PRESERVING PUBLIC HOUSING THROUGH CONVERSION TO LONG-TERM SECTION 8 HOUSING ASSISTANCE PAYMENT (HAP) CONTRACTS:

Two Recapitalization Examples under HUD's Rental Assistance Demonstration (RAD)

The Rental Assistance Demonstration (RAD) allows Public Housing Agencies (PHAs) to convert public housing to long-term Section 8 property-based contracts—either Project-Based Section 8 or Project-Based Vouchers.[1] One of the main objectives of RAD is to address the very large backlog of capital needs that has accumulated over the years for the nation's 1.2 million units of public housing. This backlog is estimated at over $26 billion, or about $23,365 per unit.[2]

Today, the Capital Fund Program provides the primary source of funding for public housing repairs and renovations. However, Capital Fund annual appropriations have consistently fallen below the amounts required to keep pace with basic capital needs. These chronic funding shortfalls have contributed to the loss of over 230,000 public housing units in the past fifteen years, only a little more than 80,000 of which have been redeveloped.[3]

Under RAD, PHAs would essentially exchange operating and capital subsidies under the Public Housing program for long-term Section 8 project-based rental assistance contracts. Property-based Section 8 contracts would provide PHAs access to private financing to renovate their properties, consistent with other Federally-assisted housing programs. Private financing could take the form of loan proceeds (debt) or equity (typically generated through Federal Low-Income Housing Tax Credits).

This paper illustrates the leveraging potential of converting public housing to project-based Section 8, using the fictitious Washington Park and Lincoln Fields projects. For Washington Park, we show a traditional debt model. For Lincoln Fields, we show a combination of debt and equity financing.

WASHINGTON PARK is a 100-unit public housing project for seniors that has not been renovated since it was built in 1975. It is clean and habitable, but like any un-restored building of that age, the project needs work. The steel-frame windows are drafty; the central boiler is unreliable; the roof is past its useful life; the parking lots require resurfacing; the building needs painting; and more. Overall, the project's backlog of repairs and improvements totals $1.5 million, or $15,000 per unit.

The Capital Fund Program provides about $180,000 annually for this project, or 12% of the property's capital backlog amount. With this amount, the PHA is able to make piecemeal repairs to keep the building open and operational, but has no funding to undertake

Washington Park Preservation Needs

Capital Needs	*Project*	*Per Unit*
Roofs	$250,000	$2,500
Kitchens	$450,000	$4,500
Windows	$100,000	$1,000
Site	$150,000	$1,500
Heating & Cooling	$250,000	$2,500
Plumbing	$150,000	$1,500
Community Facilities	$150,000	$1,500
Total	**$1,500,000**	**$15,000**

[1] RAD also provides long-term rental assistance options for the Mod Rehab, Rent Supplement, and Rental Assistance Payment programs. For more information, see www.hud.gov/rad

[2] See *Capital Needs in the Public Housing Program* (Cambridge, MA: Abt Associates, 2010).

[3] Most of the remaining hard units were replaced with vouchers.

the comprehensive improvements that are necessary for long-term sustainability and livability, or to meet acceptable community standards.

Conversion: By contrast, conversion to a long-term, property-based Section 8 contract under RAD would enable the PHA not only to eliminate the capital needs backlog with mortgage proceeds, but also to establish a replacement reserve account so that capital repair and replacement needs could be addressed as they arise. In addition, the PHA would likely realize operating cost savings through the replacement of its windows, boiler, and insulation with more energy-efficient alternatives.

The subsidy available to fund HAP contracts under RAD is limited to public housing subsidy levels. Washington Park today receives an annual Operating Fund allocation of $336,000, or $280 per unit monthly (PUM), and collects $300,000 in tenant rents, or $250 PUM on average. Combined with its Capital Fund allocation, the resulting contract rent following a RAD conversion would be $680 PUM. Following conversion, the Housing Assistance Payment (HAP) would fund the difference between the contract rent and tenant rents, which would continue to be limited to 30% of household income.

Washington Park
Contract Rent Calculation (PUM)*

Operating Fund	$280
Capital Fund	+$150
Tenant Rents	+$250
Contract Rent	**$680**

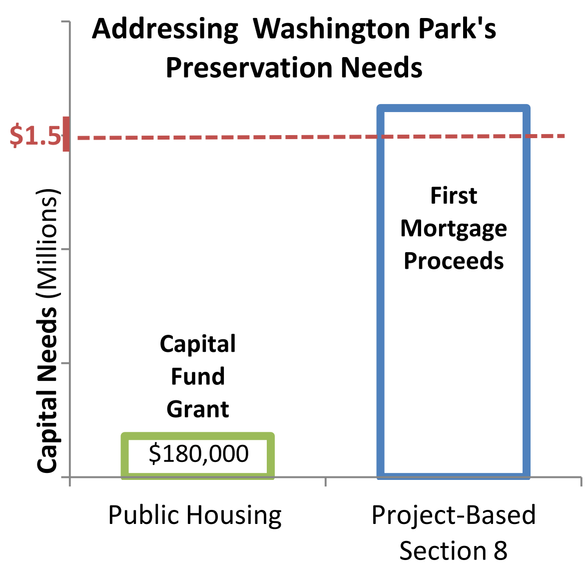
*The RAD Implementation Notice will include a complete explanation of contract rent calculations.

Washington Park Pro Forma
with Project-Based Rental Assistance

Income and Expenses	*Project Annual*	*PUM*
Gross Potential Rents	$816,000	$680
Adjustments (vacancies, etc)	(24,500)	($20)
Effective Gross Income	$791,500	$660
Operating Expenses	($597,600)	($498)
Annual Reserve Deposit	($50,400)	($42)
Net Operating Income	**$143,500**	**$120**
Annual Debt Service	($119,600)	($100)
Cash Flow	$23,900	$20
Total First Mortgage*	**$1.62 million** ($16,200 per unit)	

*See Pro Forma Notes on page 4

After adjusting for vacancies, bad debt, and other income, and after deducting operating costs and a reasonable deposit for a new replacement reserves account, the project would have a net operating income (NOI) of $120 PUM, with which the PHA could support a first mortgage of more than $1.6 million. These mortgage proceeds are sufficient to address the project's capital needs. In contrast, under today's Capital Fund Program, the PHA would have to set-aside about 9 years of funding to reach this same dollar amount; however, in the meantime, additional capital repair and replacement needs would accumulate.



LINCOLN FIELDS is a 200-unit public housing project for families. It needs many of the same systems upgrades and overdue replacements as Washington Park. In addition, the PHA would like to make marketability improvements to the property to address the small apartment sizes, inadequate parking, and the lack of community space. The total cost of rehabilitation is $9 million, or $45,000 per unit. Like Washington Park, the Capital Fund provided for this project, at $360,000 annual or $150 PUM, falls far short of project needs.

Lincoln Fields Preservation Needs

Capital Needs	*Project*	*Per Unit*
Roofs	$500,000	$2,500
Kitchens	$1,100,000	$5,500
Windows	$500,000	$2,500
Site	$1,600,000	$8,000
Heating & Cooling	$900,000	$4,500
Plumbing	$600,000	$3,000
Community Facilities	$2,000,000	$10,000
Space Reconfiguration	$1,800,000	$9,000
Total	**$9,000,000**	**$45,000**

Conversion: Current funding levels yield a contract rent of $820 PUM. At these contract rents the project can support a $7 million first mortgage, or about three-fourths of its modernization needs. To fill the remaining gap, the PHA secures 4% low-income housing tax credits, which are available from the local Housing Finance Agency with tax-exempt financing (as long as bond proceeds cover 50% of rehab costs). After paying associated financing and professional fees, the PHA has enough capital to fully execute its $9 million rehabilitation plan.

Lincoln Fields
Contract Rent Calculation (PUM)

Operating Fund	$350
Capital Fund	+$160
Tenant Rents	+$310
Contract Rent	**$820**

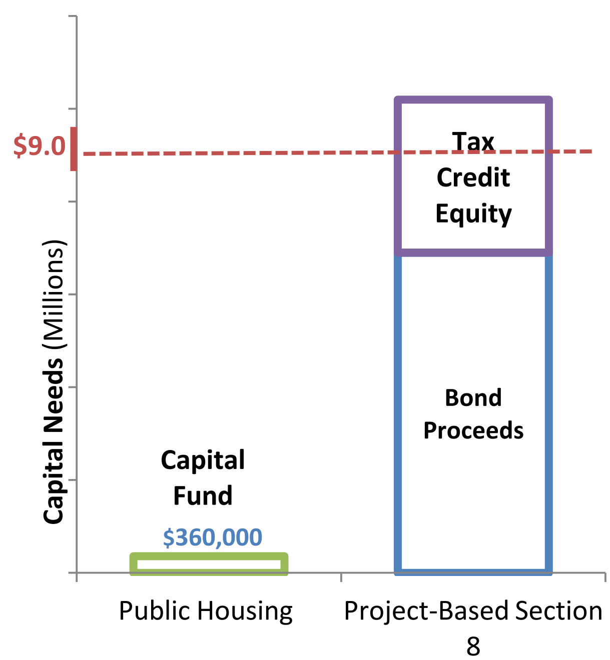
Lincoln Fields Pro Forma
with Project-Based Rental Assistance,
Tax-Exempt Bonds, & 4% LIHTC

Income and Expenses	*Project Annual*	*PUM*
Gross Potential Rents	$1,968,000	$820
Adjustments (vacancies, etc)	(137,760)	($57)
Effective Gross Income	$1,830,240	$763
Operating Expenses	($1,185,600)	($494)
Annual Reserve Deposit	($100,000)	($42)
Net Operating Income	**$543,969**	**$227**
Annual Debt Service	($453,308)	($189)
Cash Flow	$90,662	$38
Tax-Exempt Bond Proceeds	**$6.9 million** ($34,500 per unit)	
4% Low-Income Housing Tax Credit Equity	**$2.1 million ($17,500 per unit)**	
Debt & Equity Proceeds*	**$9.0 million ($45,000)**	

*See Pro Forma Notes on page 4

As with Washington Park, the conversion to a long-term Section 8 contract allows Lincoln Fields access to needed rehab proceeds not possible under the Public Housing program.

Addressing Lincoln Fields' Preservation Needs



Washington Park Pro Forma Notes

1. *Terms of Loan:* 6.7% interest (including mortgage insurance premium of 0.45%), 35-year amortization, and debt service coverage ratio of 1.20.
2. Current market interest rates are lower than used for this example; however, because current terms are historically low, we used slightly higher rates to provide a more conservative estimate.
3. In addition to capital repair costs, mortgage proceeds cover financing fees and an initial deposit into the capital replacement reserve account.

Lincoln Fields Pro Forma Notes

1. *Terms of Loan:* 5.7% on HFA-issued tax-exempt bond (including mortgage insurance premium of 0.45%), 35-year amortization, and debt service coverage ratio of 1.20.
2. Current tax-exempt bond rates are lower than used for this example; however, because current terms are historically low, we used slightly higher rates to provide a more conservative estimate.
3. Pro forma includes a 7% vacancy rate, which is standard in tax credit underwriting.
4. Tax credit equity shown is net of developer fees, financing fees, initial deposits into the capital replacement reserve and the operating reserve, and other soft costs associated with tax credits and tax-exempt bonds. In general, 4% tax credits are particularly effective when loan proceeds can support at least two-thirds of project rehab needs; in cases where capital needs are greater, a project would need 9% tax credits or other forms of federal or local equity to fill the financing gap.