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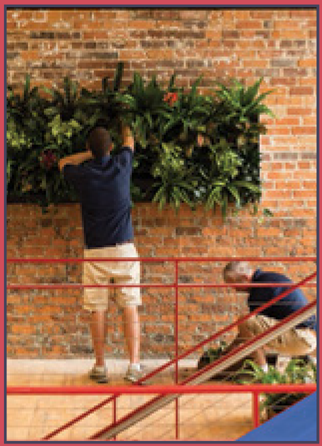

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The Public Housing Finance Update

BY ROD SOLOMON

THIS UPDATE generally covers events of 2016 and early 2017. Given the sea change with the new administration and congressional atmosphere, likely new developments and their implications for public housing investments have to be addressed. But first, a brief look back.

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The Obama Years

IN THE FACE OF a public housing capital backlog (estimated at $25.7 billion as of 2010 by a congressionally-mandated HUD study), the Obama administration put substantial emphasis on the preservation or replacement of the 1.1-million-unit public housing stock. The most obvious manifestations were the inclusion of $4 billion in public housing Capital Funds in the 2009 stimulus package and the development, advocacy for enactment and implementation of the Rental Assistance Demonstration (RAD) to allow the conversion of public housing subsidies on an equal-cost basis to long-term Section 8 contracts. The RAD effort drew in part on previous HUD, consultant and advocacy group proposals. By the end of 2016, RAD had leveraged almost $3.5 billion in Low-Income Housing Tax Credit (Tax Credit) equity and other sources. This number represents work in progress, covering about 31% of the number of units Congress has authorized for conversion. In addition to these initiatives, continuation of earlier initiatives including mixed-finance public housing, Capital Fund Financing Program (CFFP), energy performance contract (EPC) financing, Choice Neighborhoods as a successor to the HOPE VI program to replace severely distressed public and assisted housing, and replacement of several thousand public housing units with project-based vouchers (PBV) under non-RAD demolition and disposition procedures, contributed to the preservation or replacement effort.

The average annual appropriation for the public housing Capital Fund—still the basic source of capital funds for most of the public housing stock--was $2.03 billion apart from the stimulus funds or $2.53 billion including them, compared to $2.62 billion in the George W. Bush years and $2.83 billion in the Clinton years. Instead of RAD, public housing preservation or replacement was bolstered by new CFFP funds borrowed of approximately $2.5 billion in the Bush years. $6.7 billion in HOPE VI grants from 1993 to 2010 but sharply reduced after 2003 changed the image of public housing and bolstered surrounding communities by replacing the legendary worst, massive developments with mixed-income low-rises and vouchers. This possibly was a precondition for support of RAD's less photogenic but in some respects broader preservation effort. RAD will reach more units if allowed to play out, ends the renovated or replaced developments' reliance on falling annual public housing appropriations and sets aside capital replacement reserves to be drawn upon for future needs.

RAD Spotlight: Macon-Bibb County, Ga.

The legacy of the Obama years as to preservation or replacement of the public housing stock will depend significantly on the staying power and effectiveness of RAD, both as to the completion of conversions Congress already has authorized (a legacy now to be shared with the Trump administration) and going forward. The Obama administration deserves credit for the highly innovative and effective development and implementation of a new preservation option that already has allowed numerous public housing authorities (PHAs) to undertake comprehensive rehabilitation of their public housing stock that would not have been possible otherwise. HUD has used substantial discretion in RAD's administration to make preservation and replacement transactions work, and that has been important to RAD's early success.

2016 Developments and Current Status

Rental Assistance Demonstration

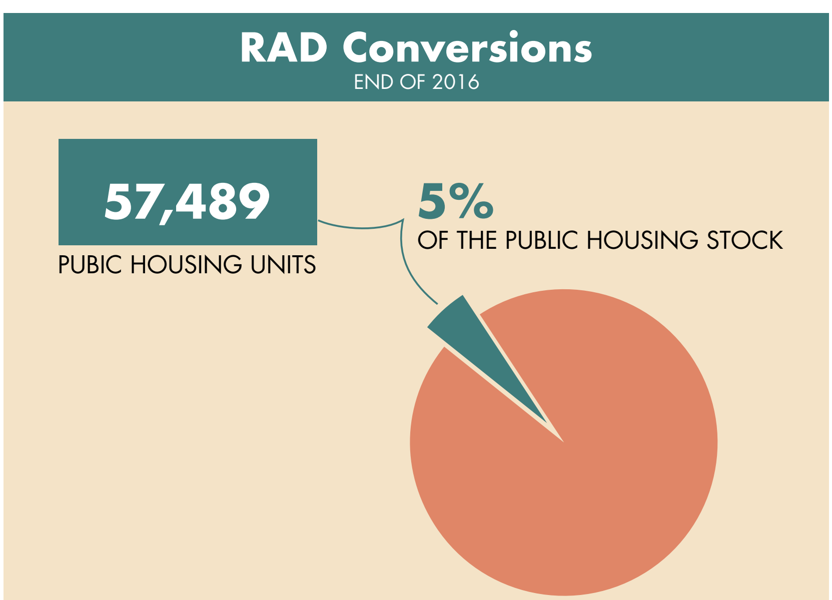
By the end of 2016, 57,489 public housing units had converted to RAD. This is an enormous achievement, but still represents only about 5 percent of the public housing stock.

HUD published a thorough interim evaluation of RAD that amplified and examined the details of this success. With respect to the critical question of RAD's ability to leverage outside resources, the evaluation found a leveraging ratio for non-PHA funding relative to PHA funding of 7.61:1 if PHA take-back financing, generally provided for sale of the public housing sites to entities that can benefit from Tax Credits with any repayments coming from excess cash flow, is not considered. The largest source of leveraged funds was Tax Credit equity, slightly over twice as large a source as first mortgage debt.

Although still operated as a demonstration with considerable flexibility, in some respects RAD has become more institutionalized. In November 2016, HUD issued an 80-page notice reiterating or adding detailed rules regarding relocation, fair housing and related matters. For the first time since RAD started, in a few instances PHAs were considering whether public housing mixed-finance would be the easier path to follow from a regulatory standpoint. Streamlining efforts are in order, both generally and particularly regarding small projects and small PHAs.

HUD acknowledged from the outset that given its no-additional-cost structure, RAD would not be able to support rents at high enough levels to leverage sufficient capital for high-needs developments absent another large-scale funding source such as 9 percent Tax Credits or a Choice Neighborhoods grant. The Obama Administration for several years asked Congress for additional funding to allow supplementation of RAD rents for high-priority projects that otherwise would not be feasible; again for 2017, neither house of Congress supported the proposal in their preliminary committee bills. The need for additional funding is likely to become greater, because some PHAs dedicated the local funds they had accumulated to support their highest-priority RAD conversions and now are tapped out of resources to contribute to additional transactions.

The administra-



tion also again asked Congress to repeal the cap on the number of RAD units, currently at 185,000 units. It would be beneficial to PHA capital planning if the cap were removed, so that PHAs could consider RAD a permanent alternative for preserving their housing and plan for RAD conversions of developments at the most opportune times (e.g., when they need recapitalization and funds can be leveraged to make the transactions work).

Additional emphasis on the fair housing and economic opportunity aspects of location of projects in minority and high-poverty areas, both initiated by the administration and resulting from a 2015 Supreme Court decision upholding discriminatory effect as opposed to intent as a basis for bringing a Fair Housing Act claim, *Inclusive Communities, Inc., v. Texas Department of Housing and Community Affairs*, brought more scrutiny to proposed RAD new construction on current public housing sites and the ability of RAD to produce off-site replacement housing. The straining to make many RAD projects feasible had the same effect for a different reason: if some RAD units could be placed off-site in a market where PBV-eligible rents are considerably higher than allowable RAD rents, a PHA could backfill on site with PBVs funded from its local voucher pool to close a financing gap without losing local housing subsidy units. But the ability to generate off-site units had some constraints in addition to lack of suitable available sites, including low RAD rents and the RAD statutory limitation to public or non-profit ownership unless new Tax Credits are involved. It would be reasonable to revisit this limitation as applicable to off-site replacement in the interest of facilitating additional off-site units, as long as the fundamental RAD requirement essentially for Section 8 contracts in perpetuity is locked in.

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Several of the 39 PHAs provided additional regulatory and funding flexibility under the Moving to Work (MTW) demonstration, including Cambridge (Mass.), Philadelphia, Orlando, San Bernardino and others, made RAD transactions work by supplementing RAD rents with annual voucher funding. HUD has limited this possibility to MTW agencies, but has RAD statutory authority to allow its use more broadly. Such broader use could be justified on a defined, limited basis (e.g., to provide gap financing that would secure substantial leveraging), with full consideration that the trade-off is less money available for issuing non-RAD vouchers.

PHAs such as San Francisco and Boulder made RAD transactions work by combining RAD units with units supported by non-RAD PBV. Cambridge and other PHAs have varied this approach by using RAD for developments where financially feasible and separately financing other developments with non-RAD PBV, so that in total their inventories can be renovated. PHAs only can undertake this approach and avoid losing subsidy units, however, if HUD awards them replacement "tenant protection" vouchers in connection with approved public housing demolition or disposition applications. HUD's grounds for such approvals have been limited since HUD narrowed them in a 2012 notice unrealistically based on a claim that PHAs generally have alternative resources for preservation. Use of this mechanism also could be limited in the future if the level of appropriations for tenant protection vouchers, which has been adequate to support approved applications, becomes inadequate.

HOTMA and Project-Based Vouchers

The year 2016 saw passage of the first free-standing housing programs authorizing legislation since the Housing Quality and Work Responsibility Act of 1998: the Housing Opportunity Through Modernization Act of

2016 (HOTMA). HOTMA contains important PBV provisions that will enable PBVs' broader and more effective use, including in conjunction with public housing redevelopment with or without a RAD component. Provisions that could facilitate redevelopment include exemption from the 20 percent cap on use of voucher assistance for PBVs attached to units formerly receiving long-term federal housing subsidies or to units replacing such units, which will enable a PHA to use PBVs for these efforts without running into the cap and having to forego important project-basing elsewhere; increasing the cap for some categories including projects serving the homeless and in areas where tenant-based vouchers are difficult to use; and elimination of the competition requirement for awarding PBVs for improvement or replacement of a public housing site where the PHA has an ownership interest. What HOTMA could not do is produce additional resources for the PBVs, and thus the level of appropriations for tenant protection vouchers and vouchers more generally is key to the successful use of these HOTMA provisions.

In late 2016, HUD in some respects overhauled the voucher program by requiring fair market rents to be set on a zip-code rather than metropolitan-wide basis in 24 metropolitan areas. After concerns were expressed that resulting reduced rents would make PBV projects infeasible in some revitalizing but still relatively low-rent inner-city areas, HUD made application of this "Small-Area FMRs" initiative voluntary as to use of PBV in areas otherwise required to participate.

Mixed-Finance, CFFP, EPCs, Choice Neighborhoods

These initiatives continued during 2016, but the first three depend on reasonable public housing appropriations levels and continued participation of units in the public housing program. Thus, their use is affected by poor public housing appropriations prospects and the availability of RAD. All but one CFFP financing involved the refunding of outstanding bonds or loans on more advantageous terms rather than solely new funding. Choice Neighborhoods' limited appropriations resulted in only four new public housing-related grants.

The New Landscape

Spending

Implementation of the President's proposed slashing of domestic discretionary funds to support a defense build-up could stop progress and accelerate public housing's deterioration. If Congress were to cut $2 billion of $6.4 billion in annual public housing funding as was proposed in the administration's internal budget discussions and to sustain that reduced funding level, this would happen. Such cuts would cripple RAD by forcing reductions in RAD rents for future transactions to adhere to RAD's no-cost requirement for conversions from public housing to Section 8, thus rendering transactions infeasible. The President's budget also proposes to zero out other programs, notably including the community development block grant and HOME funding, that have been important sources for gap funding that already is often needed to make RAD transactions feasible; these programs would be needed even more if tax changes cause Tax Credits to be a less powerful revitalization tool.

Taxes

A tax overhaul has not occurred since the Bush tax cuts fifteen years ago or, with respect to more fundamental

Affordable housing advocates have been quick to jump in and say that affordable housing is infrastructure and that any large-scale initiative must include investments such as in public housing capital improvements that also will be an effective engine for creating jobs.

structural changes, forty years ago. Nevertheless, this looks like a possibility now, with a cut in corporate taxes a major focus. There are important potential cross-currents for public housing investments. RAD and other public housing investments have been heavily dependent on Tax Credits, which in turn have been a target of some tax reform proposals that brand Tax Credits as inefficient tax expenditures. While 4 percent Tax Credits have become much more important as PHAs have combined them with RAD to accomplish rehabilitation, the tax overhaul proposed by the Chairman of the House Ways and Means Committee in 2013 called for elimination of 4 percent Tax Credits. On the other hand, a bipartisan bill to improve and expand Tax Credits already has been introduced by Senate Finance Committee chairman Hatch (R-UT) and taxation subcommittee member Cantwell (D-WA), and a companion House bill has been introduced.

A substantial corporate tax cut would lower the value of Tax Credits to corporate taxpayers, whose potential tax liability to be off-set by Tax Credits would drop. Just the discussion of this change has compromised the Tax Credit market. Some PHAs already are estimating or seeing10-15 percent drops in Tax Credit yields, more contingencies, delays in investor commitments or lack of investor interest, in view of the uncertainty of Congressional action. If corporate tax rates are to be cut, at minimum Congress should strengthen Tax Credits to counteract the cut. A tax overhaul also may involve trimming and revamping of the government's largest housing subsidy, the mortgage interest deduction. The National Low-Income Housing Coalition is leading a "United for Homes" campaign to direct a significant portion of any savings to low-income housing.

Infrastructure

While senior administration officials have advocated for a $1 trillion investment in infrastructure, the priority for this proposal is unclear. The proposal mostly has been expressed as large new tax credits for investments in bridges, roads and possibly public utilities such as water works, which could pay for themselves in user fees. Affordable housing advocates have been quick to jump in and say that affordable housing is infrastructure and that any large-scale initiative must include investments such as in public housing capital improvements that also will be an effective engine for creating jobs. New HUD Secretary Ben Carson has reiterated that housing is infrastructure. Leading Senate Democrats have proposed to include public housing preservation among the potential uses of $100 billion in a "Revitalizing America's Main Streets" portion of their $1 trillion infrastructure appropriations proposal.

The job creation argument helped produce inclusion of $4 billion in public housing Capital Funds in the stimulus package in 2009, but whether the Administration and Congress will view infrastructure this broadly and be willing to increase direct appropriations for it remains to be seen. At minimum, the emphasis on infrastructure should bolster the argument to retain and strengthen Tax Credits.

Time Limits, Work Requirements, Block Grants, Deregulation

The House Republican leadership's "A Better Way to Fight Poverty" proposed overhaul of the safety net includes a matching of time limits on assistance for housing programs to the welfare program changes enacted in 1996, as well as measures to assure that assisted families other than senior or disabled persons are working or in educational programs. Such changes obviously would alter who receives housing assistance over time and how they are treated, but not funding for or interest in public housing invest-

Preservation and replacement basic proposals

- Responsible public housing operating funding
- Increased public housing capital funding (infrastructure bill to augment annual appropriations?)
- Tax credit expansion (more than counteract any corporate tax cut; include 4 percent credits)
- Eliminate RAD unit cap (and HUD streamline processing)
- Retain gap funding sources

Flexibility to make high-priority proposals feasible

- Facilitate combination RAD/non-RAD project-based voucher combinations (modify public housing disposition test)
- Allow voucher funds to supplement RAD for non-MTW PHAs in high-leveraging transactions
- Allow off-site private ownership of RAD replacement units to facilitate on-site revitalization, subject to ongoing RAD low-income housing use restrictions

ments unless such changes cause increased federal funding support (a plausible idea in theory, but with no history to cite that suggests this would occur).

While previous Republican administrations proposed block granting of the voucher program to the states and this Republican leadership has supported more local flexibility, this Congress' proposal now may be a further expansion of the MTW program that already is authorized to expand by up to 100 small- and medium-sized PHAs by the 2016 HUD appropriations act. The additional flexibility provided to MTW agencies has allowed them to augment public and affordable housing investments through measures such as providing gap funding or loan guarantees to make transactions feasible, although such measures mostly will not be possible for MTW agencies to pursue if there are severe funding cuts.

Making our Best Case

Under RAD and through other initiatives, efforts to improve and where appropriate replace public housing in recent years have had some inspiring successes. This has been a team effort, unique community by community, led often by PHAs in partnership with their residents but also by cities, states and private non-profit and for-profit developers and with vital contributions from lenders and investors. A broad coalition must emphasize these local successes, including the full role of indispensable partners and the benefits not just of housing but of resident health and advancement, jobs and community revitalization. The enormous needs must continue to be highlighted and the impact of harmful proposals loudly made clear. The discussion should be about the best means of comprehensively, efficiently and effectively preserving or replacing this valuable resource. ■

RAD Spotlight: Proposed mid-rise building in Elgin, Ill.