



OFFICE OF HOUSING

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

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Daniel Garcia-Diaz
Director, Financial Markets and Community Investment
Government Accountability Office
441 G Street NW
Washington, DC 20548

Dear Director Garcia-Diaz:

Thank you for the opportunity to respond to the Draft Report GAO-18-123 entitled "Rental Assistance Demonstration: HUD Needs to Take Action to Improve Metrics and Ongoing Oversight" received on December 27, 2017. This letter responds to the Recommendations for Executive Action with respect to the Rental Assistance Demonstration (RAD).

HUD appreciates the thoughtfulness and thoroughness of GAO's review of RAD. We are pleased that in its analysis GAO found that the financing for RAD conversions yielded significant funds for construction (\$4.4 billion or nearly \$60,000 per unit converted to RAD as of the date of GAO's analysis); that contract documents on closed properties include key provisions to ensure affordable rents and foreclosure protections; that PHAs found RAD to be flexible and responsive; and that HUD has put procedures in place to evaluate and monitor the impact of conversion. We are further pleased that GAO did not identify deficiencies or impediments in RAD's design that would jeopardize the ability of the program to facilitate access to capital or provide protections for residents. HUD agrees with GAO's findings that there are actions HUD can take to improve on metrics used to assess program impact and to build on existing oversight structures.

RAD has proven highly successful at generating the capital properties need to be rehabilitated or redeveloped. To date, PHAs and their partners have secured over \$5 billion towards construction investment in over 87,000 units across 822 public housing properties that have converted under RAD. In many cases, these improvements have dramatically improved the quality of housing for low-income households. The improvements help to ensure that this housing, some of which was at risk of loss from the affordable housing inventory, remains affordable for the long-term. Through HUD's Housing Assistance Payment (HAP) contracts, which must be renewed at each expiration, and the RAD Use Agreements recorded on the land and also perpetually renewed, RAD creates both policy and contractual measures to preserve the long-term affordability of this housing. Meanwhile, in RAD, HUD has established the most robust set of resident rights of any HUD program. Among these rights are the following, which is not an exhaustive listing:

- Required resident notices prior to application;
- Required resident consultation and meetings prior to conversion;
- Required description of the RAD conversion in the PHA plan (amendments to which require a public process);
- A right to return to the property following any temporary relocation;

- Relocation protections in accordance with the Uniform Relocation Act (URA) and, in some cases, in excess of the URA requirements;
- Prohibition of re-screening residents upon “move-in” to the Section 8 property;
- Application of Section 3 low-income hiring requirements, even though in many cases the law would not have otherwise required it;
- A “phase-in” of resident rents if residents were paying less than 30% of adjusted income prior to conversion;
- Grievance and termination procedures consistent with public housing requirements;
- Resident organizing rights;
- Resident organization funding; and
- A right to request a tenant-based voucher after a period of residency at the converted property (“choice-mobility”).

No other HUD program aimed at improving and/or redeveloping affordable housing adopts such a comprehensive suite of rights to ensure that residents benefit from the conversion.

In support of the important questions analyzed in GAO’s report, HUD’s Office of Policy Development and Research (PD&R) has funded an independent evaluation of RAD, by Econometrica, Inc., which will, at least in part, address many of GAO’s findings. This evaluation was initiated to respond to the statutory requirement that HUD report on the impact of RAD on the preservation and improvement of public housing, the amount of private sector leveraging as a result of such conversion, and the effect of such conversion on tenants. HUD PD&R has published two reports as part of this evaluation. These existing reports provide information on RAD financing sources, including leverage ratios discussed extensively in this GAO report. HUD PD&R intends to publish one additional report as part of the current evaluation effort, which will provide updated leverage ratios, information on changes in the physical condition of RAD properties, and information on the effect of RAD on residents. To document the effect of RAD on residents, Econometrica is conducting a statistically representative survey of residents and analyzing HUD administrative data from the IMS/PIC and TRACS systems. We look forward to this and other initiatives to expand our understanding of RAD’s impact.

HUD’s response to the GAO recommendations are provided below:

Recommendation #1:

HUD should include provisions in its post-closing monitoring procedures to collect comprehensive quality data on financial outcomes upon completion of construction, which could include requiring third-party certification of and collecting supporting documentation for all financing sources and costs.

HUD Response:

HUD agrees that it is critical to rely on comprehensive quality data to effectively analyze development sources and uses. HUD currently relies on the executed contracts that reflect all of the obligated sources that funders provide to the transaction and all the uses that HUD and the sources of capital financing have approved at closing. In most cases, the sources and uses do not materially

change between the time of closing and construction completion. Through contingency line items, development budgets are structured to accommodate the modest adjustments that do occur. As such, for many transactions, there may be minimal benefit, relative to the additional reporting burden, to secure a revised sources and uses statement following the completion of construction. HUD agrees, however, that when there are cost over-runs or other significant changes to the sources or uses, HUD should routinely collect an updated listing of sources and uses and related documentation. HUD will review, and revise as appropriate, the post completion certifications required to ensure HUD collects quality data regarding RAD conversions.

Recommendation #2:

HUD should improve the accuracy of RAD leverage metrics — such as better selecting inputs to the leverage ratio calculation and clearly identifying what the leverage ratio measures — and calculate a private-sector leverage ratio.

HUD Response:

HUD agrees that the RAD leverage metrics can be improved to better identify what is being measured, to offer more consistent measurements over time, to more clearly identify which measures are addressing the statutory reporting requirement, and to better communicate the impact of RAD. There are a variety of important metrics that HUD uses to measure the financial and physical effects of RAD, including tracking total investment towards the rehabilitation or construction of converted properties, reviewing third party assessments of the capital needs of each property undergoing conversion, ensuring that any identified current capital needs are addressed, calculating the anticipated ongoing capital investments properties will need, and requiring the owner to set aside funds into a reserve in order to address those future needs. Leverage ratios, which is a focus of this report, represent another important measure of the financial impacts of RAD. As described above, HUD has contracted with a professional evaluator to assess the specific research areas required for evaluation by RAD's authorizing statute, including assessing private leverage. Recognizing that there are a variety of acceptable methodologies in generating a leverage ratio, the evaluation has, to-date, reported multiple leverage ratios to address a range of possible analyses and categorized each source of financing so that readers can evaluate other approaches. Apart from the RAD evaluation, HUD published a separate leverage ratio comparing public housing sources to all other sources contributed to RAD transactions. We believe this is one of several legitimate and relevant measures of the program's impact, even if it does not itself satisfy the statutory evaluation requirement. However, we acknowledge that publishing leverage ratios over time that use differing methodologies could be potentially misleading. As a result, HUD will identify a small number of relevant leverage ratios with distinct methodologies and will routinely publish these ratios together with clear identification and explanation so that audiences are fully informed and can select the ratio most relevant to their purposes. HUD will also ensure that the private-sector leverage ratio required by statute is clearly identified and is included in the RAD evaluation. If only one ratio is used in any materials, the nature of the ratio will be clearly identified. Further, we appreciate GAO's discovery that certain transaction sources were improperly classified. HUD plans to re-examine the source and uses chart of accounts so that data can be more clearly reported going forward. Finally, HUD will review prior transaction records to re-classify certain development sources according to the revised chart of accounts.

Recommendation #3:

HUD should prioritize the development and implementation of monitoring procedures to ensure that resident safeguards are implemented.

HUD Response:

As described above, RAD has adopted the most robust set of resident rights and protections of any HUD program. We are pleased to see that GAO has not found the resident safeguards to be weak or inadequate and instead focused on HUD's monitoring protocols. To use HUD's resources most effectively, and consistent with protocol under other HUD programs, including the public housing program, HUD employs a risk-based approach to monitoring resident rights in RAD. This approach involves a combination of 1) universal transaction reviews (monitoring, for example, resident notification, PHA Plan adoption, and the presence of resident eviction and grievance procedural rights in the tenant lease), 2) owner certification and reporting (monitoring, for example, the right of return and, consequently, the prohibition on rescreeing), 3) review of transactions that exhibit particular features (monitoring, for example, relocation procedures and the right of return), and 4) education of residents and local organizations so that they understand their rights and can alert HUD if their rights are being violated (monitoring, for example, recognition of resident organizations and funding).

While HUD has both a comprehensive and risk-based approach to overseeing resident protections, HUD agrees that we can better document the monitoring procedures we use and can accelerate the implementation of additional monitoring procedures currently under development. Further, we agree that, in addition to the general PBV monitoring protocol the Office of Public and Indian Housing has implemented, more is needed to monitor the right of residents to request and move with a tenant-based voucher after a period of residency (i.e., choice-mobility). To this end, HUD PD&R is seeking funding for additional research on RAD, with particular attention to the choice-mobility option, which will provide greater insight into utilization and impact of choice-mobility, and will provide insight on how to design ongoing monitoring efforts.

Recommendation #4:

HUD should determine how it can use available program-wide data from public housing and section 8 databases, in addition to resident logs, for analysis of the use and enforcement of RAD resident protections.

HUD Response:

HUD agrees with GAO that HUD should use existing data systems whenever possible to monitor resident protections. Indeed, the RAD evaluation will attempt to use system data to glean significant information on resident demographics and impacts. Through these efforts, the evaluators may identify mechanisms for HUD to routinely use system data to monitor RAD outcomes. However, we know there are significant limitations with existing systems that will prevent HUD from tracking household-level rights without a significant new IT investment in modernization. For example, existing systems are incapable of providing information on residents while they are being relocated.

As a result, today HUD uses other mechanisms to track and monitor RAD resident safeguards. For example, to monitor compliance with the right of return, HUD reviews any proposed relocation activity in which residents may not return prior to conversion. In addition, at the completion of construction HUD collects property-specific data on the number of families that returned. When a compliance review is warranted based on analysis of the submitted data, HUD will review the required resident log that PHAs and owners must maintain, among other resources. HUD will examine whether we can use existing data systems to further buttress this and other monitoring protocols.

Recommendation #5:

HUD should prioritize the development and implementation of procedures to assess risks to the preservation of unit affordability.

HUD Response:

HUD agrees that it is essential to assess and mitigate risks to the preservation of unit affordability, particularly given the backlog of capital needs in the public housing program and the ongoing deterioration of public housing units. With respect to participating units, the RAD program itself effectively mitigates the greatest current risk to the preservation of unit affordability – the capital backlog and the risk of insufficient funds to address capital needs as they come due. To assess and mitigate this risk, it is critically important to maintain high standards to ensure long-term preservation of unit affordability. HUD employs robust underwriting standards prior to permitting conversion, which is the first line of defense to ensure long-term preservation, and we are gratified that GAO did not identify deficiencies in our underwriting standards. On an ongoing basis, HUD administers a risk assessment protocol, based on collection of financial statements and periodic inspections and management and occupancy reviews, to evaluate the affordable housing preservation risk to project based rental assistance properties, including RAD PBRA properties. For project-based vouchers, local agencies are the front-line oversight bodies. HUD is evaluating what additional oversight may be necessary and has piloted a monitoring process (initiated in the summer of 2017) for HUD monitoring of RAD PBV properties. Based on the strength of HUD's underwriting, reinforced by existing and possible additional risk assessment protocols, HUD expects default, bankruptcy, or foreclosure to be exceedingly rare events. In the event of some adverse action, we are confident that the HAP contract and RAD Use Agreement are effective instruments to ensure unit affordability and provide HUD the tools to intervene appropriately. HUD is currently developing internal procedures for HUD action in the event of default, bankruptcy, or foreclosure, to oversee the transfer of the property to a capable entity. HUD also plans to develop internal procedures regarding transfer of the rental assistance to another site, and effective ways to protect residents in the event the HAP contract at a site needs to be terminated. These internal protocols will provide HUD with an effective tool-kit to preserve affordable units in the unlikely event of a bankruptcy or foreclosure.

HUD thanks GAO for its review of RAD and for its recommendations aimed at making RAD a stronger program. We look forward to adopting measures to improve on metrics used to assess and report program impact and to build on existing oversight structures.

Sincerely,

A handwritten signature in blue ink, appearing to read "Dana T. Wade". The signature is fluid and cursive, with the first name "Dana" and last name "Wade" clearly distinguishable.

Dana T. Wade
General Deputy Assistant Secretary for Housing