The 2010 Public Housing Investment Update

BY ROD SOLOMON

THE PAST YEAR has been paradoxical for investments to improve public housing. The Obama administration proposed legislation and funding to address the $20-30 billion capital needs backlog on an unprecedented scale. HUD Secretary Shaun Donovan called a financing involving rehabilitation of 20,000 units in New York City "the most important day in the history of preserving public housing in the United States." Substantial progress was made to commit the extraordinary $4 billion appropriation of AmericanRecovery and Reinvestment Act (ARRA) funds to public housing improvements. But the administration's proposal received substantial criticism, and public housing authorities (PHAs) attempting to finance improvements continued to feel the impact of the 2008 collapse in the low-income housing tax credit (Tax Credit) and finance markets.

Part 1: Leveraging and Investment Progress

Stimulus Implementation

Annual appropriations for the public housing capital fund (Capital Fund) have been in the $2.5 billion range for several years, only modestly above the amount HUD estimated in 2000 to be needed to keep up with annual deterioration in the nation's 1.1 million public housing units. The $4 billion ARRA appropriation, on top of the annual

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Capital Fund appropriation, thus marked the first significant effort apart from demolition and replacement under the HOPE VI program to cut into the capital needs backlog since the mid-1990s.

While concerns had been expressed whether PHAs could obligate and expend this magnitude of funds in a timely fashion, commitment of the $3 billion distributed to approximately 3,000 PHAs by formula appears to be an unqualified success. In March 2010, HUD announced that the PHAs obligated virtually all of these funds within ARRA's one-year deadline. ARRA's one-year obligation deadline for the competitively awarded $1 billion is more difficult to meet, because a higher proportion of funds is committed to larger, more complex projects, often involving Tax Credits or other leveraging, and PHAs do not have flexibility to move funds among proposed investments. HUD's decision to award $600 million of the $1 billion to proposals for greening public housing marks an important jump in the scale of funding used in this manner, which should lead to important "best practices" for future investments.

A number of PHAs' ARRA initiatives include innovative mechanisms for leveraging funds. The competitive grants were provided in large enough amounts that several PHAs could take advantage of a law, enacted in 1998 and regularly used in HOPE VI public housing redevelopment transactions, which allows issuance of tax-exempt bonds with construction draws collateralized by HUD capital grants. The grants then are used after the construction period to repay the bonds. In turn, issuance of these bonds allows PHAs to qualify under the tax laws for access to 4% Tax Credits. By selling the ability to use Tax Credits to investors who will be passive partners of entities that must continue to operate the properties as public housing, often with the PHAs or related corporations as managing general partners, PHAs can maintain control of the properties and increase capital funding by 25-50%.

Public housing authorities attempting to finance improvements continued to feel the impact of the 2008 collapse in the low-income housing tax credit and finance markets.

At the time HUD distributed ARRA formula capital funds, HUD added a requirement that each PHA do a physical needs assessment (PNA) of its public housing stock. But the determination of the most useful form of PNA, particularly in view of the projected inability of most PHAs to fulfill their capital needs, proved too elusive for HUD to implement its requirement as ARRA funds were obligated.

The initial evidence is that the ARRA appropriation will be a one-time event. Congress returned the Capital Fund appropriation to $2.5 billion for fiscal 2010. The administration proposed only $2 billion for

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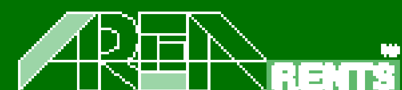


fiscal 2011, arguing in part that PHAs still were expending the ARRA funds. It appeared that Congress would restore the amount to $2.5 billion. Congress did seem poised to continue this year's gain in funding for replacement of distressed public housing under HOPE VI, or of distressed public and other federally-assisted housing under the administration's proposed "Choice Neighborhoods" program, from the $100 million annual level in the Bush years to $200-$250 million.

Continued Tax Credit Difficulties

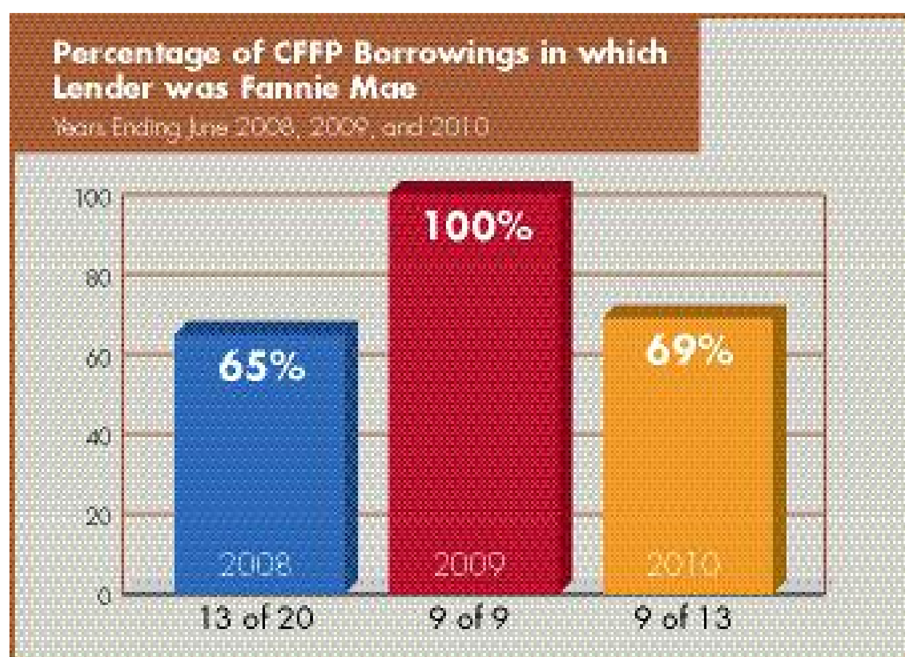
For the last 15 years, the major source of equity or grant funds for public housing above appropriations levels, as opposed to borrowed funds that must be repaid, has been the Tax Credit program. Last year, the National Leased Housing Association reported that nationally, Tax Credit investment fell from approximately $9 billion in 2006-2007 to approximately $5.5 billion in 2008. In the past year, the Tax Credit market rebounded to the point that more transactions were going forward, but receipt of funds from sale of the Tax Credits continued to be in the 65 cents to 85 cents range per dollar of Tax Credits rather than prices of over $1 several years ago. This meant substantial funding gaps. Some PHAs were able to take advantage of either the Treasury Department's Tax Credit Exchange Program (TCEP) or HUD's Tax Credit Assistance Program (TCAP), both enacted in ARRA, to replace anticipated Tax Credit equity with cash so that transactions could go forward.

The New York City Housing Authority transaction, cited earlier, demonstrated that the largest Tax Credit transactions could be completed. In that transaction, made possible on a one-time basis by ARRA, NYCHA raised $180 million in Tax Credit equity to be coupled with $110 million of ARRA funds for the renovation of approximately 20,000 units originally built as city- or state-aided units. The Tax Credit price was 82 cents per dollar of Tax Credits.

Capital Fund Financing Program: Innovations and Problems

Under the Capital Fund Financing Program (CFFP), PHAs may pledge future funds they expect to receive under the Capital Fund formula to the repayment of loans or bonds. The year ending June 30, 2009 was the lowest-volume year since the initiative began in 2000 at $42 million, but CFFP volume rebounded to $88 million for the year ending June 30, 2010. In addition to "plain vanilla" borrowings, several PHAs, including Albany (N.Y.), Cuyahoga County (Ohio), and Montgomery County (Ill.), combined proceeds from CFFP tax-exempt borrowing and income from the sale of Tax Credits to renovate or replace public housing. Other innovative approaches included the Pittsburgh Housing Authority's use of resources available as a result of its funding flexibility as a Moving to Work demonstration (MTW) participant to collateralize a variable-rate loan, and thus counteract the interest-rate risk so that the PHA could benefit substantially from lower interest rates. The same transaction included 9% Tax Credits and use of Capital Funds awarded for replacement public housing to repay the loan.

Almost three-fourths of the approved CFFP proposals in the past three years have been financed by Fannie Mae, which in 2004 developed a standardized initiative that made the program accessible for PHAs needing relatively small loans. In the summer of 2010, the Federal Housing Finance Agency, which regulates Fannie Mae, determined that this initiative was inconsistent with the Fannie Mae enabling legislation's emphasis on funding mortgage-backed loans and must be stopped. There are legal arguments to the contrary. If the current determination stands, an important source of CFFP loans will be eliminated.



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Additional Leveraging Mechanisms

In addition to CFFP, several PHAs used the statutory flexibility enacted in 1998 to mortgage public housing properties as security to assure regulatory agencies that they would fulfill the requirements of TCEP or TCAP. The Rock Island (Ill.) PHA used statutory authority that allows operating subsidies to be used to repay debt incurred for public housing renovations; the PHA pledged excess operating reserves for this purpose and thus effectively used the reserves for renovations.

Another increasingly important means of addressing capital needs—and specifically energy conservation needs—is HUD's energy performance contracting (EPC) program. The EPC program now has financed over $700 million in energy-conserving investments, including a $63 million initiative of the Boston Housing Authority in the past year. The financing is made possible by HUD rules that allow PHAs to retain operating subsidies (that otherwise would have to be returned to HUD after three years as energy bills drop) to provide a source for financing conservation-related and modest other public housing improvements. HUD still has work to do to refine and streamline the approval process so that more PHAs will take advantage of this opportunity.

In some circumstances, PHAs have been able to finance renovations or the development of additional affordable housing through conversion of public housing to tenant-based vouchers or project-based vouchers (PBV). The vouchers have provided a steadier—and, in some rental markets, more generous—funding stream than public housing. Moreover, the use of PBV facilitates borrowing against an individual property's projected rental income stream, which can be leveraged to a much greater extent than future Capital Fund appropriations. CFFP transactions typically have required minimum debt service coverage (DSC) ratios of projected funds available for repayment to debt service levels of 3:1; minimum DSC ratios for property-based borrowings are more typically in the 1:15:1 range.

It is important to acknowledge immediately that the administration's proposal finally could provide a means of putting public housing on a path toward long-term sustainability.

Significant transactions of this nature were advanced during the past year by several California and other PHAs (e.g., Newark, N.J.), who found that they could meet the renovation needs of public housing that would have been impossible to meet if the property had remained within the public housing system. In several cases, PBV will be combined with proceeds from sale of 4% Tax Credits to raise the necessary funds.

San Diego's comprehensive effort to leverage its former public housing stock by borrowing against the properties continued, generally without use of PVB or Tax Credits. Approximately $92 million was raised to produce approximately an additional 700 low-income units, about twice the number of units required by HUD.

Part 2: New Legislation: PETRA and Alternatives

In its fiscal 2011 budget, the administration proposed to accelerate and overhaul public housing funding by enabling widespread conversion of public housing and some other rental assistance programs to project-based Section 8. This proposal, initially called "Transforming Rental Assistance," gave public housing preservation a new level of attention. The administration's fiscal 2010 budget justification had suggested a 20,000-unit "demonstration" of this nature; by contrast, the fiscal 2011 budget proposal contemplated the initial conversion of 300,000 units and leveraging of $7.5 billion through borrowing against the properties' future rental income. In some respects the breadth of the proposal was even greater, encompassing eventual streamlining of 13 rental assistance programs and incorporation of various measures to bolster the ability of families receiving project-based assistance to move with tenant-based vouchers after a waiting period.

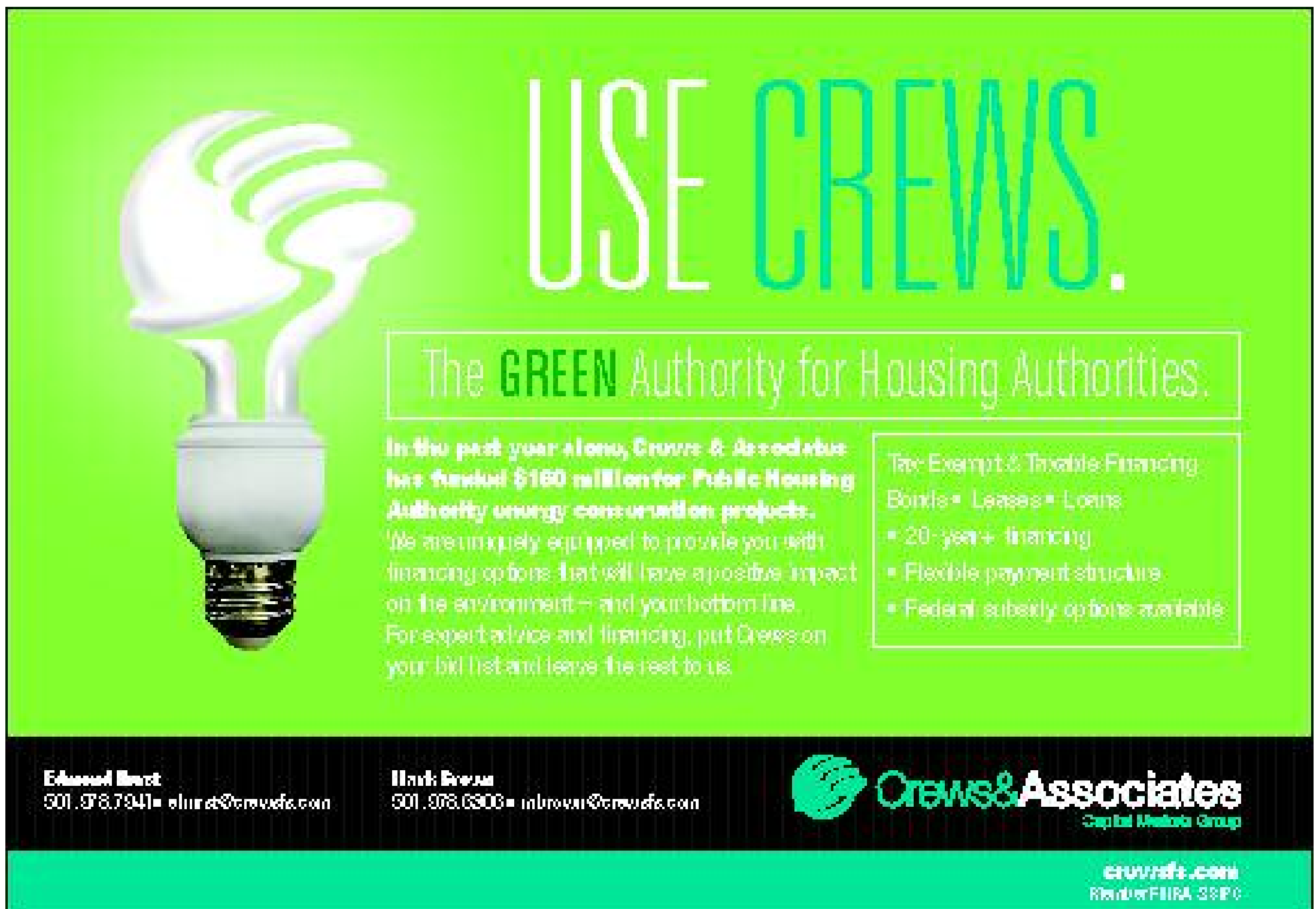
The administration's proposal includes higher per-unit annual Section 8 amounts relative to public housing to provide adequate funding for financing rehabilitation and ongoing property needs, including capital replacement reserves. The long-term Section 8 contracts, even though subject to annual appropriations, would be more likely than the public housing system to

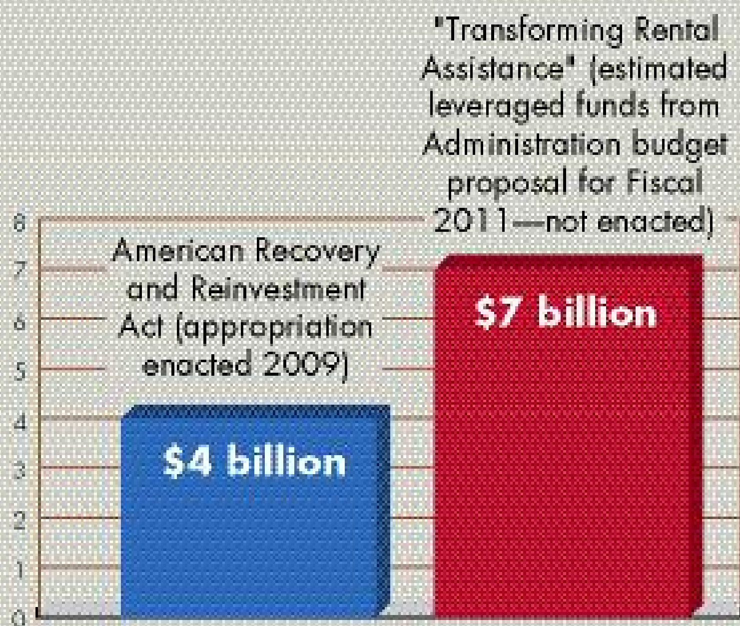
encourage future operating funding stability.

It is important to acknowledge immediately that the administration's proposal finally could provide a means of putting public housing on a path toward long-term sustainability. The ARRA $4 billion appropriation was very important, but not a sustained approach to addressing the enormous capital backlog and ongoing financial needs. The evidence is conclusive that this backlog and the deficiencies in public housing conditions it represents will not be addressed adequately by annual appropriations. A proposal to facilitate large-scale leveraging clearly is necessary to preserve critical housing resources.

Despite the proposal's obvious promise for public housing preservation, stakeholders expressed strong concerns. Some of these related to the substantial reach of the administration's proposal, far past a voluntary initiative to preserve public housing. Owners of other types of assisted housing saw little benefit from the proposal and were concerned that increased turnover resulting from its mobility provisions might be expensive or undermine stable occupancy. Among other concerns, PHAs worried that the administration's goal of streamlining programs meant that the initiative ultimately cannot be voluntary; the mobility provision would be problematic for development stability and unfair to persons on voucher waiting lists (even though the proposal would not decrease the number of new affordable housing opportunities and its generation of capital to preserve units ultimately would increase such opportunities); and the administration's initially-expressed intent to favor PHAs that distribute vouchers on a regional basis in the competition for funding signaled an intention to eventually to force the regionalization of the voucher program.

With respect to public housing preservation, the leadership of the House Financial Services Committee highlighted the risk of foreclosure and the possibility of losing low-income housing resources as a result—without direct reference to the demolition or disposition of approximately 200,000 public housing units that has occurred under the current system and the proposal's potential to





These amounts do not include annual appropriations for public housing Capital Fund, which largely must address accruing capital needs according to the 2000 HUD-sponsored study, HOPE VI or Choice Neighborhoods funds, or other leveraged funds such as Low-Income Housing Tax Credits. The Administration estimates leverage from the Transforming Rental Assistance approach of as much as $27 billion if the approach is continued over a period of years.

preserve many units whose future is otherwise in jeopardy. The Appropriations committees added that the proposal's long-term cost implications were not fully developed or alternatives fully explored, the proposal itself was evolving, and an inventory-wide capital needs assessment to update the approximate cost of addressing the backlog was in progress but not yet completed. Commentators correctly pointed out that the proposal's potential to finance improvements varies widely depending on local rent levels.

As of this writing in August 2010, the administration's legislation (the "Preservation, Enhancement, and Transformation of Rental Assistance Act of 2010"—PETRA) has not advanced, and initial versions of appropriations acts for fiscal 2011 have not included funding. The House Financial Services Committee instead reported proposed legislation to make public housing energy conservation investments attractive when funded with annual formula funds as well as third-party financing, and to provide federal guarantees for CFFP financing.

The House-proposed energy conservation initiative could provide PHAs a much-needed means of generating additional operating funds, while bolstering efficient operations. The proposed CFFP loan guarantees could allow for significant additional borrowing by minimizing lender/bondholder risks. On the other hand, the federal government would be assuming the "appropriations risk," which federal guarantors would have take into account as they set the extent of allowable additional guaranteed borrowing. A CFFP loan guarantee also would not add annual appropriations to increase renovations, or be likely to change the annual dynamic of volatility in public housing appropriations.

Where Does This Leave Us?

While the Tax Credit and financial markets are far from fully rebounded from 2008, the possibilities for favorable transactions are better than a year ago. Thanks to ARRA, PHAs have more investment resources and experience. PHAs have various mechanisms to leverage capital funding under current laws that they should continue to pursue aggressively.

On the legislative front, a proposal to facilitate the conversion of public housing developments to project-based Section 8 on a voluntary basis (and as one of several approaches to promote additional leveraging and more adequate ongoing funding) remains critical. The administration and Congress should re-focus as necessary on the aspects of proposals that will allow the basic goal of preserving low-income housing resources on a much more widespread basis to be accomplished. Risk of foreclosure should be addressed dispassionately, with adoption of reasonable measures to protect low-income units without undermining leveraging potential and assessment of risks and benefits, recognizing that doing nothing also poses substantial risk to preservation. Everyone involved—the administration, Congress, PHAs, resident groups, and others concerned with the public housing program—should work together promptly to reach a consensus that can allow such a preservation effort to begin. ■