



PUBLIC HOUSING REINVESTMENT INITIATIVE

March 2003

1. What is the Public Housing Reinvestment Initiative?

Introduction

There exists an estimated \$18 billion backlog in funding required to renovate and modernize aging public housing. This backlog of unmet capital needs translates into substandard living conditions for public housing residents. In addition, each year the newly accrued capital needs approximate \$2 billion. Annual appropriations for the Capital Fund program to pay for public housing renovations are in the \$2-3 billion range. If this Nation is to make substantial and timely progress in improving living conditions for residents, a new approach is necessary that does not rely solely on annual appropriations.

The current program also is not structured to facilitate the best management practices to the same extent as other affordable housing. Rental property across America is managed and financed on a development-by-development basis—except for public housing. Public housing agencies (PHAs) receive one annual grant for operating subsidies and one for capital covering all of their properties combined, and manage their properties accordingly. This system does not demand the same level of management and financial discipline that other owners must exercise to be successful. While most PHAs are good managers, many PHAs would benefit from the additional management discipline required by accountability on an individual property basis.

The Proposal

The Public Housing Reinvestment Initiative (PHRI) would provide a new way to address public housing's capital needs, in a manner that also will result in additional management accountability at the individual property level. PHAs could finance improvements by replacing their subsidies for individual public housing developments or portions of developments, with HUD commitments of additional project-based voucher assistance. The PHAs would then pledge the rents, including voucher revenues, from each property to secure private financing to rehabilitate or replace their aging properties.

Participation in PHRI would be voluntary. HUD would distribute public housing capital and operating funds fully to PHAs under the usual program formulas. PHAs that choose to participate could then do so. PHAs could commit capital and operating funds they have received under the formulas for initial expenses and the first year of the project-based voucher contract. The development then would be under a long-term project-based voucher contract rather than a public housing contract with HUD, and subsequent contract years would be funded through voucher renewals added to the renewal funding that otherwise would be available.

This year's proposal contains a new feature: a HUD guarantee of up to 80% of the loan principal used to finance the capital improvements. These loan guarantees should encourage lender participation in PHRI on favorable terms. The budget provides enough funding (\$131 million) to allow HUD to guarantee more than \$1.7 billion in loans. This year's proposal also contains modifications to address other concerns raised during last year's discussions. These modifications have the effect of more clearly preserving PHRI developments for long-term low-income occupancy.

2 (a). What Would PHRI Allow Housing Authorities To Do?

- Accelerate efforts to address public housing capital needs and reduce the further accumulation of needs pending receipt of annual Capital Fund appropriations.
- Transform management of public housing into asset management of individual properties, as is done for other affordable housing and private multifamily real estate generally.
- For participating properties, eliminate public housing regulations and replace them with the more streamlined project-based voucher rules.

2 (b). How Would This Initiative Benefit Public Housing Residents?

- Improve their living conditions much more rapidly.
- Grant families more mobility and housing choice. Public housing families must live in public housing developments to keep their subsidies. Project-based voucher families have priority to receive a locally-issued voucher after one year. If they move, PHAs may replace them at the development with another subsidized family.

3 (a). Why is HUD proposing PHRI?

- To provide PHAs with another optional tool to address the backlog of public housing capital needs instead of waiting for annual Capital Fund appropriations.
- To leverage public housing subsidies with private funds to better meet public housing modernization needs and reduce levels of substandard housing.
- To align public housing management practices more closely with asset management principles used in affordable housing (for example, low-income tax credit developments) and more generally in private sector real estate finance and management.
- To make subsidies available to individual properties, based on that property's individual characteristics and relative position in the market, which will promote property-based planning, financial management, and accountability.

3 (b). How Does PHRI Differ From Other Financing PHAs Can Do Now?

PHRI differs from the financing tools already being used by some PHAs because it provides for financing on an individual property basis. Such financings are typical of multifamily rental financing other than public housing. In these financings, the rents from the property and a mortgage on the property are pledged as security for the loan, and a long-term loan is provided. The section 8 contract, subject to annual renewals, provides additional security with which lenders are familiar.

Several PHAs have received loans or issued bonds based solely on the pledge of repayment from future Capital Fund appropriations. These loans are necessarily limited by lenders' concerns regarding the risk of future Capital Fund appropriations. Thus, lenders generally have not been willing to loan amounts greater than about one third of a PHA's Capital Fund share. By contrast, PHRI could allow PHAs to address the capital needs of substantially more of their housing stock. Loan terms may be more favorable depending on the circumstances. Moreover, property-based management oversight and discipline is brought to bear that is not present in the current loan transactions.

4 (a). How Would PHRI Work?

Identification and approval of developments

- PHAs would identify properties suitable for PHRI by preparing a cost analysis to determine the scope of capital improvements and estimating post-renovation market rent levels.
- If market rents were high enough to support project costs, including a loan for the necessary capital improvements, then PHRI would be feasible.
- PHAs also may make up-front capital contributions from public housing capital funds or other sources to write down capital costs and make project-based financing feasible.
- Replacement housing would be eligible in appropriate cases.
- PHAs would work with lenders to develop conversion proposals.
- Rent levels for converted properties would be set at market levels, constrained by applicable voucher payment standards. These rents may be lower than rents set under the standard project-based voucher program, as long as they are sufficient to cover project costs, including operating costs, debt service, and a capital reserve contribution.
- To encourage lender participation, HUD could guarantee up to 80% of the loan principal.
- HUD would approve PHRI proposals through a streamlined process.
- PHRI units would not be subject to project-based voucher program statutory limits on the number of such vouchers, their site location and the percentage of subsidized units per building.

Funding

- PHAs would cover the first year of the project-based voucher contract with public housing capital and operating funds received under the formulas. Afterward, a PHRI development would be removed from the public housing formulas because it is no longer public housing.
- Renewals of project-based assistance contracts would come from appropriations for Section 8 vouchers, added to the amount available for renewals.

Rules for operations

- PHRI units must be maintained as assisted housing for the same length of time they would be maintained as public housing (20 years for modernization and 40 years for development), subject to annual appropriations for voucher renewals.
- To enhance the program's ability to attract capital, HUD may approve in advance the termination, in the event of foreclosure, of these restricted use periods. In individual transactions the Section 8 contract may or may not be continued upon foreclosure. If the Section 8 contract were terminated, tenants would be protected with enhanced vouchers.
- To allow for additional income mixing, flexibility and housing choices, up to one-quarter of PHRI units located in developments for non-elderly or disabled families could be rented to unassisted families, and a PHA could use the project-based voucher for those units in its tenant-based voucher program. The development would remain fully covered by the Section 8 project-based contract. Additional units later could be rented at the development to assisted families, as long as the PHA reduced the number of additional tenant-based vouchers in use.
- A PHA typically would create a subsidiary as a single-purpose entity to be the owner and borrower for each conversion transaction, as is common in other affordable housing financing structures. PHAs may already create such entities for various purposes.
- Converted units would remain subject to the cooperation agreement between the PHA and the local government, which includes exemption from property taxes.

4 (b). Can You Provide an Example of How PHRI Would Work?

The following example demonstrates how PHRI would work with a fictitious public housing authority that desires to make substantial renovations to one of its developments.

**Public Housing Reinvestment Initiative
Example**

PLEASANTVILLE HOUSING AUTHORITY (PHA)

Pleasantville Housing Authority (PHA)

- **10 public housing developments**
- **1,500 total public housing units**
- **\$3.4 million annual Capital Fund grant from HUD**

Fairview Terrace

- **One of PHA's 10 public housing developments**
- **200 units (13% of PHA's stock)**
- **Forty years old; needs substantial capital improvements**
- **Capital needs are approximately \$4 million (\$20,000 per unit)**

Under current funding system, PHA has two choices:

- **Use all of its capital grant for more than one year (\$4 million relative to \$3.4 million) to comprehensively improve the 13% of its units at Fairview, substantially reducing funds available for PHA's other 9 developments**

OR

- **Defer most improvements at Fairview and spread capital funds among the most urgent needs at all 10 developments**

Under PHRI, PHA could:

- **Convert Fairview to project-based vouchers (using public housing funds for the first year and voucher renewal funds thereafter)**
- **Borrow \$4 million from a private lender (plus transaction costs)**
- **Pledge the stream of rents, backed by the voucher contract, to debt repayment**
- **Receive a HUD loan guarantee for up to eighty percent of loan principal**
- **Spend approximately \$335,000 in the initial year to finance \$4 million in improvements at Fairview, leaving almost \$3.1 million for PHA's other developments**
- **Initial year costs include \$335,000 in debt service and any loan guarantee premium (equivalent to a 7% interest rate)**

Under proposed financing system, PHA would meet monthly per unit debt obligations and other expenses as follows:

Debt service (\$4.2 million, 30 years, 7%)	140
Debt service coverage factor (15% of debt service)	21
Capital replacement reserve (\$500 per unit per year)	42
Operating costs	400
Vacancy loss adjustment	<u>25</u>
Rent needed to support the loan	\$628

Feasibility of Debt Financing at Fairview

- **Potential lenders would underwrite a capital improvement loan at a level not to exceed market rents**
- **Lender interest is bolstered by the partial loan guarantee**
- **HUD would not approve rents above applicable voucher payment standard**
- **Therefore, if market rents for Fairview, and the applicable payment standard, are at or above \$628 per unit per month, then a loan of the necessary size could be supported and approved**
- **If market rents are below \$628 per unit per month, then a smaller loan could be supported and approved and the PHA could decide to address the remaining capital backlog with public housing Capital Funds or other available funding**

6. What Legislation Has Been Proposed to Authorize this Initiative?

HUD's FY 2004 budget proposal includes proposed legislation that would create the Public Housing Reinvestment Initiative. Section 208 of the Administrative Provisions in the budget proposal would add subsection (o) to Section 9 of the U.S. Housing Act of 1937, which addresses the public housing capital and operating funds.

- Section 9(o)(1) would authorize the Secretary to approve, on a project-by-project basis, requests by public housing agencies for the conversion of public housing developments or portions of developments to project-based voucher assistance. Such assistance may be provided on the site of existing public housing developments, or on other sites, provided that the number of public housing units converted equals the number of units receiving project-based assistance after the conversion. A commitment must have been obtained from an approved lender for a mortgage loan to finance necessary acquisition costs or capital improvements. The PHA must be in compliance with Capital Fund obligation and expenditure deadlines.
- Section 9(o)(2) would provide that the initial year of any contract for project-based assistance under this section may be funded with amounts appropriated for the public housing capital fund or operating fund or from other amounts appropriated for this purpose. It would also provide that any renewal of such contracts shall be funded with amounts appropriated for Section 8 vouchers.
- Section 9(o)(3) would provide that project-based assistance provided to developments converted from public housing shall be administered under section 8(o)(13) of the Act, which otherwise governs the project-basing of Section 8 vouchers, except as provided in subsections 9(o)(3)(A) through (G).
- Subsection 9(o)(3)(A) would provide that subparagraphs (C)(ii) and (D) of Section 8(o)(13), relating to deconcentration of poverty and the percentage of units in a building that may be subsidized, respectively, shall not apply to public housing developments converted to project-based assistance.
- Subsection 9(o)(3)(B)(i) would provide that units converted to project-based assistance shall be subject to use restrictions requiring the units to be maintained as assisted housing and provided project-based assistance for the same length of time as they would have been required to be maintained as public housing absent such conversion, subject to the availability of appropriations to renew contracts for assistance payments.
- Subsection 9(o)(3)(B)(ii) also would provide that, notwithstanding the use restrictions described above, when dwelling units which are receiving project-based assistance pursuant to a conversion under this subsection (and which are not located in developments or portions of developments which house only elderly

persons or persons with disabilities, or both) become vacant, then the public housing agency may rent up to one-fourth of such units to families who do not receive Section 8 assistance. During the period that any such unit is rented to an unassisted family, the agency may use in its tenant-based voucher program the voucher which otherwise would have been project-based for that unit.

- Section 9(o)(3)(B)(iii) would provide that if HUD determines that such action would further the purposes of this subsection, then HUD may provide for termination of the restricted use period in the event that any units converted to project-based assistance are foreclosed upon (or otherwise disposed of pursuant to an instrument in lieu of foreclosure), unless the Secretary determines that the foreclosure is part of an arrangement the purpose of which is to terminate the use restrictions, or a bona fide and reasonable contract acceptable to the Secretary is presented by a person who is willing to continue the use restrictions. If HUD allows termination of the restricted use period, then HUD shall provide enhanced voucher assistance under section 8(t) of the Act to any family occupying an assisted unit at the time of such termination.
- Subsection 9(o)(3)(C) would provide that any units converted to project-based assistance shall remain covered by and subject to the provisions in the public housing cooperation agreement entered into between the city and the public housing agency.
- Subsection 9(o)(3)(D) would provide that any units converted to project-based assistance shall not be included as tenant-based assistance that is attached to a structure for the purposes of the 20 percent limitation on the portion of an agency's voucher program that may be project-based, as set forth in Section 8(o)(13)(B) of the Act.
- Subsection 9(o)(3)(E) would provide that the Secretary may set the rent level for a unit converted to project-based voucher assistance at a level that is lower than that which would be set under the standard project-based voucher program under Section 8(o)(13) of the Act. However, the rent level must be set at a level that is sufficient to cover the cost of the conversion to project-based assistance, including debt service payments on obligations to finance the cost of any necessary rehabilitation, contributions to a capital reserve, amounts necessary for adequate debt service coverage, the cost of the subsequent operation of the housing as project-based assistance, and any other necessary costs.
- Subsection 9(o)(3)(F) would provide that where units converted to project-based assistance under this subsection are owned or controlled by the public housing agency, HUD may administer or make alternative arrangements to administer the obligations otherwise required of the public housing agency under the annual contributions contract.

- Subsection 9(o)(3)(G) would provide that the Secretary may waive or make alternative arrangements regarding any other provision of law or regulation where the Secretary determines that this would facilitate a successful transition to project-based voucher assistance.
- Section 9(o)(4) would provide that the conversion of a public housing development to project-based assistance shall not be considered a disposition under Section 18 of the Act (which applies to the demolition or disposition of public housing), as long as the public housing agency or an entity controlled by that agency retains ownership of the development.
- Section 9(o)(5) would authorize the Secretary to guarantee up to 80 percent of the principal amount of loans made to finance capital costs of units converted under PHRI. Loans guaranteed would have a term not to exceed 40 years. The Secretary would be authorized to require additional security as a condition for making such guarantees, and may require the payment of premiums. Remedies available to the Secretary would include acquiring possession of, or title to, the property; instituting proceedings for foreclosure; or taking other action to prevent or mitigate losses in connection with a guarantee. This section would also authorize the appropriation of such sums as are necessary to cover the costs of guarantees, the payment of amounts payable under such guarantees, and other costs of carrying out this aspect of PHRI.
- A new Section 9(d)(1)(K) would add to the list of eligible uses of public housing capital funds, assistance in the financing of necessary renovations to or other capital expenses for any development receiving project-based voucher assistance under Section 9(o). Eligible uses would include upfront capital contributions to such developments where needed to make financing feasible and the purchase or provision of letters of credit or other credit enhancements, initial contributions to any necessary reserves, and any contributions that the Secretary may require for the initial administration of subsection (o).

7. Please Provide a Copy of the Proposed Legislation.

Section 208 of the Administrative Provisions of the budget proposal reads as follows:

SEC. 208. Development-Based Subsidies.

(a) IN GENERAL.—Section 9 of the United States Housing Act of 1937 (42 U.S.C. 1437g) is amended by adding at the end the following new subsection:

“(o) DEVELOPMENT-BASED SUBSIDIES.—

“(1) IN GENERAL.—In order to facilitate the financing of capital needs and development-based financial management and accountability, the Secretary may approve, on a project-by-project basis, the conversion of a public housing project or a portion of a public housing project to structures receiving project-based voucher assistance, which structures may be on or off the original site of the public housing project, provided—

“(A) that the number of public housing units converted under this subsection shall be equal to the number of units receiving project-based voucher assistance under this subsection, and that a commitment has first been obtained from an approved lender for a mortgage loan secured by the property to finance qualified, necessary acquisition or capital improvements under terms established by the Secretary; and

“(B) that the Secretary shall not approve the conversion of any public housing project or portion of a project that is owned by a public housing agency that is not in compliance with the provisions of subsection (j) at such time as the Secretary is asked to consider such approval.

“For purposes of this subsection and any other section or subsection of this Act, where the Secretary determines that such construction would assist with the execution of this subsection, any reference to a project or dwelling unit owned by a public housing agency shall be deemed to include a project or dwelling unit owned by an entity controlled by such agency.

(2) FUNDING OF VOUCHERS.—The initial year of any contract for project-based voucher assistance under this subsection may be funded with amounts made available in an appropriations Act under the headings making amounts available for the purposes set forth in subsections (d) or (e) of this section. Any renewal of such contracts shall be funded with appropriated amounts available for the renewal of assistance under section 8.

“(3) Project-based voucher assistance provided under this subsection shall be administered under section 8(o)(13), except that—

“(A) subparagraphs (C)(ii) and (D) of such section shall not apply;

“(B)(i) any units converted to project-based voucher assistance under this subsection shall be maintained as assisted housing and provided project-based voucher assistance for the same length of time as the housing would have been required under subsection

(d)(3) of this section to be operated and maintained as public housing (restricted use period), subject to the availability of sufficient appropriated funds for the purpose of renewing expiring contracts for assistance payments, as provided in advance in appropriations

Acts;

“(ii) notwithstanding clause (i), when dwelling units which are receiving project-based voucher assistance pursuant to a conversion under this subsection and which are not located in developments or portions of developments predominantly occupied by elderly persons or persons with disabilities, or both, become vacant, the public housing agency may rent up to one-fourth of such units to unassisted families, and for each unit so rented for the duration of such rental may

use the assistance otherwise associated with that unit to provide tenant-based voucher assistance under section 8; and

“(iii)(I) notwithstanding clause (i), if the Secretary determines that such action would further the purposes of this subsection, the Secretary may provide for termination of the restricted use period set forth in clause (i) if any units converted to project-based voucher assistance under this subsection are foreclosed upon (or otherwise disposed of pursuant to an instrument in lieu of foreclosure), on the date the units are acquired by foreclosure (or instrument in lieu of foreclosure), unless—

“(aa) the Secretary determines that the foreclosure is part of an arrangement the purpose of which is to terminate the restricted use period; or

“(bb) a bona fide and reasonable contract acceptable to the Secretary to purchase such units is presented by a person who is willing to continue such use restrictions; and

“(II) if the Secretary provides for termination of the restricted use period pursuant to subclause (I) and if the contract for project-based assistance is also being terminated or is expiring, the Secretary shall make available enhanced voucher assistance under section 8(t) to any eligible family occupying an assisted unit at the time of such termination;

“(C) any units converted to project-based voucher assistance under this subsection shall remain covered by and subject to the provisions in the public housing cooperation agreement entered into between the governing body of the locality involved and the public housing agency;

“(D) any units converted to project-based voucher assistance under this subsection shall not be included as tenant-based assistance that is attached to a structure for the purposes of the 20 percent limitation set forth in section 8(o)(13)(B);

“(E) the rent level for a unit converted to project-based voucher assistance under this subsection may be set at a level lower than the level at which such rent would otherwise be set pursuant to section 8(o)(13)(H), provided such lower level is sufficient, in the determination of the Secretary, to cover debt service payments on obligations to finance the cost of any necessary rehabilitation, contributions to a capital reserve, amounts necessary for adequate debt service coverage, the cost of the subsequent operation of the housing as project-based voucher assistance, and any other necessary costs;

“(F) where units converted to project-based voucher assistance under this subsection are owned by the public housing agency (including an entity controlled by such agency), the Secretary may administer or make alternative arrangements to administer the obligations otherwise required of the public housing agency under the annual contributions contract; and

“(G) the Secretary may waive, or specify alternative requirements for, applicable provisions of this Act where the Secretary determines that such waiver or requirements would facilitate a successful transition from public housing to project-based voucher assistance.

“(4) TREATMENT OF CONVERSION.—The conversion of public housing units to project-based voucher assistance under this subsection, including any disposition of public housing units to an entity controlled by the public housing agency prior to but in furtherance of such conversion, shall not be considered a disposition under section 18 of this Act.

“(5) FEDERAL GUARANTEES FOR FINANCING.—

“(A) AUTHORITY.—Subject to the Federal Credit Reform Act of 1990, as amended, the Secretary may, upon such terms and conditions as the Secretary may prescribe regulations, make commitments to guarantee total loan principal only, not to exceed 80 percent of the principal amount of the loans, notes or other obligations issued to finance qualified, necessary acquisition or capital improvements of units converted under this subsection.

“(B) TERMS OF LOANS.—Loans, notes or other obligations guaranteed pursuant to this subsection shall be in such form and denominations, have such maturities not to exceed forty years, and be subject to such conditions as may be prescribed by the Secretary.

“(C) SECURITY.—As a condition for issuing guarantees under this subsection, the Secretary shall require the entity to furnish, at the discretion of the Secretary, such security as may be deemed appropriate by the Secretary in making such guarantees. In addition, in connection with any loan, note, or other obligation guaranteed pursuant to this subsection, the Secretary may require the payment of a premium charge, which premium charge shall be retained and used by the Secretary to offset the risk to the government associated with such guarantee.

“(D) REMEDIES.—In addition to other available remedies, with respect to any property securing a loan, note, or other obligation guaranteed under this subsection, or with respect to any such guarantee, the Secretary is hereby authorized to—

“(1) acquire possession of, or title to, the property by voluntary conveyance in exchange for extinguishment of the loan, note, or other obligation guaranteed under this subsection;

“(2) institute proceedings for foreclosure, including proceedings under the Multifamily Mortgage Foreclosure Act of 1981 (12 U.S.C. 3701 et seq.); or

“(3) take action the Secretary determines to be necessary to prevent or mitigate losses in connection with the guarantee under this subsection.

“The Secretary is authorized to accept assignment of any loan, note or other obligation guaranteed under this subsection and to exercise all the rights of a holder of such debt instrument, including the right to sell such loan, note, or other obligation, and to take such action and advance such sums as may be necessary to preserve or protect the lien of such loan, note or other obligation.

“(E) AUTHORIZATION OF APPROPRIATIONS FOR CREDIT SUBSIDY AND OTHER COSTS OF CARRYING OUT THIS PARAGRAPH.—There are authorized to be appropriated to cover the costs (as such of guarantees under this paragraph, the payment of amounts payable under such guarantees, and other costs of carrying out this paragraph, such sums as may be necessary for fiscal year 2004 and fiscal years thereafter: Provided, That such costs, including the cost of modifying such loans, shall be as defined in section 502 of the Congressional Budget Act of 1974.”.

(b) USE OF CAPITAL FUND AMOUNTS FOR CONVERSION.—Section 9(d)(1) of the United States Housing Act of 1937 (42 U.S.C. 1437g(d)(1)) is amended—

(1) in subparagraph (I), by striking “; and” at the end;

(2) in subparagraph (J), by striking the period and inserting “; and”; and

(3) by inserting at the end the following new subparagraph:

“(K) assistance in the financing for necessary renovations to, or other capital expenses for, any project receiving project-based voucher assistance pursuant to subsection (o) of this section, including the making of capital contributions to such projects where needed to make financing feasible and the purchase or provision of letters of credit or other credit enhancements necessary to carry out such subsection, initial contributions to any necessary reserves, and any contributions that the Secretary may require for the initial administration of such subsection (o) with respect to such project.”.