BY ROD SOLOMON

This annual report has wrestled with one question for each of its dozen years: how the 1.1-million unit public housing stock can be sustained or replaced as a low-income housing resource, despite woefully inadequate public housing funding. The grim prospects for adequate direct funding are clear in the preliminary appropriations decisions for fiscal year 2016. The Senate Appropriations Committee proposes a 1980s-level $1.74 billion for the Capital Fund, a $131 million cut from last year and over $1.5 billion short of estimated new annual capital (accrual) needs without even addressing a $26 billion needs backlog, and a public housing Operating Fund appropriation sufficient to fund 84 percent of what HUD's cost formula says a well-managed public housing authority (PHA) needs. The House numbers are worse. Given these prospects, this article largely discusses alternatives to dependence on public housing appropriations.

The Rental Assistance Demonstration Program

Despite the dismal appropriations picture, HUD has been able

JOURNAL OF
Housing & Community Development

Published by National Association of Housing and Redevelopment Officials Washington, D.C.

PUBLISHER/CEO
Saul N. Ramirez, Jr.

EDITOR
Sylvia Gimenez

ASSISTANT EDITOR
Carmen Smith

DESIGN & PRODUCTION
Wilson-Pirk Advertising Inc.
Washington, DC 20016
202.425.4697

ADVERTISING REPRESENTATIVE
The Townsend Group, Inc.
2 Wisconsin Circle, Suite 900
Chevy Chase, MD 20815
301.215.6710
Fax: 301.215.7704

NAHRO HEADQUARTERS
630 Eye Street, N.W.
Washington, DC 20001-3736
202.289.3500
Toll Free: 877.866.2476
Fax: 202.289.8181
Web site: www.nahro.org
E-mail: nahro@nahro.org

All manuscripts and editorial information should be sent to the Journal of Housing & Community Development, NAHRO, 630 Eye Street, N.W., Washington, DC 20001-3736. Publication in Journal of Housing & Community Development does not constitute an endorsement of any product, service, or material referred to, nor does the publication of an advertisement represent an endorsement by the NAHRO Officials or the Journal of Housing & Community Development. All articles represent the viewpoints of the authors and are not necessarily those of the magazine or publisher. Letters to the editor will be published at the discretion of the editor.

Copies of the Journal of Housing & Community Development are available in 16mm microfilm, 35mm microfilm, 105mm microfiche, and issue and article copies through University of Microfilms International (UMI), 300 North Zeeb Road, Ann Arbor, MI 48106-1346, 313/761-4700.

Journal of Housing & Community Development (ISSN 1534-648X) is published bi-monthly (January, March, May, July, September, and November, with Buyer's Guide published in May) by the National Association of Housing and Redevelopment Officials, 630 Eye Street, N.W., Washington, DC 20001-3736. The annual subscription cost for members of NAHRO is $25, which is included in membership dues. Nonmember subscription: $45 per year. Single copy: $7.50. Periodicals postage paid at Washington, D.C., and additional mailing offices.

POSTMASTER: Send address corrections or changes to the Journal of Housing & Community Development, NAHRO, 630 Eye Street, N.W., Washington, DC 20001-3736.

to launch the Rental Assistance Demonstration (RAD) to allow for conversion of public housing subsidies to project-based Section 8. RAD's requirement for initial budget neutrality—i.e., that subsidy not increase as a result of conversion—enabled Congressional enactment despite the budget meltdown. Its reliance on Section 8 contracts as a more stable budget platform than annual public housing appropriations is proving very effective for leveraging funds.

> How can the 1.1-million unit public housing stock be sustained or replaced as a low-income housing resource, despite woefully inadequate public housing funding?

RAD contains characteristics considered important by diverse elements of the political spectrum: protection of current residents, required one-for-one replacement of public housing units and restriction of the properties to low-income housing essentially for as long as Congress appropriates the subsidies (emphasized by resident advocates); substantial private-sector participation and cost-neutrality (emphasized by conservatives); administrative deregulation and the ability to choose between conversion to the project-based voucher program administered by PHAs or to the project-based rental assistance program administered by HUD contract administrators (emphasized by PHAs); and a "choice-mobility" element providing for resident priority to move with a tenant-based voucher (emphasized by fair housing advocates and HUD).

But RAD's budget neutrality requirement links its success to public housing appropriations. The requirement already disqualifies a substantial portion of public housing sites. If public housing appropriations are cut further, the math of RAD conversion will work for fewer public housing developments.

HUD addressed this issue initially by setting allowable RAD contract rents based on a grandfathered 2012 appropriations level, rather than on the lower 2013 sequestration year. That strategy, however, only could work once. Moreover, RAD depends in significant part on capital gap funding to make Low-Income Housing Tax Credit (LIHTC) transactions work. Thus, actions such as cuts to HOME program or National Housing Trust Fund resources would eliminate some future RAD transactions.

RAD: Roll-out, Expansion and Growing Pains

HUD's initial roll-out of RAD was outstanding in several respects. These included a comprehensive explanatory and regulatory notice, on-line information allowing PHAs to preliminarily assess RAD's feasibility for individual public housing developments, easy on-line applications to participate, and concentrated technical assistance and outreach. HUD also encouraged an onslaught of applications by its well-publicized

Largest Total Closed RAD Transactions by PHA and Total Construction Costs (as of mid-November 2015)

PHA	Construction Costs (in millions)
San Francisco	395
El Paso	113
Cambridge (Mass.)	93
DeKalb County (Ga.)	65
Montgomery County (Md.)	45
Boulder Housing Partners (Co.)	32
Ann Arbor (Mich.)	29
Baltimore	28
New Haven	26
Fresno County	24
Fort Worth	21
Maricopa County	21
City of Fresno	21

*Source: HUD Office of Recapitalization.

Includes RAD and non-RAD units.

San Francisco's closings on 11/20/15 added $94 million not included above.

decision to allow applications submitted in 2013 to obtain higher RAD rents based on 2012 public housing funding levels. That, coupled with initial RAD success stories and effective lobbying, led Congress to increase the cap on participating public housing units from 60,000 to 185,000 units in December 2014.

A by-product of these actions is a project-by-project processing challenge of a magnitude that HUD rarely has faced. As of mid-November 2015, RAD applications had been submitted for over 190,000 units. The conversion process had been completed for approximately 22,000 units, leaving over 15 percent of the public housing stock somewhere in the conversion process.

HUD issued a revised implementing notice in June 2015 that acknowledged this challenge by eliminating interim required milestones for converting projects, but added up-front fair housing-related reviews, new relocation constraints and other requirements. Governmental actions are always subject to various cross-currents, and here the Supreme Court case bolstering HUD's fair housing efforts and follow-up HUD regulations have led to more focused attention on that aspect of RAD transactions involving new construction or new sites. HUD must address these concerns in an already-taxed individual project review and closing structure, while meeting processing imperatives including tight deadlines on use of 9 percent LIHTCs.

RAD: Early Success and Evaluation Issues

RAD's most basic purpose is to provide an additional means of leveraging capital funds, and the initial leveraging is impressive. As of mid-November 2015, the demonstration had reached over $1.4 billion in construction activity for the closed transactions.

A secret weapon of RAD has been 4 percent LIHTCs. While the award of 9 percent LIHTCs is highly competitive in most states, 4 percent LIHTCs widely are under-subscribed. This has occurred in part because the 4 percent LIHTCs provide a relatively thin subsidy given the income limitations for the households that must be served and the law requires their use with tax-exempt lending—thus their use has somewhat limited applicability and carries high transaction costs. But when used in conjunction with Section 8, the subsidy reach of the 4 percent LIHTCs is not a problem. In addition, the reach of these LIHTCs is increased for rehabilitation projects because their value is based partly on investors' cost of acquiring the existing public housing units from the PHA, and this cost based on appraised value of the units can be very high in high-cost cities. As a result, a substantial number of closed or proposed large-portfolio transactions depend on 4 percent LIHTCs—for high-cost areas including San Francisco, Cambridge (Mass.), Cook County (Ill.), Baltimore (Md.), and potentially the District of Columbia, as well as relatively lower-cost El Paso (Tex.), potentially Mobile (Ala.) and others. Leveraging from the use of 4 percent LIHTCs exceeded $700 million in closed transactions by mid-November 2015.

One of the most exciting of the portfolio transactions is in San Francisco, where the city is contributing substantial funds to a collaborative effort with the San Francisco Housing Authority and private owners to accomplish a 3,464-unit conversion including over $700 million in rehabilitation costs. Because of San Francisco's high costs, this effort requires a combination of RAD and tenant-protection vouchers resulting from the disposition of eight large sites that will be project-based, as well as the City funding and 4 percent LIHTCs.

Another interesting portfolio approach funded with both RAD and supplemental funds is in high-cost Cambridge, where this 2,130-unit transaction including approximately $260 million in rehabilitation costs is made possible with Moving to Work (MtW) funds and 4 percent LIHTC equity in addition to the RAD funding. The RAD statute is flexible enough that HUD could allow non-MtW PHAs to use voucher funding in a similar supplemental manner, if circumstances warrant. To accomplish virtually full conversion to Section 8 of its public housing, Cambridge left its highest rehabilitation-cost development out of the RAD portfolio and instead will address that development's needs through disposition and higher-subsidy project-based vouchers.

The RAD statute appropriately calls for a substantial evaluation effort, and the first report was published for the period ending September 30, 2014.[1] This report concludes that "...[p]ublic housing funds represent approximately 5 percent of total capital funding proposed for these RAD projects, with a corresponding leveraging ration of more than 19:1." While RAD's initial performance is far beyond most expectations, this figure exaggerates leveraging because the commitments of appropriations equivalent to annual public housing capital funds to pay a portion of RAD rents are not taken into account.

The evaluation of RAD leveraging needs to be sophisticated, including projected comparisons with the results of using other available mechanisms like the Capital Fund Financing Program to raise capital by borrowing against future Capital Fund appropriations (CFFP), energy performance contracting to finance energy-conserving improvements by borrowing against operating subsidy made available by projected energy cost savings that HUD would allow PHAs to retain (EPC), or mixed-finance transactions typically combining public housing

1 Status of HUD's Rental Assistance Demonstration (RAD) Evaluation and Results to Date," prepared for HUD by Econometrica, Inc.

funds with LIHTCs and possibly other funding sources. Possible spillover effects on use of those mechanisms also need to be considered, so that RAD's net impact is clearer.

It is not too early to consider issues regarding the recapitalization of RAD sites that will be needed in 15-20 years. One of RAD's program strengths is that it is building in capital replacement reserves, which the public housing program has not done, except in mixed-finance transactions. But in keeping with its no-new-cost concern, RAD's annual rent escalation is limited to adjustments for operating cost increases; there is not a "mark up to market" mechanism. The properties will be restricted to low-income use and should be considerably better off than if they had remained public housing, but the financial robustness of the RAD structure nevertheless will need timely reviews.

RAD Policy Proposals

The Administration's fiscal 2016 budget proposes $10 million to supplement RAD rents and thus make more projects feasible and to eliminate the unit cap. The $10 million could result in substantial leveraging of other funds for public housing preservation or replacement. While HUD more than has its hands full under the current cap, the cap largely freezes the universe of proposals and thus limits consideration of important preservation options for some PHAs. Some in Congress remain concerned regarding loss of low-income housing and public control of the units under RAD. The RAD law aims to protect against loss of units even in foreclosure, by requiring use of the sites as low-income housing to continue.

The continued availability of 4 percent LIHTCs is fundamental to RAD's success. The former Chairman of the Ways & Means Committee's 2014 comprehensive tax reform proposal eliminates 4 percent LIHTCs. Their elimination would limit RAD substantially.

Other Public Housing Initiatives: CFFP, EPC and More

What about the 85 percent of the public housing stock that is not converting to RAD, at least so far?

Since 2000, the Capital Fund Financing Program (CFFP) has resulted in HUD-approved proposals for accelerating the availability of over $4.5 billion in capital, but new activity has slowed in view of reduced appropriations to commit, greater future appropriations risk and the availability of RAD. HUD listed $38.8 million in approvals for calendar year 2014 and $23 million for calendar year 2015 through August, of which several were refinancings of earlier borrowings. In addition, some PHAs were prepaying current borrowings, so that they would be free to undertake RAD transactions or simply would have more annual capital funds available to meet ongoing needs. Since the summer of 2014, such transactions have been undertaken at least by the Baltimore, Philadelphia and Cook County, Ill. PHAs, and some other large or medium-sized PHAs (including the District of Columbia, Orlando, Fla. and Mobile, Ala. PHAs) are considering this. Additional PHAs, such as Philadelphia and four Maryland PHAs, are considering refinancing transactions of current bond issues to take advantage of reduced interest rates.

With respect to Energy Performance Contracts (EPCs), the total project cost amount for approvals from July 1, 2014 to June 30, 2015 was approximately $120 million. About 45 percent of this amount was for one PHA, Birmingham (Ala.). The total is up from about $85 million for the previous year, but down from some earlier time periods unaffected by RAD.

The volume of public housing mixed-finance transactions has decreased considerably in view of the availability of RAD (expected to be a better future appropriations alternative) and the drying up of HOPE VI funds that drove many of these transactions by providing much of the needed capital resource. The total development costs for approved mixed-finance transactions has fallen from roughly $1 billion in federal fiscal year 2012 to $821 million in federal fiscal year 2014 and $642 million for most of fiscal year 2015. Both the total number of units and of public housing units involved also have

Public Housing Mixed-Finance Approvals

	Public Housing	Total Units	Total $
FY12	2708	4910	$1,004,806,244
FY13	1708	3686	$961,189,380
FY14	1184	2806	$820,901,311
FY15	953	2371	$642,754,162

*Source: derived from HUD Office of Public Housing Investments data.

fallen. While the number of units involved each year is just a few thousand, these are highly leveraged federal investments that are designed to have fundamental neighborhood impacts. Given the minimal proposed appropriations levels for Choice Neighborhoods, HOPE VI's successor program, that program is not going to reverse this picture despite its great leveraging record thus far.

One of the important additional funding sources has been the flexibility of the MtW program that allows PHAs to use non-public housing funds (typically voucher funds) to supplement public housing resources. Several very large PHAs (including Atlanta, Baltimore, the District of Columbia, Philadelphia and Seattle) have kept public housing conditions tolerable or fueled replacement efforts by using MtW resources. While there have been spend-down issues in some localities, related in part to the timing of replacement housing initiatives, these investments have been crucial. Recognizing the trade-off with issuance of vouchers, however, HUD has proposed to reduce MtW agencies' funding flexibility when their current 10-year agreements are extended.

The New York City Housing Authority (NYCHA), which owns and administers more than 15 percent of the nation's public housing, is in its worst-ever financial position—a $2.5 billion cumulative projected operating deficit over 10 years and nearly $17 billion in self-reported unmet capital needs for major infrastructure repairs. NYCHA has recognized that the regular public housing funding process will not address these needs and has turned elsewhere. Proposed actions include infill mixed-income housing development, conversion of scattered-sites to Section 8, cost-cutting measures and a proposed EPC of at least $100 million. In March 2015, NYCHA received an unprecedented $3 billion from the Federal Emergency Management Agency to repair and protect 33 developments damaged by Hurricane Sandy, with half of the funds designated for repairs and half to implement resiliency measures to provide better protection from future disasters.

Since 2000, the Capital Fund Financing Program (CFFP) has resulted in HUD-approved proposals for accelerating the availability of over $4.5 billion in capital, but new activity has slowed.

Some other large PHAs that do not expect to be rescued from the funding crunch by RAD also have begun to seek innovative solutions. The Boston Housing Authority put out a series of requests for proposals seeking to take advantage of the potential for conversion to mixed-income developments in some locations or other possibilities such as private-sector development of ancillary land. The goal is to leverage capital to enable the preservation or replacement of the current low-income units.

The proposed Senate appropriations act contains several new mechanisms to support PHAs' capital efforts, including ability for PHAs to accumulate replacement reserves, more flexibility to use operating funding for capital needs and a demonstration program to allow PHAs to keep operating savings from utility conservation investments, irrespective of whether these investments are made with third-party financing through the EPC mechanism. The first two undoubtedly would help some PHAs and may facilitate local ingenuity in ways not yet imagined, although it is still fair to ask "with what money" given enormous overall unfunded needs. The demonstration utility conservation program would provide PHAs some ability to make investments that could yield additional future operating resources.

Moving the Ball Forward

Given RAD's promise, the Administration is rightly devoting the attention needed to address the processing challenge. Enactment of the Administration's RAD budget proposals would assist further. We must do what we can to protect complementary programs including HOME and 4 percent LIHTCs. Given RAD's fiscal limitations and thus limited feasibility on its own, we also most push harder to be creative with potential complementary funding sources including project-basing of replacement vouchers.

The effort cannot be all about RAD and thus still a relatively small fraction of the public housing stock. We must keep fighting for more reasonable program funding, and seize both local and national opportunities, to improve or replace this housing and facilitate progress for its residents. ■

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