Interim Report

Evaluation of HUD's Rental Assistance Demonstration (RAD)

Summary

U.S. Department of Housing and Urban Development | Office of Policy Development and Research

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The U.S. Department of Housing and Urban Development (HUD) and public housing authorities (PHAs) have long struggled to maintain the country's 1.1 million public housing units. In 2010, a study prepared for HUD estimated the backlog of public housing capital needs to be approximately $26 billion, with each subsequent year accruing an additional $3.4 billion in unmet capital needs.[1] Congress authorized the Rental Assistance Demonstration (RAD) in 2012 to test a new way of meeting this substantial funding challenge. RAD authorizes PHAs to convert public housing properties to project-based Section 8 contracts, which is expected to provide a more stable, long-term funding stream and to make it easier for PHAs to leverage additional funding sources. New research released by HUD examines how the RAD program has performed to date. The interim report of the RAD evaluation (released September 2016) is the first independent assessment of RAD and completes the first phase of the evaluation mandated by Congress in its authorization of RAD. The report provides evidence that the program is on track to accomplish its primary goal of attracting substantial new capital and stabilizing the physical and financial condition of federally assisted housing properties. This brief summarizes some key findings from the report, which is available at *https://www.huduser.gov/portal/publications/RAD_Evaluation.html*.

How RAD Works

RAD is a voluntary program; PHAs decide whether to participate, and they can apply to convert individual projects, multiple projects, or their entire portfolio. If HUD approves a PHA's application, the PHA begins a process of evaluating capital needs and securing financing to address those capital needs. At the end of that process, HUD removes the public housing "Declaration of Trust" and converts the funding that a property had received through the public housing program into a Housing Assistance Payment (HAP) contract. Through long-term HAP contracts that automatically renew and a long-term Use Agreement that is recorded on the land, RAD ensures that the property will continue to serve low-income residents while permitting the property itself to serve as security for debt needed for rehabilitation.

Through **October 2015**, **185 RAD projects** had completed closing with a total of **$2.5 billion** in financing.

[1] Abt Associates Inc. 2010. *Capital Needs in the Public Housing Program: Revised Final Report.* Report prepared for the U.S. Department of Housing and Urban Development. Washington, DC: U.S. Department of Housing and Urban Development.

Overview of RAD Activity

From the program's inception through the fall of 2015, 423 PHAs submitted 1,078 applications for RAD conversion. This total represents 14 percent of all PHAs and 16 percent of all public housing developments. **HUD has already made awards up to the cap that Congress set of 185,000 units that may be converted, and thousands of units are on a waiting list.** As of October 2015, 185 projects, with 19,255 public housing units, had reached closing—completing the conversion process—with $2.5 billion in financing.[2] Congress has not appropriated any supplemental funding for RAD transactions, so PHAs rely exclusively on existing resources and external funding. Of the $2.5 billion in total financing, only $250 million came from public housing funds, which equates to a leverage ratio of nearly 9:1. That is, for every $1 of public housing funds, RAD is leveraging $9 from sources such as Low-Income Housing Tax Credit equity, private mortgage debt, accrued equity in the land, grants, and other funding.

The majority (63 percent) of RAD projects studied are undergoing some level of rehabilitation. Some of those with the most severe capital needs are being demolished and rebuilt (19 percent of RAD conversions). Other properties (18 percent of RAD conversions) do not have immediate capital needs but are converting for other reasons, such as establishing a strong capital reserve for future repairs, or because they believe the Section 8 platform will simplify their operations. On average, the closed projects studied for this report are undergoing $60,877 per unit in construction costs.

Centre Meadows (Lexington, KY before RAD construction)

RAD Participation Trends

RAD is most popular with medium and large PHAs (those with at least 250 units of public housing). Only 8 percent of small PHAs are participating in RAD compared with 29 percent of medium PHAs and 48 percent of large PHAs; and yet, small PHAs that pursue RAD are converting a larger portion of their portfolio. As a result, units owned by small PHAs are only slightly less common in RAD than they are in the full public housing universe.

Many PHAs are converting a subset of their public housing properties through RAD; in these cases, the report examines factors that appear to influence a PHA's decision to convert a particular property. The variables that increase the likelihood that a project will be submitted for RAD conversion include lower median household income in the development, lower poverty rate in the surrounding neighborhood, and stronger financial position of the development (higher per-unit operating funds and lower per-unit operating expenses).

A factor in whether a PHA will apply for RAD is whether the RAD rents can support the property's immediate and long-term financing needs. In some cases, PHAs determined that the rents from Section 8 would not be sufficient to attract the capital necessary to make all required repairs. RAD is currently operating without HUD receiving additional appropriations for public housing or project-based Section 8. PHAs report that they would need supplemental funding to convert some of their more challenging properties.

Centre Meadows (Lexington, KY during RAD construction)

[2] This interim report analyzes only the conversions that occurred through October 2015.

Long-Term Financial Implications of RAD

In addition to enabling the infusion of upfront capital—the $2.5 billion secured by the 185 projects that closed as of October 2015—RAD appears to put converting properties on a stronger long-term financial trajectory. The interim report presents four case studies of actual RAD projects, along with a counterfactual (how the PHA might have funded equivalent investments without the opportunities presented by RAD). For each case study, the report analyzes the development budget (the budget for upfront repairs and investment) and the long-term (20-year) operating pro forma.

Under RAD, rents are set at cost-neutral levels based on existing public housing funding and are adjusted only by the operating cost adjustment factor for the life of the HAP contract. The four case studies show that this stable and predictable revenue stream enables the properties to cover their operating expenses, pay debt service to finance immediate capital improvements, and fund a reserve for future repair needs. When compared with each case study's counterfactual modeling forecast, the RAD properties perform substantially better over time than they would have if they had remained in the public housing program.

Ongoing Research

The interim report provides important insights into the implementation of the RAD program, but it is still too early to fully assess the program's effectiveness and whether the projected physical and financial improvements will be achieved. It is also too early to say how RAD affects the residents of converting properties. These critical issues will be analyzed in the second phase of this study. Researchers will conduct physical condition assessments at a sample of RAD and non-RAD properties, analyze financial reports for RAD and non-RAD properties, examine administrative data on the location of RAD residents, and survey a sample of RAD residents to understand how the program affected them. The findings from this second phase are expected be published in December 2018.

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