce annual PHA debt service payments by taking advantage of reduced interest rates, thus leaving more room to fund annual renovations or additional borrowing. The Chicago Housing Authority defeased its large bond issue in early 2013 (defeasance is necessary until current bonds can be retired); other PHAs or bond issuers who had indicated that they were exploring refinancing included Philadelphia, Puerto Rico, and Maryland, Illinois and Alabama on behalf of pools of PHA borrowers. The situation is evolving, however; the recent increase in interest rates has reduced projected savings from refinancing, and some PHAs may decide that projected savings do not justify going forward.

The NYCHA bond issue that HUD approved in August 2013 has generated approximately \$200 million for defeasance and approximately \$475 million for new work, in significant part for critical and legally required façade work. The transaction is a reminder of the efficiency of the CFFP mechanism for generating large capital amounts.

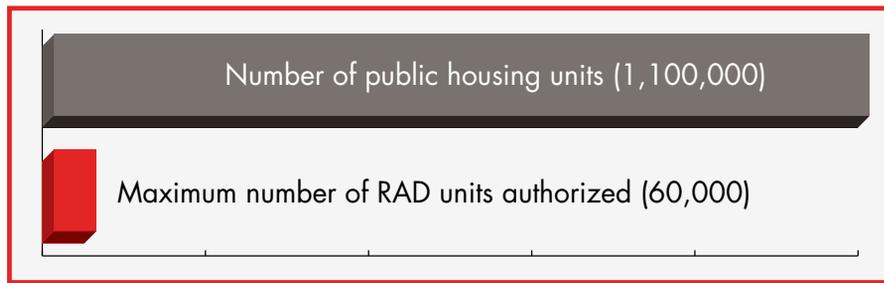
Tax Credits are unaffected directly by annual appropriations levels, although the program is slated for review as Congress takes up tax reform. Tax Credits continued to provide vital assistance to public housing stock preservation transactions. The impact continued to be greater in large metropolitan areas where investors need Community Reinvestment Act credits and thus paid higher prices for use of the Tax Credits.

The RAD Lifeboat

RAD allows PHAs to convert public housing subsidies to Section 8 project-based subsidies on an individual development basis, so that these developments can borrow funds for renovations, accumulate reserves and otherwise support themselves in the same manner as other subsidized rental housing. The hope also is that Section 8 will continue to be supported in the appropriations process, and thus that conversion will place the former public housing stock on a better long-term financial footing than remaining in the public housing program.

The Obama administration's proposed predecessor legislation to RAD included funding for higher per-unit Section 8 subsidies than current public housing subsidies, to increase the number of instances where conversion could generate Section 8 rents high enough to support borrowing for necessary capital improvements. Congress,

Relative Size of RAD Demonstration



however, limited subsidies to the public housing subsidy levels. Thus, a unit's initial RAD rent is capped by the sum of public housing operating funds, public housing capital funds and tenant rents provided for the unit.

This limitation eliminated many PHA applications, but other PHAs proceeded. Some PHAs proposed conversions that require little capital work, to expose properties to Section 8 rather than public housing annual appropriations and to reduce regulation in some respects. Other PHAs found that Section 8 more easily can facilitate leveraging than public housing, among other reasons because the Section 8 units unlike public housing units can carry debt, and thus proposed RAD transactions that might not have been viable as public housing mixed-finance. Still others took advantage of the additional flexibility HUD is offering as part of RAD—for example, to use HOME funds provided to state or local governments or “Replacement Housing Factor” (RHF) public housing funds that otherwise are not permitted to be used for public housing renovations.

HUD undertook extensive RAD marketing and an effective effort to provide training and technical assistance of all kinds. The effort included publication of an “Inventory Assessment Tool” that allows PHAs to see the RAD rent for each individual development and plug in a few assumptions that

yield the amount of borrowing the rents would support. Despite this push, the initial RAD month-long competitive period in the fall of 2012 yielded only 11,910 HUD-approved units of the 60,000-unit ceiling Congress has authorized.

HUD, however, continued its efforts and liberalized RAD rules in July 2013. Most importantly, for applications submitted this year, HUD is applying the statutory limitation on subsidies to public housing levels by using 2012 rather than reduced 2013 public housing appropriations. Other important changes provide for advance RAD commitments on a portfolio rather than individual project basis, which will extend even further the rent caps based on 2012 public housing appropriations; variation in RAD rents for converting individual developments from cost-neutral rents relative to public housing, as long as the average for a group of developments converted by the PHA will be cost neutral; ability for MTW agencies to supplement RAD rents on an ongoing basis with available MTW funds; and use of RHF funds projected to be received in future years for replacement public housing instead to supplement the annual RAD rents.

Shortly after HUD announced the changes, Secretary Shaun Donovan estimated approximately 70,000 public housing units for which PHAs had expressed interest in conversions and urged PHAs not to delay submitting applications,

given that HUD is approving them on a first-come, first-served basis and could hit the statutory ceiling. HUD also asked Congress for a substantial increase in the ceiling. The liberalized rules have had an effect; as of late September 2013, HUD had received applications for over 32,000 units.

RAD Pending Issues—Funding and Leveraging

The most fundamental issue ultimately will be the extent to which RAD can fulfill its goal of providing an effective means of preserving the public housing stock. HUD reported that just the initially approved RAD applications proposed to generate \$660 million in capital apart from PHA-supplied and secondary financing, including \$257 million in loans and \$409 million in Tax Credit equity.

Because the first RAD transactions are just reaching closing and actual leverage will differ from projections, RAD's initial leveraging record is not yet established. Apart from leveraging, the extent to which RAD preserves housing by achieving better sustained funding than public housing will have to be judged over the long term. Also, RAD may in some instances substitute for financing that could have occurred through HUD's Energy Performance Contract (EPC) initiative, because RAD like EPCs can capitalize the value of future energy savings generated by capital improvements; and CFFP, because RAD conversions reduce a PHA's public housing inventory and thus the projected future annual capital grants that could secure CFFP debt.

It has been clear all along that RAD with rents capped by public housing subsidies would not enable PHAs even with borrowing

and other leveraging to address the capital backlog needs of a substantial percentage of public housing units. HUD thus proposed that \$10 million be appropriated in 2014 to supplement RAD rents for developments in high-poverty neighborhoods where the government is supporting comprehensive revitalization. Because the funding would supplement current subsidies to make more transactions viable, even this relatively small amount would have a significant impact.

RAD Administration

Both HUD and PHAs are grappling with the administrative issues arising from launching a program that addresses developments' financial needs individually and changes their subsidy platform. HUD is doing its best to resolve many regulatory issues, both foreseen and unforeseen, in a timely fashion. PHAs have to take the steps needed so that RAD developments will stand on their own financially; in many instances, cope with a new experience of obtaining Federal Housing Administration (FHA) insurance, including related requirements such as detailed physical conditions assessments; and address the expectations of a different division of HUD.

PHAs also have to make the choice, incorporated in the RAD statute in part to obtain consensus for passage, whether to convert public housing to Section 8 project-based vouchers (PBV) or project-based rental assistance (PBRA). PBV is administered by PHAs and funded as part of their overall voucher funding. Under PBRA, HUD or a contract administrator for HUD contracts with the owner and appropriations are through a separate project-based assistance account.

Each choice has advantages (see chart). PHAs generally have had more experience with PBV and the program structure allows the PHA to administer the subsidy and earn an administrative fee. Voucher

renewal appropriations, however, have been shakier historically than PBRA appropriations—for 2013, a funding pro-ration of 94 percent of voucher needs versus full funding for PBRA (achieved, though, by funding contracts only through the fiscal year and counting on new appropriations). The PBV statute also has more prescriptive rules as to provision of local vouchers to residents who want to move and provision of supportive services to non-elderly, non-disabled families than PBRA, which HUD largely has maintained for the RAD demonstration to address concentrations of low-income families. HUD reports that thus far, PHAs have been fairly evenly split in their chance of PBV or PBRA.

Considerations in Choosing PBRA vs. PBV

Item	PBRA	PBV
1. Rent Caps	Current funding cannot exceed 120% of the fair market rent (FMR), unless the current funding is less than market, in which case the current funding cannot exceed 150% of FMR. Initial funding capped at public housing level.	Current funding cannot exceed the lower of (1) reasonable rent or (2) 110% of FMR. Initial funding capped at public housing level.
2. Choice Mobility	Resident may request next available voucher after two years; however, voucher agency may limit to not more than 15% of project in any year and not more than 33% of voucher turnover due to RAD.	Resident may request next available voucher after one year, with no limitations.
3. Voucher Admin Fee	N/A	PHA earns Section 8 voucher admin fee for all units converted to PBV.
4. Appropriations	Annual funding subject to appropriations; however, the Congress has never failed to renew a PBRA contract	An agency's voucher funding is subject to annual appropriations. Because of the required RAD Use Agreement, if Congress provides less than full funding for the Voucher program (i.e., proration), the PHA administering the voucher program may well likely need to absorb the cuts from its non-RAD voucher units.
5. Income Mixing	N/A	Under normal PBV rules, not more than 25% of units in a project can be assisted, unless the units are elderly or disabled, scattered site, or receiving supportive services. RAD increased the threshold to 50%, with the same exceptions.

SOURCE: ADAPTED FROM HUD MATERIALS

Alternatives Where RAD Does Not Work Financially

A number of PHAs have preserved public housing stock during the past few years by obtaining HUD approval for disposition based on inability to sustain the developments with public housing funding, project-basing the replacement vouchers HUD awarded as a result of the disposition to the developments, and then financing the necessary rehabilitation. The funding difference between RAD rents and voucher program rents leaves a substantial number of public housing units where rehabilitation sufficient to provide long-term viability could be financed with rents at allowable voucher levels and using 4 percent Tax Credits, but not with RAD and 4 percent Tax Credits.

HUD largely stopped such disposition approvals last year, by issuing a notice that declared that insufficient public housing funding would not be accepted as a reason for disposition. The predictable result has been that PHAs no longer have an avenue to obtain fully-funded vouchers for preservation of housing that could attain long-term viability with reasonable investment.

HUD should modify this policy to be more consistent with the Administration's otherwise strong emphasis on preserving low-income housing, even though the impact of the change will be limited by the availability of appropriated vouchers that could be used in this manner. With such a change, for example, HUD sometimes could broker innovative solutions that combine RAD for some of a PHA's units with replacement vouchers for others. HUD approved such a "partial RAD" solution to a disposition proposed before the Notice became effective, under which the Housing Authority of the City of Santa Barbara (CA)

RAD provides a promising new option, but the bigger picture remains that the public housing resource needs more money if the stock is to be preserved.

will be able to preserve all of its public housing through RAD and a limited HUD commitment of replacement vouchers.

Thanks to progress under the HOPE VI program and other initiatives over many years, the legendary severely distressed public housing projects (e.g., Chicago gallery-style family high-rises) are largely gone and in many cases replaced with viable mixed-income housing. But there is a significant amount of public housing still needs to be replaced. The funding need is substantial; current sources consist basically of 9 percent Tax Credits or the Administration's Choice Neighborhoods Initiative. The latter builds upon and broadens HOPE VI by emphasis on aspects of revitalization other than housing, including education from early childhood forward, crime prevention and transportation. Congress, however, has limited funding thus far so that only a handful of annual grants can be supported.

Needed Federal Action and Local Ingenuity

The actions needed at the federal level to support preservation or

replacement of public housing include obtaining the best possible Capital Fund and Operating Fund, which will continue to support most of the public housing stock, as well as Section 8, appropriations; supportive RAD changes including enactment of at least the Administration's proposed modest appropriation and increase in allowable RAD units, as well as HUD's continued prioritization of RAD's administrative development and a more supportive policy regarding supplemental use of tenant protection vouchers; enactment after many years of trying of program deregulation measures including ability of additional capable PHAs to access MTW; and assurance of continued availability of the Tax Credit program to harness additional resources.

Particularly given likely mixed success at best regarding appropriations, PHAs will have to continue to turn over every stone to salvage, preserve and even improve the public housing stock. They will have to evaluate options carefully; for example, whether RAD would work financially and whether Section 8 could be a better option financially and administratively in the long run than CFFP, even though CFFP may be easier for promptly raising large sums of capital.

RAD provides a promising new option, but the bigger picture remains that the public housing resource needs more money if the stock is to be preserved. We must continue our work as citizens to achieve support for a government that will give the preservation of low-income housing a higher priority. ■

Rod Solomon, an attorney with Hawkins Delafield and Wood LLP in Washington, D.C., may be reached at rsolomon@hawkins.com.