The Collaborative Q&A—Accelerating Public Housing Conversions to the Section 8 Platform

The *RAD Collaborative* ***(RC)*** recently framed proposals [recommendations for converting all public housing to Section 8] culled from practitioner ideas for accelerating the conversion of the public and assisted housing stock to the Section 8 platform. In this conversation with public housing and industry leaders we discuss how the balance of public housing inventory could be converted at an accelerated pace in the coming years with modest HUD policy changes and Congressional support.

The ***RC*** asked Jeff Patterson ***(JP),*** CEO of the Cuyahoga Metropolitan Housing Authority, Tony Perez ***(TP)***, Secretary-Executive Director of the Housing Authority of the City of Milwaukee, Rob Hazelton ***(RH)***, President & CEO of Dominion Due Diligence/D3 and Steve Holmquist ***(SH)***, Member, Reno & Cavanaugh—each of whom with considerable experience in using RAD, Section 18 Demo/Dispo, LIHTCs, FHA insurance and other resources—for their thoughts on how to deploy these tools in new and varied ways to achieve this goal.

RC: *One proposal to expedite the redevelopment of the oldest public housing properties is for HUD to declare that properties built, say, prior to 1970, as de facto obsolete, and award Tenant Protection Vouchers (TPVs) needed to redevelop them in a simple application. No cumbersome determination of physical or functional obsolescence or separate TPV application needed; just a solid plan for redeveloping these sites in a timely fashion.*

Jeff, you've had considerable experience with HOPE VI and RAD over the years in converting about 25% of your 10,436-unit public housing portfolio to date. How could this proposal expedite your remaining repositioning work in Cleveland?

JP: The idea of 'de facto obsolescence' is an interesting one. This could help us in two important ways. First, this would certainly ease the planning burden on housing authorities. Each section 18 application takes a lot of time and money to produce the required documentation for a physical obsolescence determination by HUD's Special Application Center (SAC). Yet in many cases the obsolescence verdict is fairly obvious to all—especially the residents. The real challenge is planning what can best be done with obsolete developments and putting together the resources to accomplish that.

This is where the second big benefit comes in—flexibility. Declaring obsolescence at the outset would provide considerable flexibility in planning how to transform our entire portfolio so that we could then execute the plan in a realistic sequence. For example, it would inspire a lot more confidence among residents living in our oldest, most outdated properties today—and we have many that were built prior to 1945!—that yes, we all agree that your property needs to be replaced and we are planning accordingly. With all properties declared obsolescent today, we could devise a much more believable near-and mid-term plan. We could begin work on multiple sites at once. We could more readily build first at sites with available land, demolish part of another site with problem buildings, relocate

interested residents, and show more activity across sites. It would also send a signal to the real estate market that CMHA now controls all of these properties—not HUD—and could readily respond to financing opportunities and larger neighborhood redevelopment plans. Land banking sites that have low market values today would also enable us to dispose of that land in the future when values may rise substantially.

RC: *Tony, can you tell us about your conversion efforts—and how a simple obsolescence declaration for your older, remaining properties could help you finish your work?*

Since 2016, HACM has converted roughly 30% of our conventional public housing to RAD PBV involving 1,068 units in 15 transactions. We've completed no-debt conversions for properties recently improved with tax credits; new construction supported by a Choice Neighborhoods Implementation grant; and in-place rehabilitation of several senior and disabled high rises. We've done about all we can via RAD. The remaining 1,950 units in our portfolio are 65 years old on average and require $150 million for just basic rehab without any major improvements. They are effectively obsolete. We can't substantially rehab or replace them to market standards that fit surrounding neighborhood contexts without fair market rents, especially if we have to compete with a Section 8 or tax credit property in the same area. Plus, getting property-by-property obsolescence determinations is time consuming, costly and inefficient. Similar to CMHA, if we could get a blanket obsolescence determination for our oldest properties, we could better plan a continuous redevelopment program. We could more readily access needed financial resources when the time was right, not when a next Section 18 approval came through.

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RC: *Rob, in addition to CMHA and HACM, you've recently helped dozens of PHAs undertake Section 18-required physical obsolescence studies for properties that are 50, 60, even 70 years old. What's the case for a new policy that just declares these properties obsolete?*

RH: Properties in excess of 45-50 years of age almost always get approval for demo. We have physical obsolescence data from our work with PHAs that support this. Why? They were constructed to an earlier standard, which has been superseded by 6 to 7 updates to building codes. We've seen dramatic changes to mechanical, electric, plumbing and energy standards over five decades.

A policy that declares pre-1970 buildings physically or functionally obsolete simply recognizes reality. Plus, if we consider the harsh impacts of the coronavirus on seniors, it's prudent to also consider the functional obsolescence of senior buildings. Many of them were designed according to now outdated least-cost vertical building standards that often pack 150+ seniors in high-rises served by two small elevators. That's a serious functional problem today. These older buildings are obsolete, period, regardless of how we choose to characterize it. So there's no reason a PHA should have to spend approximately $20,000 per Section 18 submission to prove this.

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RC: Steve, when you were at HUD and since, you've had a hand in shaping the Section 18 statute and regs. Presumably, since HUD has changed Section 18 criteria and requirements over the years, can we assume it has the statutory authority and regulatory ability to declare 50-year old properties automatically obsolete and award them TPVs? Or would HUD need help from Congress to do this?

SH: Some context is important here. In response to mounting capital backlogs, Congress added in 1998 Section 18 to the Housing Act of 1937, allowing PHAs either to demolish or dispose of public housing as they thought best, provided they met certain criteria. If you look back at the statute itself, HUD has considerable discretion to determine when a property is suitable for demolition or disposition. As for demolition, the statute talks about a project being "obsolete as to physical condition, location, or other factors", which is very broad and gives HUD a lot of leeway to make a determination of obsolescence. Yet HUD's current regulations and guidance are more restrictive and require a very detailed analysis of replacement costs, even when there are obvious indicators that a property no longer provides adequate housing, especially where there are original design flaws.

HUD could easily waive these non-statutory requirements to declare projects to be obsolete based on age or other factors. Further, as to disposition authority, for a number of years HUD has chosen to apply an obsolescence test even though the statute doesn't require it. In fact, the statute says, basically, that HUD can permit disposition of a property, and therefore the conversion of it from public housing to Section 8, if it's in the "best interests" of the residents and the PHA. So, HUD could do this on its own, although it would help for Congress to affirm this policy. The other thing Congress could and should do is to also affirm the automatic award of TPVs when a demo-dispo determination is made, rather than requiring a subsequent additional application for them. This would both allay concerns of residents and stakeholders about possibly losing subsidies and assure PHAs that the TPVs will be there for financing purposes when needed. This is especially important as we expect the demand for TPVs in the future to increase significantly.

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RC: *In the last few years, the SAC and the Recap Office have creatively worked together to complement Section 18 and RAD authorities by introducing the so-called RAD 75/25 blend and the "last 50" disposition policy to support more costly projects and portfolio repositioning. Based on some earlier waivers and recent requests, it seems a next logical step would be to allow PHAs to blend RAD and Section 18 generated TPVs in flexible proportions—perhaps requesting more TPVs for properties that are truly at risk of being lost from the inventory while agreeing to maximize RAD as feasible for other properties.*

Tony, can you describe how you might use such flexibility to help complete conversions in Milwaukee?

TP: Flexibilities to have more financing choices related to the RAD 75/25 would be of great assistance to our portfolio. A good example of HACM's ability to immediately use flexibility would be on our Mitchell Court site. The development is 100 unit midrise with a preference for elderly and disabled targeted for preservation. Under the 75/25 mix, the deal is not financially feasible. If we had the flexibility to increase the mix to 50/50 we could leverage the 15% increase in TPV rents to source an additional $750,000 in debt. With this increase debt the deal becomes a viable option without 9% LIHTCs to protect the affordability of our most at-risk population.

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RC: *The Recap Office has increasingly made undertaking large RAD portfolio conversions more practical recognizing the need for careful planning, building development teams, assembling financing, etc., which can play out over several years. Jeff and Tony, you've both opted to lock in strong RAD rents for well-planned, multi-year portfolio conversion approaches. It seems more PHAs would be doing the same. What are you hearing from colleagues about why they're not—and how to address their concerns?*

JP: The most common reason that I hear from colleagues for not pursuing a RAD portfolio conversion is that they believe that they don't have the staff and financial resources to convert all of their properties. To that point, we faced a steep learning curve as housing professionals with a skill set focused on conventional public housing that suddenly came to grips with why and how we would change that program to RAD PBRA or PBV. That includes significant operational change in shifting subsidy systems to a Section 8-based platform.

Yet we found RAD to be a great vehicle to recapitalize and stabilize and properties so that they are financially viable for the long term. Our first RAD deal took a $2 million capital investment on our end, which in turn allowed us to leverage more than $20 million in capital improvements for a 267-unit tower. A 10:1 leverage ratio goes a long way in addressing the capital backlog for public housing.

Going through the complexities of one or two full recapitalizations with debt and tax credits while converting the balance of a portfolio to the Section 8 platform is a good way to learn how it all works—including the systems, reporting and asset management changes. Making the program permanent allows housing authorities to build capacity and maximize financial leverage according to a multi-year plan. That's what we're doing across our 10,000-unit inventory.

TP: The complexity of conversion and development often creates fear of the unknown for agencies that have not completed HOPE VI or tax credit investments. A portfolio conversion requires in-depth communication and planning with stakeholders, including residents, staff, board members and local elected officials. Resistance and questions often arise around the program still being a demonstration. If Congress would move to make the program permanent it would show more strength as a repositioning option and allow PHAs more time to plan and implement at a pace that meets local needs.

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RC: *Steve and Rob, maybe you can address this issue, which we hear a fair amount about: It's great that HUD is making Section 18 increasingly flexible, offering RAD blends with TPVs and other options to help with repositioning. But project-basing Section 18-generated TPVs has a set of requirements and one form of a PBV contract—and any RAD PBVs used in tandem have different requirements—and a different form of contract. This causes a lot of long-term headaches for PHAs that must navigate different requirements and then administer two contracts—often in a single project. What can be done to somehow integrate the different requirements and ideally get to a single form of PBV contract?*

SH: The key step here is for HUD to continue aligning RAD PBV and standard PBV program requirements where that will ease program implementation, which it's started to do recently. Many additional PBV provisions available under RAD seem reasonable to extend to Section 18-generated TPVs when PHAs project-base them in converting and improving conventional public housing. Allowing rental assistance payments during the rehab process and delaying the period units must meet HQS to the completion of rehab, for example, would be particularly helpful. As public housing conversions evolve to the point where RAD, Section 18 with TPVs, voluntary conversion, and other tools may be involved in a single project, or different phases of the same project, a good discussion about a common set of requirements would help meld them in practice. From there, HUD has clear authority to change the form of a HAP contract through a standard OMB review and approval process. So the contract form best follows getting to common requirements.

RH: As Steve says, these are not statutory issues, but more about aligning RAD and varied PBV and Section 18 practices. RAD has established strong tenant protections and aligned its procedures to established industry practices. Why not just extend RAD-tested PBV requirements to all blended and Section 18 projects, which HUD started to do in the blends introduced to date? We might also suggest in the current 75/25 blends that HUD use the Multifamily Substantial Rehabilitation definition as the construction threshold instead of the 60% of Housing Construction Cost. The HCC standard typically results in costs above $80,000/unit and not reachable without 9% LIHTCs, which defeats the original policy intent of reducing 9% LIHTC demand.

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RC: *Thanks to all of you. These are some great "next-gen" ideas on using RAD and Section 18 to expedite the conversion and repositioning of the public housing in the near term. There's likely to be much more discussion on this ahead!*