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Three Ideas to Build on RAD's Success

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The U.S. Department of Housing and Urban Development's (HUD's) Rental Assistance Demonstration (RAD) program is a rarity: It was introduced and expanded under the Barack Obama administration, then further embraced and expanded under President Donald Trump.

There are two components of RAD – public housing, and HUD's other non-public housing legacy rental assistance programs. The non-public housing component of RAD has no cap or expiration and allows the conversion of various other HUD rental assistance programs into project-based Section 8 or project-based voucher programs.

RAD has been around six years. During that time, the cap on the number of public housing homes that can be converted to non-public housing to facilitate raising private capital for recapitalization has increased three times.

March's 2018 omnibus spending bill brought the latest raise in the cap, from 225,000 units to 455,000, as well as a four-year extension of the public housing component of the program through 2024. The omnibus bill also expanded the non-public housing RAD to include more than 120,000 units in Section

202 Supportive Housing for the Elderly properties with Project Rental Assistance Contracts (PRACs).

With approximately 1.2 million public housing homes in the nation and a RAD ceiling of 455,000 (although as stated, RAD applies to more than public housing), the program is a major player, especially in public housing.

Background

RAD was implemented as a demonstration program as part of the Consolidated and Further Continuing Appropriations Act of 2012 to address the unmet capital needs of federally assisted rental-housing properties by converting them to Section 8 funding with private ownership.

For public housing authorities, one of the biggest benefits is that RAD allows them relief from public housing regulations, including HUD scoring and rules that limit how to use assets and personnel. PHAs

continued on page 2

continued from page 1

have flexibility to take advantage of their employees' skills, including grants, property management and more – all accessing private capital to preserve and renovate ailing public housing properties.

RAD allows conversion into HUD rental assistance programs under two platforms: the project-based Section 8 platform, where HUD contracts directly with a particular owner and property to provide rental assistance and Section 8 project-based vouchers, where HUD contracts with public housing agencies who in turn then execute separate contracts with particular owners and properties. In addition to simplification, the Section 8 contracts for RAD properties allow developers to more easily qualify for financing and makes the property attractive to investors in low-income housing tax credits (LIHTCs).

Tax credits have been a significant capital driver of RAD conversions, comprising about 40 percent of all RAD financing sources. Of the LIHTC financing, more than two-thirds are financed by 4 percent LIHTCs and private activity bonds, and the rest through volume cap allocated LIHTCs. There are other sources that can be used in the RAD program, including conventional debt, FHA loans, takeback financing funds, public housing operating reserve funds and more.

Through March 2018, more than 91,000 public housing units had been converted through the RAD program and many more were in the pipeline.

Public Housing's Challenge

Public housing has a capital needs crisis. In 2010, there was an estimated \$26 billion in capital repairs, a gap the National Low Income Housing Coalition now estimates at \$40 billion—an estimate in line with HUD's prediction that the need grows by \$3.4 billion annually. For perspective, HUD said in January that it would take 47 years for PHAs to complete the capital

needs work using federally appropriated money—years during which existing public housing would continue to deteriorate, at a rate that is greater than the annual budget level.

It's an impossible uphill climb that RAD was created to fix.

However, not everyone agrees that it's the solution.

Critics of the RAD program are few, but vocal—chief among them Rep. Maxine Waters, D-Calif., who is also the top Democrat on the House Financial Services Committee overseeing HUD programs. Waters and others base their criticism on history, particularly the HUD HOPE VI program, which was launched in the 1990s to revitalize public housing and change it into mixed-income developments. The problem? HOPE VI wasn't a one-for-one replacement program, meaning some tenants weren't protected during the transition and thousands of homes were permanently lost.

Following HOPE VI, HUD turned to its Choice Neighborhoods Initiative program, which was launched in 2010 as a successor to HOPE VI and focused on leveraging public and private dollars to support locally driven strategies for not just revitalization of public housing, but also privately owned HUD-assisted housing—with a focus on housing, people and the rest of the neighborhood. The Choice Neighborhood Initiative improved upon HOPE VI in some respects, but is at a much smaller scale.

Both programs created concern about any future programs addressing the preservation needs of public housing, so when HUD turned to RAD, scars remain.

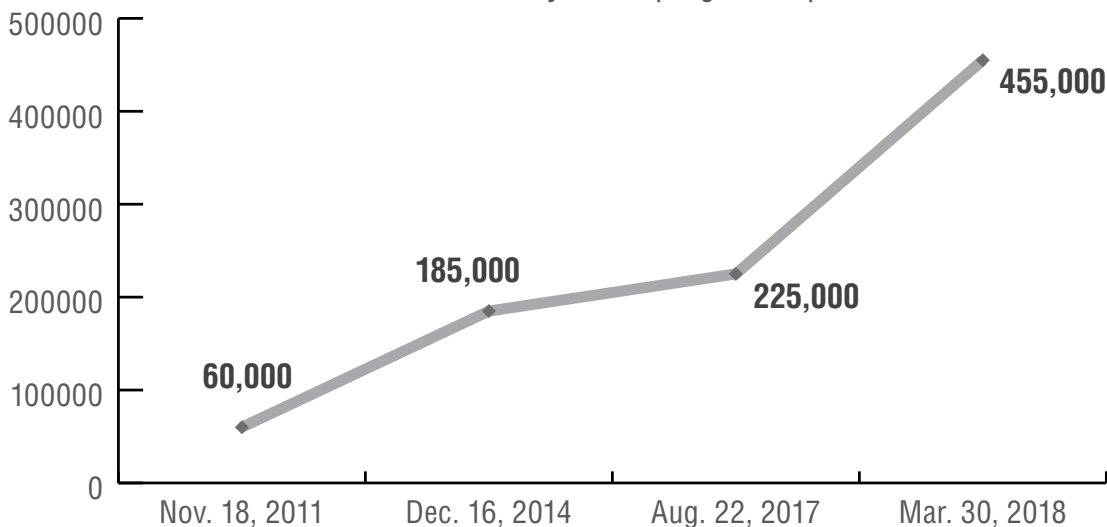
RAD's administration hasn't been perfect. The U.S. Government Accountability Office released a report in March that was critical of HUD's handling of

continued on page 3

RAD Expansion

The U.S. Department of Housing and Urban Development's (HUD's) Rental Assistance Demonstration (RAD) program cap on the number of housing units that can be converted has increased three times.

Here is the history of the program cap:



Source: Novogradac & Company LLP

continued from page 2

some aspects of RAD. Significantly, the report wasn't critical of the program overall, just of how it was being measured.

Still, with the expansion of the cap and with more PHAs making the decision to use RAD to convert properties, traditionally financed public housing is quickly diminishing.

Improving the Program

RAD is just six years old and continues to evolve. There are some areas where the program can improve—whether it's through legislation, oversight or in combining with other programs.

Here are three suggestions to make RAD better:

1. Provide PHAs extra funding for RAD conversions.

RAD was implemented with a promise of no budget impact, so Congress has been reluctant to add money—

even if it's needed to make the program practical for some PHAs and certain properties.

The fiscal year 2018 omnibus spending bill had the effect of increasing the proration for the Public Housing Operating Fund subsidy to 92.90 percent of formula eligibility. However, RAD conversions are being funded at 2016 proration levels of 90.21 percent. If HUD increases the proration to 2018 levels, a PHA converting to RAD will receive 2.69 percent more of their formula eligibility.

However, many PHAs are interested in a RAD conversion, but lack the funds for even the requisite initial studies and predevelopment work. Additionally, there is a gap between what some PHAs receive under Section 9 public housing funding and Section 8 funding, and federal money to bridge the initial gap would make it possible.

continued on page 4

continued from page 3

The Senate's FY 2018 HUD spending bill provided \$4 million in incremental funding that could be applied to such conversions, but the omnibus bill had no such funding. The Trump administration budget request for FY 2019 has \$100 million in incremental funding for all RAD, so the idea has some powerful supporters.

It's worth pursuing.

2. Create more soft funding sources.

LIHTC properties routinely need soft funding sources and RAD is no exception. In fact, RAD properties have a greater need and that supply is drying up. Creativity is necessary.

Two obvious sources for soft funds are the HOME Investment Partnership program and Community Development Block Grants (CDBGs), which are funded at \$1.36 billion and \$3.24 billion, respectively in the omnibus spending bill—43 percent and 8 percent increases respectively compared to the previous year and a dramatic switch from Trump's proposed FY 2018 and FY 2019 budgets, which would eliminate them. That's a good start, but there's another source that could play a big role in RAD: opportunity zones (OZs), which was established in tax reform.

OZs are designed to encourage investment in low-income communities by deferring taxes on gains. Subject to guidance from the IRS, one area in which this is a natural fit is housing, as OZ investments can be combined with the LIHTC—a particularly good fit for RAD conversions, since 4 percent LIHTC deals make up two-thirds of all LIHTC transactions. The deferral of gains is an option that is more attractive to investors for 4 percent LIHTC properties than 9 percent properties.

Guidance encouraging the use of OZ investments in affordable housing could be a valuable tool to allow

many RAD developments to pencil out. It's possible that an unintended but positive consequence of the OZ legislation could be to boost the RAD program.

3. Pass the Affordable Housing Credit Improvement Act.

The Affordable Housing Credit Improvement Act remains alive in Congress after provisions linked to it (a 12.5 increase in annual LIHTC allocations over four years and income averaging at LIHTC properties) made it into the omnibus bill. For those considering the RAD program, passage of the bill would be huge.

The biggest boost would come from the proposed minimum 4 percent LIHTC rate, which would make a significant dent in financial gaps for RAD developments. As said earlier, more than two-thirds of RAD properties receiving LIHTC financing are done as 4 percent bond deals, a proportion expected to continue to grow. A jump from 3.28 percent (the April "4 percent LIHTC" percentage) to 4 percent (the minimum if the Affordable Housing Credit Improvement Act passes) would bring in significantly more equity.

The 50 percent allocation increase for 9 percent LIHTCs, proposed in the Senate version of the legislation, would obviously make it easier for RAD developments to access this highly competitive resource, too. Additionally, income-averaging—which allows tenants with incomes up to 80 percent of the AMI to qualify as long as the average of all tenant incomes is 60 percent—would be helpful in RAD conversions.

Other provisions that would be useful to RAD conversions include the provision to allow housing credit agencies to increase the eligible basis of properties by up to 50 percent if 20 percent of the apartments are designed for residents earning 30 percent of the AMI, the repeal of the qualified census tract population cap and an extension of state discretion on the 30

continued on page 5

continued from page 4

percent basis boost to make bond-financed properties financially feasible.

Building on RAD's Success

Public housing and other HUD legacy programs are struggling. With RAD, Congress found an ever-increasing vehicle to improve the lives of tenants and

to allow PHAs to focus on areas where they can make a greater difference.

The expansion of the cap and of programs eligible for RAD is a great start. With some tweaks and greater expansion, RAD can do even more good. ❖

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