U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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House Financial Services Subcommittee on
Insurance, Housing and Community Opportunity
On
HUD's Fiscal Year 2012 Rental Assistance Demonstration

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Good afternoon Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee. I want to thank you for holding this hearing and giving me the opportunity to testify on the proposed Rental Assistance Demonstration, submitted as part of the Fiscal Year 2012 Budget Request.

This committee has played a key role in helping provide and maintain affordable, quality homes to some of this nation's most vulnerable populations, and I thank you for that leadership.

For the last few years, the Department, in collaboration with Congress and a wide range of stakeholders, has explored strategies both to preserve a number of the nation's core affordable rental housing programs—including public housing and the privately owned and managed assisted housing inventory—and to safeguard the significant taxpayer investment that has gone into this stock each year. And I appreciate this opportunity to discuss these strategies today and to comment on the recent action taken by appropriators.

Challenges Facing Public Housing Preservation

We meet at an important moment. Today the need for affordable housing is greater than ever. According to HUD's most recent Worst Case Housing Needs report, 7 million very low-income renter households pay more than half their income for housing, live in substandard housing or both. Essential to meeting the needs of these families is public and assisted housing – which provides 2.5 million quality, affordable homes in communities across the country, nearly 20% of which are located in rural and small towns. In all, 4.5 million households—a third of whom include an elderly or disabled family member—depend on help from HUD to pay the rent – whether in public housing or private subsidized housing.

The taxpayer has invested significantly over the last 75 years in the development and maintenance of these homes. Like all housing, this stock requires periodic recapitalization to maintain and modernize the buildings. Indeed, most forms of affordable housing can leverage funding from private investors and other non-federal government sources to make these repairs.

But public housing and properties funded through HUD's so-called "legacy programs" generally can't, Chairman Biggert. As a result, repairs to these homes tend to be put off longer, which makes the cost of maintaining them more expensive. Unfortunately, this leaves owners with deteriorating buildings, and little choice but to either demolish these homes or sell them.

Antiquated laws largely require the Federal government to be the sole investor in public housing. As a result, PHAs are not able to leverage their assets in ways that nearly every other form of affordable housing can in order to adequately fund long-term operations and capital needs. Further, year-to-year budgetary fluctuations lead to less predictable funding streams that make it more difficult for PHAs to effectively plan for long-term needs.

As a result, Chairman Biggert, we have lost over 150,000 public housing units to demolition or disposition over the past 15 years.

And given the Department's 2010 Capital Needs in the Public Housing Program study, we see no sign that this trend will change anytime soon. This Congressionally-funded study estimated that the aggregate national capital backlog is between $22 and $26 billion—or, $22,000 to $24,000 per unit—in the public housing portfolio alone. We cannot come close to meeting this need through annual appropriations, particularly when we are in a period of tight fiscal constraints, and our ability to leverage other forms of private and public investment is very limited.

Further, Public Housing is not the only inventory at risk. Equally critical are the parts of our privately-owned and managed affordable housing stock that are facing the end of their contract terms, with either no option to renew, or, the inability to renew on terms needed to attract capital for reinvesting in their properties. The combined 48,800 units in our Rent Supplement, Rental Assistance Payment, and Section 8 Moderate Rehabilitation programs are the most vulnerable among this category.

For the 23,800 Rent Supplement and Rental Assistance Payment units, HUD lacks the authority to renew them under Section 8 project-based rental assistance when their contract expires. Meanwhile the 25,000 units funded through contracts under the Moderate Rehabilitation program are limited to one year contacts that limit their ability to leverage capital.

Equally as important is our need to fundamentally improve the public housing system. Even if Congress were able to provide the $22 to $26 billion to address the public housing inventory's backlog of capital needs, my decades of corporate and public sector experience managing housing tell me that we can build a better system that harnesses the resources and discipline of the private market without compromising the important mission of publicly supported housing. My experience also tells me that we can build a system that does not leave America's poorest families isolated – with too few choices and too little opportunity to take responsibility for their own futures.

I believe we can do better – and I am confident this subcommittee would agree.

<u>21st Century Preservation Tools</u>

Collectively, these challenges require a commitment to preservation using proven tools that so many other forms of affordable housing have accessed over the last four decades. These tools will put our most vulnerable stock on a more solid foundation for the future and provide residents with access to more opportunity.

The Rental Assistance Demonstration that we have proposed as part of HUD's FY 2012 Budget request represents an important step in the right direction. We have worked hard and listened to you and many others in our formulation of this demonstration.

As this Subcommittee knows, last year we proposed an ambitious, multi-year effort called the Transforming Rental Assistance initiative, or, TRA to streamline HUD's affordable housing programs into one Section 8 program with a single stream of funding. This effort sparked an important conversation about increasing the ability of the public and private sectors to work together to invest in the success of these properties and the families who live in them.

Taking into account the concepts that emerged from that conversation, we designed a demonstration, focusing on the stocks with the greatest need, using tools with the broadest support, engaging stakeholders—from the public housing industry, to multifamily owners and managers, to residents—and sought input from Members and staff of this Subcommittee in particular. This process culminated in the Rental Assistance Demonstration we discuss today.

This Demonstration would be voluntary and would allow public housing and units in the Rent Supplement, Rental Housing Assistance Payment, and Section 8 Moderate Rehab programs to convert their federal funding source. PHAs and owners can choose to participate if they feel that the Demonstration would be the best option for preservation in their local communities, or they can choose to remain in their current program. At its core, the Demonstration is very much about giving PHAs, owners, and local residents the choice to determine the strategies that would best work for their home towns.

Key Goals of the Rental Assistance Demonstration

The Demonstration differs from our TRA proposal in important ways including strengthening public control and foreclosure protections, while at the same time eliminating proposals that would have regionalized public housing administration. It builds on the basics of what we know already works to preserve affordable housing and has five key goals:

Long-Term Stability. The Demonstration puts public housing on a stable funding platform that will allow owners to plan for the future and maintain their properties. Specifically, it would allow PHAs and owners of Moderate Rehabilitation (Mod Rehab), Rent Supplement, and Rental Assistance Payment (RAP) properties the option to convert their current or expiring form of rental assistance to either a Section 8 Project Based Voucher (PBV) contract or a Section 8 Project Based Rental Assistance (PBRA) contract.

PBVs and PBRA have proven to be effective tools for preservation and affordability. Further, there is widespread acceptance and familiarity within the lending community around Section 8, and HUD already has the internal infrastructure to manage Section 8 contracts.

- For PHAs, this essentially means trading operating and capital subsidies under the Public Housing program for long-term, 20 year PBRA contracts.

- For the Rent Supp and RAP programs, HUD would convert contracts to Section 8 PBRA contracts with 20-year terms.

- For Mod Rehab properties, the Demonstration would provide a real opportunity to put them on sound financial footing and to make needed repairs by also converting to long-term, 20-year Section 8 PBRA or PBV contracts.

Safe, Proven Tools to Leverage Private Capital. The Demonstration will allow the public housing, Rent Sup, RAP and Mod Rehab programs to use the same tools to access private debt and equity that all other affordable housing programs use.

Mixed-finance affordable housing development has proven to be extraordinary successful at leveraging private capital. Currently, the long-term project-based Section 8 system successfully supports 1.3 million units of multifamily assisted housing. Overall, this inventory has generated tens of billions of dollars in debt and equity investments over the past 30 years, while the foreclosure rate in the inventory has been limited to a historical average of less than half of one percent. Conversion to this Section 8 platform will also give this housing better access to the largest source of equity for affordable housing over the last decades – the Low Income Housing Tax Credit program (LIHTC).

Over the past 25 years, the LIHTC has helped finance the construction and preservation of more than 1.8 million affordable rental homes and has leveraged more than $75 billion in private capital.

With approximately 90% of all affordable rental housing created or preserved each year receiving equity through the LIHTC program, these tools have helped bring not only new capital to affordable housing, but also a new sense of discipline that extends from the way that properties are financed to how they are managed.

Long-Term Affordability. Perhaps the most important goal of affordable housing preservation efforts such as this Demonstration is saving properties for generations to come by better managing the investment the public has already made Toward that end, participating properties will feature long-term assistance contracts and use agreements, which would protect affordability, including in the event of foreclosure or bankruptcy.

More Resident Choice and Real Resident Rights. Families should be able to choose where they live and be able to take responsibility for their futures – while also being protected from eviction, rental assistance termination or re-screening as a result of conversion. Accordingly, we expect that at least 90 percent of the Public Housing and Mod Rehab units converted under the Demonstration will provide residents with an option to move with voucher assistance after a reasonable tenure. Residents will also have an opportunity to comment on any conversion action, not be subject to re-screening, and have strong procedural and organizing rights.

Effective Public Ownership. Preserving public housing for the next generation is not about changing who owns public housing – but rather, how it is funded and the tools it can access. In the Demonstration, public housing properties will remain under the ownership or control of a public housing authority, other capable public or nonprofit entity identified by the PHA, or a limited partnership formed for purposes of accessing Low-Income Housing Tax Credits. In the unlikely event of foreclosure, bankruptcy, or enforcement action – indeed even in this economy, local multifamily owners have defaulted on their loans less than one-tenth of 1 percent of the time -- the Secretary may transfer the contract and use agreement to a capable public or nonprofit entity, and only when neither of these options is viable, may the Secretary seek to the help of a for profit entity in preserving the property. If this were to occur, it is important to note that the owner would still be required to manage the property, guarantee its affordability and maintain tenant rights in accordance with the Use Agreement.

Implementing the Demonstration

The Demonstration relies on existing tools that have proven effective at preserving affordable housing over the last 20 years or more. And while public housing and the "legacy programs" have had limited access to these tools, other programs within HUD have been using them for the past two decades – giving HUD the experience with private sector developers, investors, and lenders that is so critical to making this demonstration a success. From our work with the private sector on HOPE VI and now Choice Neighborhoods to our management of over 1.3 million units of multifamily housing with Section 8 contracts we have the infrastructure in place to both manage the conversions of traditional public housing properties to operate under Section 8 contracts and to monitor these assets over time.

And with their decades of experience in financing and developing a range of affordable housing programs, we anticipate that private sector partners will continue to play a key role in this demonstration. As we have seen in HOPE VI, many PHAs have already collaborated with the private sector in a variety of ways – from securing FHA insurance, tax-exempt bond financing, private loans and/or tax credit investments to assistance with legal, accounting and investor reporting responsibilities.

With this demonstration, PHAs will continue to sponsor, develop, own and manage forms of needed housing that the private market on its own cannot be expected to profitably produce and manage. But at the same time the private sector will be able to add capacity and expertise in the field of real estate finance and development that we believe is critical to the success of these properties and this demonstration.

2012 Appropriations

The Demonstration was included in the Administration's FY2012 Budget. The Department estimates that this federal investment could unlock billions in private investment to repair and rehabilitate participating developments, which would go a long way toward meeting the estimated $22-26 billion capital need in public housing.

The Senate-passed FY 2012 Transportation, Housing and Urban Development, and Related Agencies Appropriations Bill authorizes the transfer of operating and capital subsidies to support a Rental Assistance Demonstration targeted at the public housing portfolio (it does not include conversion authorization for units in our Rent Supplement, Rental Assistance Payment, and Moderate Rehabilitation inventories). We appreciate the Senate's action, and we believe it would give us the authority we need to take an important first step towards preserving public housing, utilizing the Demonstration model.

While we believe it makes sense to move toward a comprehensive authorization of Demonstration – and we are thus appreciative of the opportunity afforded by today's hearing to give the Demonstration concept a valuable public airing – we also believe it is reasonable, as an initial test of the proposal, to proceed for now with the option that has been included in the Senate appropriations bill. We are hopeful that the members of this subcommittee will join with us in supporting this strategy, while continuing to explore the broader authorization process through this committee.

Further, we are working with appropriators on authority that would allow for Tenant Protection Vouchers to be project-based under the PBV authority as a no-cost strategy for preserving RAP and Rent Sup HUD-assisted properties. While we are generally supportive of this approach, we do not believe it will be the right solution for every property or every PHA so it is critical that we have the ability to convert these properties to long-term PBRA contracts.

Conclusion

And so, Chairman Biggert, we believe the time has come to allow America's public housing system to take advantage of 30 years of innovations in affordable housing finance – to connect millions of families to opportunity, to turn homes too often seen as a "neighborhood problem" into community assets, and to allow owners of public and assisted housing to access the proven preservation tools available to all other affordable housing programs.

This Demonstration represents an important step toward preserving these homes for the future – and I want to thank you again for this opportunity to testify today. I would be glad to answer any questions.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
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PRESERVING PUBLIC HOUSING

THROUGH CONVERSION TO LONG-TERM SECTION 8 RENTAL ASSISTANCE CONTRACTS:

Two Recapitalization Examples Under HUD's 2012 Rental Assistance Demonstration

HUD's 2012 Budget requests Congressional approval for a rental assistance demonstration that would allow 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. One of the main objectives of the demonstration 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 $22 to $26 billion, or about $20,000 to $24,000 per unit.[1]

Today, the Capital Fund Program provides the primary source of funding for public housing repairs and renovations. Capital Fund annual appropriations, however, have consistently fallen below the amounts required to keep pace with basic capital needs. These chronic funding shortfalls have contributed to a net loss of over 150,000 public housing units in the past fifteen years.[2]

Under the demonstration PHAs would, essentially, exchange operating and capital subsidies under the public housing program for long-term Section 8 project-based rental assistance contracts.[3] 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 $2.5 million, or $25,000 per unit.

The Capital Fund Program provides about $180,000 annually for this project, or 7.2% of the property's capital backlog amount. With this amount, the PHA is able to make piecemeal

Washington Park Preservation Needs

Capital Needs	Project	Per Unit
Roofs	$250,000	$2,500
Kitchens	$550,000	$5,500
Windows	$250,000	$2,500
Site	$500,000	$5,000
Heating & Cooling	$450,000	$4,500
Plumbing	$300,000	$3,000
Community Facilities	$200,000	$2,000
Total	**$2,500,000**	**$25,000**

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

[2] Most of these hard units were replaced with vouchers.

[3] Nationally, while some projects would be able to convert without cost, the incremental cost of conversion would be about $85 per unit monthly ($1,020 per unit per annum).

repairs to keep the building open, but has no funding to undertake 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, Section 8 property-based contract under the rental assistance demonstration would enable the PHA not only to eliminate the capital needs backlog with mortgage proceeds but to establish a replacement reserve account so that capital repair and replacement needs could be addressed as they arise going forward. In addition, the PHA would likely realize operating cost savings through the replacement of its windows, boiler, and insulation with more energy-efficient alternatives.

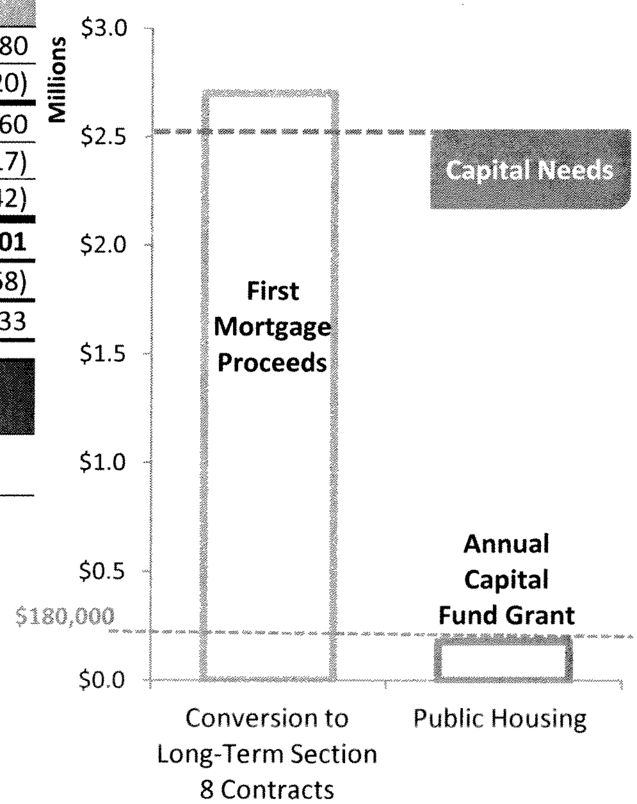
The market rents for Washington Park are $680 per unit monthly (PUM). After adjusting for vacancies, bad debt, and other income, and after deducting operating costs and a reasonable deposit for a new Replacement Reserves account, the project would have Net Operating Income (NOI) of $201 PUM, with which the PHA could support a first mortgage of more than $2.7 million. Under today's public housing Capital Fund Program, the PHA would have to set-aside about 14 years of funding to reach this same dollar amount; however, in the meantime, additional capital repair and replacement needs would accumulate.

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	($500,000)	($417)
Annual Reserve Deposit	($50,400)	($42)
Net Operating Income	**$241,100**	**$201**
Annual Debt Service	($201,000)	($168)
Cash Flow	$40,100	$33
Total First Mortgage*	**$2.71 million** ($27,100 per unit)	

*See Pro Form Notes on page 4

Addressing Washington Park's Preservation Needs



LINCOLN FIELDS is a 200-unit public housing project for families that is 80% occupied. 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 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: At estimated post-rehabilitation market 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 with tax-exempt financing from the local Housing Finance Agency. After paying associated financing and professional fees, **the PHA has enough capital to fully execute its $9 million rehabilitation plan.**

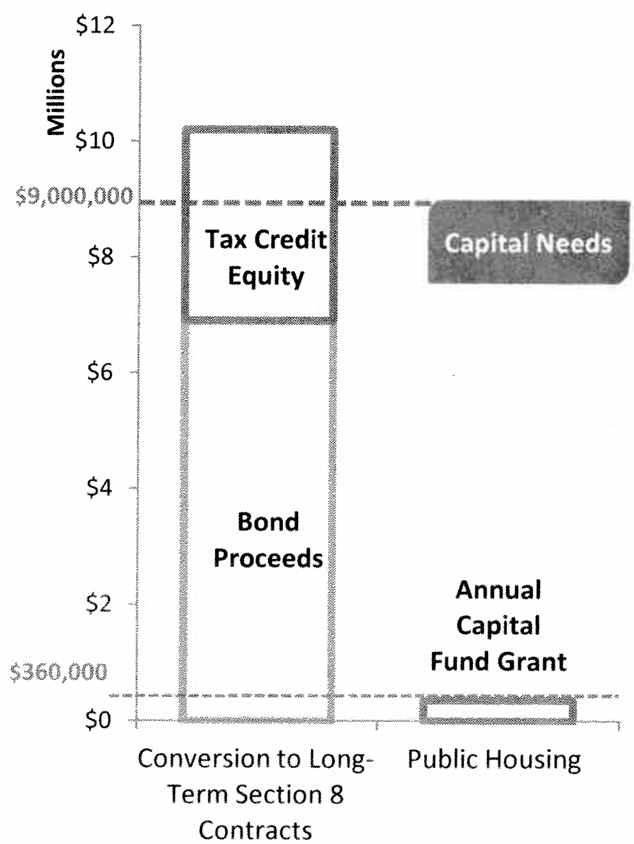
As with Washington Park, the conversoin to a long-term Section 8 contract allows Lincoln Fields to access needed rehab proceeds not possible under the public housing program.

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 Form Notes on page 4

Addressing Lincoln Fields' Preservation Needs



Washington Park Pro Forma Notes

1. *Terms of Loan:* 6.7% interest (including mortgage insurance premium), 35 year amortization, and debt service coverage 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, 35 year amortization, and debt service coverage 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. Otherwise, a project would rely on 9% tax credits or other forms of federal or local equity to fill the financing gap.