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AVENUES
TO AFFORDABILITY

FEATURE

REBOOT

Rental Assistance Demonstration ("RAD") was authorized by the Consolidated and Further Continuing Appropriations Act of 2012 (Public Law 112-55, approved November 18, 2011). The second component of RAD received additional authorization by the Consolidated Appropriations Act of 2014 (Public Law 113-76, approved January 17, 2014), which provided fiscal year 2014 appropriations for HUD (2014 Appropriations Act). The first component allows projects funded under the public housing and Section 8 Moderate Rehabilitation (Mod Rehab) programs to convert their assistance to long-term, project-based Section 8 rental assistance contracts. The second component allows owners of projects funded under the Rent Supplement (Rent Supplement), Rental Assistance Payment (RAP), and Mod Rehab programs to convert tenant protection vouchers (TPVs) to PBVs, upon contract expiration or, for owners of Rent Supplement and RAP projects, termination, occurring after October 1, 2006, and no later than December 31, 2014 .

BY CARLOS E. GUICE, SR.
C. RAY BAKER & ASSOCIATES, INC.

During a recent trip to Washington, D.C., I had dinner with my son. During our dinner conversation, he taught me a new word. That word is "reboot". This young, up-and-comer in the video game industry helped me understand that successfully managed assets in the video game industry are intellectual properties that grow into franchises. As the theory goes, once a consumer is captivated by a series they will prefer the next installment over a new game they don't recognize, giving birth to sequels, prequels, and remakes. I learned that sequels and prequels are a real challenge because they have to be consistent with the original story and, as we all know, remakes don't leave much to the imagination. My son explained that reboots are different because they let the creators keep the fundamentals that made the original story great yet allows them to take the story in a fresh direction, making it relevant for the new generation of gamers. We finished dinner; said goodbye, and left the restaurant. Walking back to the hotel, I reflected on our discussion. An analogy formed in my mind and I engaged in a thought experiment. I asked myself the following question. If RAD were a video game; would it be a sequel, or would RAD be a reboot? I wondered.

THE COST OF PUBLIC HOUSING

The public housing program is funded and regulated by the U.S. federal government; however, housing production and program service delivery are implemented by local public housing authorities ("PHAs") created by state enabling law. While most PHAs are independent, quasi-governmental entities, some are located within the structure of the local municipal government. Collectively, they manage the nation's public housing stock which totals some 1.17 million units located in 13,000 properties, providing housing for some 2.1 million residents. There are around 3,117 PHAs operating across the nation. The findings of the 2010 report, Capital Needs in the Public Housing Program commissioned by the U.S. Department of Housing and Urban Development ("HUD") estimated an $89 billion price tag associated with the capital repairs needed to adequately maintain the nation's public housing portfolio over a 20-year horizon. This looming price tag represents a major fiscal challenge for the public housing program and highlights a significant risk factor that could impact the ability of PHAs to provide safe, sanitary, and affordable housing to their residents.

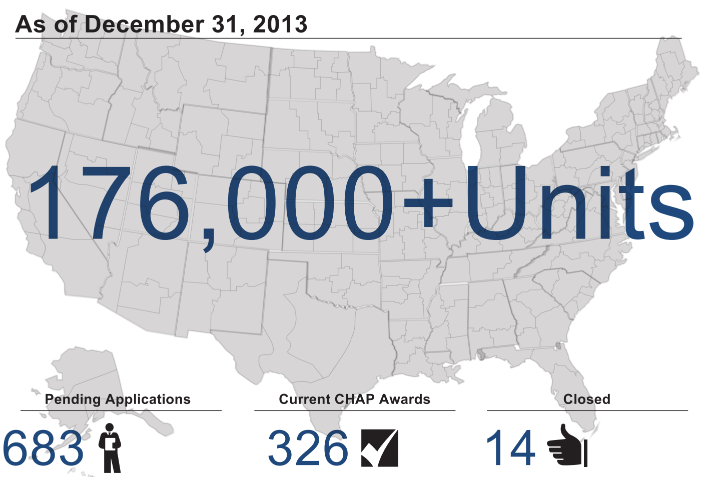
RENTAL ASSISTANCE DEMONSTRATION PROGRAM

Rental Assistance Demonstration ("RAD") was authorized by the Consolidated and Further Continuing Appropriations Act of 2012 (Public Law 112-55, approved November 18, 2011), RAD is pilot program designed to measure the degree to which a more stable funding platform can alter the investment decisions of debt and equity providers in the affordable housing market. Will the capital markets make room in its collective portfolio and allocate funds to provide the investment needed to address the immediate and long-term capital needs of the nation's public housing stock? The conversion of public housing properties to long-term, project-based Section 8 rental assistance combined with mortgage insurance provided by the Federal Housing Administration ("FHA) is a clear signal that HUD is providing the right incentives to engage the +$8 billion, low income housing tax credit equity market. The PHAs will receive no new funding; however, they will swap their current funding programs and receive a subsidy sufficient to cover mortgage payments, operating expenses, and replacement reserves. Operating subsidy, capital funds, tenant rents, and utility allowances are combined under housing assistance payment contract to cover the contract rents and utility allowances. For example:

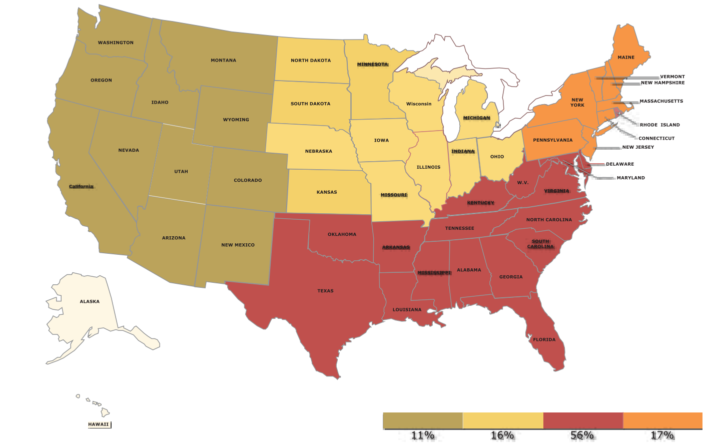
Source: Abt Associates Inc. (2010) *Capital Needs in the Public Housing Program*

PROGRAM DEMAND

The demand for program participation is high; this was demonstrated by an upsurge in PHA "first component" applications. In 2012, Congress approved a 60,000-unit conversion cap. As of December 2012, HUD had received 122 "first component" applications, requesting conversion of some 13,709 units. After extensive dialogue with PHAs throughout the country, HUD made some program and policy adjustments mid-year 2013. By December 31, 2013, HUD had received "first components" applications for over 1,000 projects from 382 separate PHAs, requesting conversion of 176,048 units – that's 15% of the national public housing portfolio.



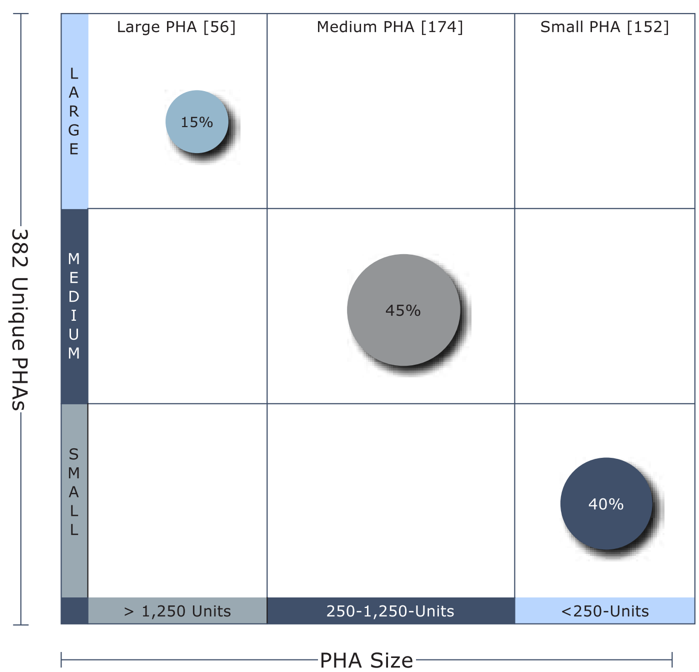
Relative demand can be demonstrated through a quick analysis of "first component" RAD applications by percentage across census regions. As of December 31, 2013, RAD applications submitted by PHAs located in Southern states represent 56% of all RAD applications. Whereas, PHAs located in the Northeast, Midwest, and Western state represented 17%, 16%, and 11%, respectively.



Public Housing RAD Applications - Breakdown by Census Region

COMPOSITION OF PHA APPLICANTS

Of all the PHA RAD applicants , 45% own and operate between 250 and 1,250 low-rent units; 40% own and operate less than 250 low rent units. Only 15% of the PHA applicants own and operate more than 1,250 units. It appears that demand for the RAD program is driven by the small to medium size PHAs.



STRUCTURE OF THE PHA POOL

Unit Allocation

If you consider the composition small, medium, and large PHAs, it's clear where the long-term demand is located. There are some 3,117 PHAs that own and operate 1,174,498 units of low-rent, public housing. The top ten PHAs collectively hold 28% of the national inventory in their portfolio, or approximately 332,468 units. Including this will skew the analysis. Controlling for this we exclude these for now. This leaves a PHA population of 3,107 PHAs holding 842,030 units, or 72% of the national portfolio. This is what we found about this PHA population:

- 101-units represent the median number of low rent units owned;
- 25% of all units are owned by small-sized PHAs;
- 38% of all units are owned by medium-sized PHAs;
- 63% of all units are owned by the small and medium-sized PHAs combined; and
- 37% of the balance of the units are owned by large-sized PHA (exclusive of the top ten).

PHA Allocation

Approximately, 2,334 or 75% of all PHAs are considered small-sized; 652 or 21% are medium-sized. The remaining 131 PHAs as large-sized PHAs that 4%, inclusive of the top ten. These numbers indicate that if RAD is to have long term success, its implementation has to occur deep within strata of the small to medium-sized PHAs which represent 96% of the entire PHA population.

CONCLUSION

For the small and medium-sized PHAs, two elements will be critical factors for success; they are: sustained capacity development and a disciplined approach to change management. Sustained capacity development is a long-term process that is not amenable to delivery pressure, quick fixes or short-term result seeking. Capacity resides within individuals, organizations, and larger systems and enabling environments. A well-functioning system or enabling environment provides the infrastructure for individuals and organizations to be able to perform.

Within the institutional framework of the affordable housing industry federal agencies; state, regional and county housing finance agencies; local community development corporations; municipal government, and community stakeholders are all part of this enabling environment.

The market is also a critical component of the enabling environment. As such, the collective actions of lenders, investors, developers, lawyers, accountants, and consultants play a critical role in providing an enabling environment that will support sustained capacity development for PHA seeking conversion. This can be reflected in the market's approach to product and service delivery. For example, financial products and services could be re-engineered to include an education and capacity building component. Business is increasingly become a knowledge driven enterprise; the affordable housing industry is no different. Consultants can focus on helping PHAs adopt a more disciplined approach change management, conducting innovative board retreats, strategy sessions, and assisting with developing business or transition plans. Moreover, the need for more sophisticated accounting, compliance, and reporting services will also increase.

As to my earlier question: my answer is "reboot". RAD is more than a "bricks and mortar" program; RAD is more than a "real estate transaction"; RAD provides an opportunity for leverage and growth. It is an opportunity to take this portfolio in a fresh direction, making it relevant for the times. If sustained capacity development can be achieved, I see no reason why RAD could not give birth to hundreds of non-profit housing corporations, providing valuable services to affordable housing residents in the local and regional markets in which they operate.

To be clear, the challenge for PHAs across the nation is nothing short of reinvention. HUD seems to have gotten the policy right with the RAD program because it offers a platform for reinvention and change. The real questions is: Can our industry provide PHAs with an enabling environment for change, transformation, development, and growth? One can hope.

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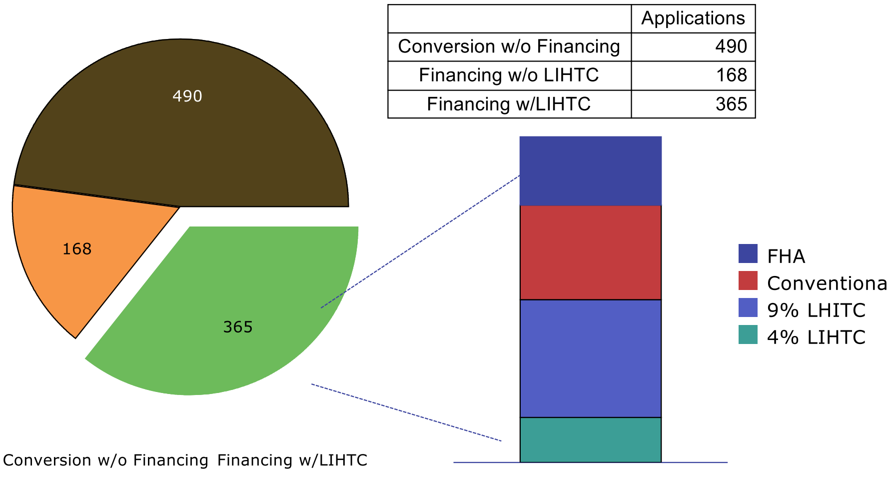
RAD Application Financing Plans

	Applications
Conversion w/o Financing	490
Financing w/o LIHTC	168
Financing w/LIHTC	365



Source: U.S. Department of Housing and Urban Development