The 2014 Public Housing Investment Update

BY ROD SOLOMON

THE U.S. DEPARTMENT of Housing and Urban Development (HUD) gave the preservation of the 1.1 million-unit public housing stock high priority this past year, as it focused on implementation of the Rental Assistance Demonstration (RAD). Efforts other than RAD, however, continued to be stymied by enormous appropriations shortfalls. The 2014 appropriation for public housing capital of $1.875 billion matched 2013 as the lowest amount since 1989. That amount falls well over $1 billion short of what HUD's last study on public housing capital needs estimated to be required annually just to prevent further deterioration, not to mention addressing a $25 billion backlog. The New York City Housing Authority (NYCHA) alone reported public housing needs of almost $4 billion in capital work by 2018 compared to an annual Capital Fund appropriation of $298 million, at the same time that it is facing a 2014 $77 million operating deficit.

The RAD Application Explosion and Unit Cap Issue

In view of such massive under-funding and more to come, public housing authorities (PHAs) had plenty of incentive to make RAD work. Most basically, RAD allows PHAs to convert individual public housing developments from public housing subsidies to long-term Section 8 rental assistance contracts, with the constraint that initial RAD contract rents will be set so that subsidy levels do not increase. Section 8 has a better appropriations track record than public housing, and the hope is that conversions of public housing to Section 8 will result in better long-term funding support and a more effective platform for leveraging loans and low-income housing tax credit (Tax Credit) investments. In addition, some of the unessential regulatory barnacles that have become attached to public housing could be shed in the conversion process.

RAD's implementation burst out this year after a year of HUD getting the initial rules in place and then modifying them. After the initial rules generated limited interest given RAD's no-subsidy-increase limitation, HUD in July 2013 added flexibility and announced that it would set RAD rents for applications received in 2013 by applying 2012 rather than reduced 2013 public housing appropriations. PHAs' fears regarding future appropriations levels, coupled with substantial HUD outreach, led to RAD applications for almost 180,000 units by the end of 2013–almost three times the 60,000-unit cap Congress imposed for the demonstration.

The RAD applications are impressive; HUD estimated that their implementation would generate over $6 billion to preserve or replace public housing. The applications take substantial advantage of the availability of both Federal Housing Administration (FHA) insurance and Tax Credits. A number of the applications rely in part on 4 percent Tax Credits, a resource that unlike competitively-awarded 9 percent Tax Credits is readily available in most states.

HUD expected that the unit cap would be increased substantially in the final fiscal 2014 appropriations act and was surprised when Congress did not do this, despite cap increases in earlier versions of the bill. There were last-minute Capitol Hill staff concerns that RAD could increase net program costs, despite the statutory prohibition on subsidy increases.

PHAs and others are making a concentrated effort to ensure that this setback is temporary. This diverse group of vocal "stakeholders," including a "Lift the RAD Cap Coalition" composed of leading non-profit and for-profit low-income housing developers, investors, lenders, consultants, PHAs and PHA groups, bodes well for RAD.

Nevertheless, the House of Representatives' fiscal 2015 HUD appropriations bill fails to raise the cap. The Ranking Member of the House Financial Services Committee, which has jurisdiction over public housing, wrote appropriators that it is too early in the demonstration to raise the cap. Other concerns surfaced, including that the low-income status of the properties might not be protected sufficiently over time. But HUD and others noted that the RAD statute generally restricts converted RAD properties to long-term low-income use, irrespective of foreclosure or other potential ownership disruptions. The Senate Appropriations Committee's bill increases the cap to 185,000, and includes the Administration's request for $10 million to support increased RAD rents that would allow more extensive rehabilitation in areas assisted by other federal investments.

Initial RAD Implementation

In the meantime, HUD, PHAs and their partners commenced implementation in earnest. Early closings raised many issues. HUD staff "silos" with different rules and cultures—responsible for public housing and for assisted housing including project-based Section 8 and FHA insurance—had to become a team. With HUD putting great priority on this endeavor, by mid-2013 approximately 45 transactions had been closed covering 4,200 units. HUD projected that 15,000 public housing units would be converted to Section 8 by the end of fiscal 2015.

In addition to processing concerns, various substantive issues arose as the first transactions closed and lenders and Tax Credit investors had to commit funds. Some potential lenders wanted to know what the statutory requirement that capable public entities are to have an ownership priority in foreclosure

Figure 1 **RAD Units Approved or Reserved: Largest Portfolio Applications**

	PHA Name	Total Number of Units
1	Housing Authority of the City of El Paso (Te...)	6,346
2	Housing Authority of the City & County of San Francisco (Calif.)	4,575
3	Housing Authority of Baltimore City (Md.)	4,063
4	Housing Authority of Greensboro, (N.C.)	2,412
5	Cambridge Housing Authority (Mass.)	2,130
6	Housing Authority of the City of Columbus (Ga.)	1,713
7	Housing Authority of the City of Asheville (N.C.)	1,525
8	Housing Authority of Savannah (Ga.)	1,408
9	Tennessee Valley Regional Housing Authority (Miss.)	1,208
10	Housing Authority of the City of Albany (Ga.)	1,117

Note: Numbers differ somewhat among HUD data sources.

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situations would mean to their ability to foreclose if necessary. HUD offered some general clarifying language for RAD documents and was considering what further steps it should take to encourage lending, consistent with the statutory requirement. Other program and financial issues were addressed as transactions closed.

As of August 2014, none of the closings had related to the large portfolio proposals (see Figure 1). In important respects, the large portfolio proposals differed significantly from one another, even within the context of the 4 percent Tax Credit transactions contemplated by several of them (e.g., El Paso, Baltimore, San Francisco, Cambridge (MA)). Differences related to the extent of PHA participation in project ownership, efforts to attract lenders and investors, the composition of those entities (e.g., one versus multiple lenders and/or investors) and use of supplemental funding.

Combination of RAD and Other Resources

For many PHAs in high operating cost areas, with significant rehabilitation needs or with both of these characteristics, RAD rent levels determined subject to the no-subsidy-increase requirement are too low to finance rehabilitation or in some cases even operating expenses. HUD allowed PHAs in the Moving to Work (MTW) demonstration program to supplement RAD rents with their MTW funds. In addition, a few PHAs, notably the Boulder (Colo.), City of Santa Barbara (Calif.) and San Francisco PHAs, proposed combinations of RAD rents for some units in a portfolio and higher rents for other units supported by tenant protection vouchers (TPV), awarded upon HUD approval of public housing disposition. This is an innovative approach for preserving more of the public housing stock with funding made available independently of RAD.

CFFP and Other Public Housing Financing and Leveraging—Holding Pattern?

HUD's Capital Fund Financing Program (CFFP), in which PHAs have been able to accelerate renovations by borrowing against future public housing capital appropriations, has been one of the most important advances resulting from the last major public housing authorizing legislation, the Quality Housing and Work Responsibility Act of 1998

(QHWRA). HUD has approved over $4.4 billion for PHA borrowings in this manner and PHAs have raised many hundreds of millions more in related Tax Credits. In August 2013, HUD approved a combined defeasance and new funding transaction for NYCHA of over $650 million.

But the only CFFP transactions approved during the next year were approximately $5 million for Lucas County, Ohio, $18 million for Newark, N.J and $750,000 for Easton. Pa. The Baltimore, Philadelphia, Mobile and Augusta PHAs all have made or are considering sizable prepayments of outstanding CFFP debt.

PHAs' reduced interest in taking on new CFFP debt or servicing what they already have in many instances relates to lower Capital Fund appropriations, the potential to undertake RAD, or both factors. Reduced appropriations means that PHAs have more difficulty committing a portion of their dwindling annual capital funds, or continuing to pay already-committed portions, at the expense of projected needs for annual capital work. PHAs contemplating new CFFP borrowing as well as RAD would have to take into account that RAD will take units out of the public housing inventory and thus reduce their formula allocation of annual capital funds, leaving less funding to secure a CFFP borrowing. That translates to reduced potential CFFP loan size to assure adequate debt service coverage. In addition to these factors, many PHAs already used CFFP and thus have lower capital needs and less room for further CFFP borrowing within debt service coverage constraints.

PHAs' use of financing for installation of energy conservation measures (Energy Performance Contracting or EPCs), which are incentivized by HUD allowing PHAs to retain utility cost savings resulting from conservation or providing additional public housing operating subsidy for payment of debt service costs, also appears to have decreased—to approximately $85 million in approved project costs for the year ending June 30, 2014. PHAs considering RAD or an EPC transaction might well choose RAD, which like an EPC transaction enables the PHA/owner to keep net utility cost savings but allows the energy-related work to be folded into broader rehabilitation work financed through the RAD mechanism.

Much more importantly in terms of volume, PHAs' use of public housing mixed-finance, where PHAs leverage borrowing and/or Tax Credit equity to produce modernized or replacement public housing units (as opposed to conversion to Section 8 under RAD), also appears to be dropping. HUD data, though incomplete, appears to show a drop in the volume of mixed-finance closings every year for the past four years and from an annual average of approximately $1.9 billion from 2003 through 2011 fiscal years (or $1.7 billion if one particularly large-volume year is omitted) to about $1 billion in 2012, $900 million in 2013 and $400 million in the first three quarters of fiscal 2014. Why this has happened is an important question. Some of the drop likely relates to the unavailability during the past several years of large public housing grants that could be used innovatively in combination with Tax Credits (first HOPE VI, then American Reinvestment and Recovery Act grants in fiscal 2009). Some of the drop may relate to investors now having less tolerance for relying on projected future public housing appropriations levels. Although RAD could not have affected the volume of mixed-finance transactions much at least until the last year or two, RAD now may look like a more promising approach given the better historical record for Section 8 than public housing appropriations. In addition, RAD typically would result in commitment of all of a development's operating and capital subsidy to the owner for use at the development, while PHAs typically make initial commitments of operating but not capital subsidies to mixed-finance transactions.

Regulatory and Legislative Steps

In October of 2013, HUD published final regulations codifying and expanding on QHWRA's Capital Fund provisions. Some of the changes appeared to recognize the diminished funding situation, for example by requiring less funding to be set aside for replacement public housing rather than modernization and by directing more of the available funds toward capital work as opposed to management improvements or security. But several new requirements were in tension with PHAs' need for flexibility to use limited funding as they saw best. A potential HUD initiative to require comprehensive physical needs assessments was criticized by PHA groups in this regard, particularly because implementation of the assessments' conclusions seemed likely to be largely undermined by inadequate appropriations. HUD defended its proposal in a report to Congressional appropriations committees and proposed flexible timing for implementation.

To provide additional spending flexibility, the Administration proposed legislation to combine

the Capital Fund with the public housing Operating Fund. In its fiscal 2015 HUD appropriations bill, the Senate Appropriations Committee responded more cautiously by retaining the two funds but authorizing PHAs of all sizes to move significant funding from the Operating Fund to the Capital Fund, increasing large PHAs' ability to move funding from the Capital Fund to the Operating Fund and allowing PHAs to use capital funds to maintain capital replacement reserves, subject to HUD regulation.

Promotion of All the Necessary Tools

HUD should be giving RAD the priority it has and trying to convince Congress to lift the cap (see Figure 2). RAD gives some PHAs the opportunity to undertake comprehensive renovations on a scale that is not going to be possible with Capital Fund appropriations in the foreseeable future. Also, PHAs should know that they can use this mechanism if it would be beneficial for them, irrespective of whether they applied (or applied for the right developments) in 2013.

But most of the current public housing stock will remain public housing, at least for a substantial number of years. So, the push for RAD is no substitute for restoration of reasonable public housing appropriations for both capital and operations. In addition, efforts to tap additional sources of federal, state and local funding for public and other low-income housing are critical—for example, the Housing Trust Fund envisioned in the Senate Banking Committee-passed version of the pending housing finance reform bill and even more dramatically, possible additional funding redirected as part of a reform of the mortgage interest deduction.

RAD also for the most part is a mechanism to rehabilitate the public housing stock in current locations, although there are some RAD proposals to transfer subsidy among sites and for new construction. Thus, RAD can be a part of but is not a substitute for the type of comprehensive community overhauls reaching far beyond housing rehabilitation that are sought by initiatives such as Choice Neighborhoods.

Preservation of the public housing stock is a tall order in these budget times. We are going to have to scramble to keep even and continue to make progress where we can with the federal, state and local resources we can put together.

Figure 2 **Largest RAD Portfolio Applications Beyond the 60,000 Unit-Cap** *(as of 5/31/14)*

	PHA Name	Total Number of Units
1	Chicago Housing Authority (Ill.)	10,895
2	Metropolitan Development & Housing Agency (Nashville, Tenn.)	5,474
3	Housing Authority of the Birmingham District (Ala.)	4,250
4	Housing Authority of the City of Charlotte (N.C.)	3,424
5	Mobile Housing Board (Ala.)	3,410
6	Tampa Housing Authority (Fla.)	3,121
7	Philadelphia Housing Authority (Penn.)	2,899
8	Housing Authority of the County of Los Angeles (Calif.)	1,843
9	Austin Housing Authority (Te...)	1,838
10	Corpus Christi Housing Authority (Tex.)	1,836
11	Municipal Housing Authority City of Yonkers (N.Y.)	1,769
12	Housing Authority of the County of Cook (Ill.)	1,656

Note: Numbers differ somewhat among HUD data sources.

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