Public Housing's New Math

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Every two years, HUD's Office of Recapitalization (Recap), which administers the Rental Assistance Demonstration (RAD) program, publishes an updated RAD Rent File. This file captures the funding each project receives under the public housing program – also called the "RAD rents" – along with the local Section 8 Fair Market Rents (FMRs). Indeed, Recap recently published the RAD rents effective for 2023. In this paper, I look at those 2023 RAD rents and what they tell us about the public housing program. At the same time, I suggest that it is essential for every PHA, in terms of evaluating HUD's repositioning options, meaning the conversion to Section 8, to compare its current funding for each public housing unit (the RAD rents) with both the market rent and 110% of the FMR. I'll explain why in just a moment. But first we need to explore the fact that, alone among the major federal housing programs, the funding provided for public housing is completely independent of local market rents – and why that has hindered repositioning planning.

Public Housing: A Non-Market Rental System

Let's assume that you were looking to rent an apartment and you happened to stumble into the manager's office of a public housing community, whereupon you asked to know the rent for, say, a 2-bedroom unit. The manager would give you a look of bewilderment, not because the manager was trying to be difficult, but because there is no such thing as a market or contract rent in public housing. In addition to tenant rents (which are capped at 30% of adjusted income), PHAs receive formula-determined operating and capital subsidies. For the Operating Fund, the formula is based on a statistical model of the operating costs in Federally-assisted housing, adjusted for factors including building type, age, bedroom distribution, location, etc. For the Capital Fund program, the formula represents an estimate of each project's backlog of capital repairs and future (accrual) needs, relative to needs throughout the program. Depending on how much the Congress appropriates in any year for the Capital Fund, each PHA simply gets its proportionate share of the national pot.

In short, the subsidies provided to PHAs are not tied to local market rents; therefore, there's no reason, under the public housing program, for a PHA to know a project's market rent or the relationship between current funding and the applicable FMR. Let's contrast that situation with how projects are funded in the two main project-based Section 8 programs:

- In the original project-based Section 8 program enacted in 1974, often referred to as "Multifamily Section 8", or Section 8 "Project-Based Rental Assistance (PBRA)", contract rents were set at 100% of the "new construction" FMR, but with the ability, with HUD approval, to go up to 120%, with annual rent adjustments.[1] Although the initial rents were also required to be "reasonable", soon a large number of projects had contract rents that were well above market,

[1] Before Congress terminated the Section 8 New Construction/Substantial Rehabilitation program, HUD published two sets of FMRs: one for new construction and one for existing housing.

which caught the eye of legislators and policy-makers. In 1997, Congress passed the Multifamily Assisted Housing Reform and Affordability Act, also known as MAHRA. Under MAHRA, when Section 8 PBRA contracts expire and get renewed, the Section 8 rents either get marked down to market (this renewal option is called "Mark-to-Market", or "M2M"), or marked up to market (generally not to exceed 150% of the FMR). Projects with above-market rents that are also FHA-insured are required upon renewal to go through M2M, which may result in restructuring of the FHA loan so that the newer (lower) market rents will be adequate to support the debt service payments. There are other MAHRA transition or phase-in provisions that we won't have time to go over here. But the big point is that, in the world of Section 8 PBRA, contract rents are now mostly pegged to market rents.

- In the Project-Based Voucher, or PBV, program, authorized in 1998, Congress allowed PHAs to project-base (at the time) up to 20% of their authorized voucher units. From the very start, PBV rents could not exceed market, with a cap. PBV rents are set at the lower of (a) the "reasonable rent" (i.e., the market rent), or (b) 110% of the applicable FMR.

Unlike public housing, therefore, the Section 8 program has always had a market rent component, even more so today than in the early years. As a result, operators of Section 8 housing are keenly aware of the market rent for each unit and the associated FMR. That's not the case with PHAs.

Repositioning Revisited

For more than a decade now, HUD has been encouraging PHAs to "reposition" their public housing, i.e., to convert from public housing to Section 8, which, among other factors, facilitates the access to private debt (mortgage proceeds) and equity (tax credits) to better preserve the assets for the long-term. There are three major repositioning (or conversion) options. [2]

- There is RAD, which allows a PHA to convert either to Section 8 PBRA or PBV, but not to exceed the project's current funding under the public housing program, subject to certain program rent caps;[3]
- There is Section 18 Demolition/Disposition (Section 18), where, if the project qualifies, HUD provides Section 8 Tenant Protection Vouchers (TPVs), which the PHA can project-base (to create project-based vouchers, or PBVs);[4] and
- There is, for PHAs with 250 or fewer units, Streamlined Voluntary Conversion (SVC), where a PHA can also project-base the TPVs, but with tenant consent.

Importantly, under Section 18 and SVC, the PBV rents are not tied to current public housing funding but are based on standard PBV requirements, i.e., the lower of the reasonable rent or 110% of FMR. As will be shown shortly, these PBV rents are generally higher, and sometimes substantially higher, than

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[2] For a greater discussion of the Section 8 conversion options for public housing, please HUD's guidebooks on repositioning, which can be accessed here: [Repositioning FAQs | HUD.gov / U.S. Department of Housing and Urban Development (HUD)]

[3] For RAD PBRA conversions, if current funding exceeds 120% of FMR, the PHA must submit a rent comparability study (RCS) to support the current funding, up to 150% of FMR. There is no RCS when current funding is below 120% of FMR. For RAD PBV conversions, rents cannot exceed the lower of: current funding, the reasonable rent, or 110% of FMR.

[4] Under Section 18, a PHA has the discretion to project-base the award of TPVs. Under SVC, the PHA must obtain consent of the tenants to project-base the TPVs.

current public housing funding. That's among the main reasons why it's so important for each PHA to know the market rent for each unit and how each project's funding compares with 110% of FMR. There are many considerations for any PHA in determining whether to convert to Section 8, of which the contract rent is just one consideration. But it's a major consideration.

The 2023 RAD Rents

The 2023 RAD Rents were just published in December 2022.[5] These amounts are based on the funding each project receives under the public housing program, inclusive of Operating Subsidies, Capital Funds, and Tenant Rents. To arrive at the 2023 rents, HUD used actual PHA funding in 2022 (on a project-by-project basis) and then adjusted those amounts for 2023 by an Operating Cost Adjustment Factor, or OCAF. Nationally, the 2022 Contract Rents were $1,013 per unit monthly (PUM). With an average 2023 OCAF of 6.3%, and with an average utility allowance of $45 PUM, the national 2023 RAD Gross Rent is $1,124 PUM.[6] In publishing its RAD rent file, HUD also publishes the corresponding FMR for each property. Consequently, we can now determine, across the country, not only the average public housing funding per project but how that funding compares with HUD's FMRs. Nationally, public housing is funded at 87% of the applicable (bedroom-adjusted) Section 8 FMR.

2023 RAD Rents (Per Unit Monthly, PUM)

2022 Capital Fund	2022 Operating Fund	2022 Tenant Rent	2022 RAD Contract Rent	2023 OCAF	2023 RAD Contract Rent	Utility Allowance	2023 RAD Gross Rent	Percentage of FMR
$268	$443	$302	$1,013	6.3%	$1,079	$45	$1,124	87%

The fact that public housing funding is even remotely close to the FMR is purely a coincidence. Remember, the public housing funding formulas have no market rent component to them.

But there are also large variations in public housing funding, relative to FMRs, both within any agency and across agencies. (There are also significant regional variations – for example, RAD rents in the Northeast, Mid-Atlantic, and West Coast are substantially lower than FMR than the RAD rents in, say, the Midwest). The table below shows the distribution of RAD rents as compared to the FMR. As indicated, 35% of all projects have rents less than 80% of the FMR and 17% have rents above 110% of the FMR.

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[5] The 2022 RAD Rent File can be accessed here: 2022_RAD_Rents_Web.xlsx (live.com)

[6] All figures are unit-weighted averages.

Distribution of 2023 RAD Gross Rents as Compared with FMRs, by Project

Category	Number of Projects	Percentage
RAD Rents < 80% of FMR	2,194	35%
RAD Rents 80-89% of FMR	972	15%
RAD Rents 90-99% of FMR	1,083	17%
RAD Rents 100-109% of FMR	996	16%
RAD Rents 110%+ of FMR	1,111	17%
Total, Public Housing Projects	6,356	

What is the FMR?

In the early years of the Section 8 voucher program, the FMR represented the 50th percentile of recent movers in any metropolitan area, excluding newly built units, public housing units, or substandard units. In 1983, the FMR was reduced to the 45th percentile and, in 1995, FMRs were lowered once more to the 40th percentile, which is where they stand today. You can think of the FMR as something like the 'middle-of-the-road' apartment in any market, although a lot depends on where one is located in the larger metro (or non-metro) market. For example, if a small PHA is located in the outer ring of the metro area, where market rents might be lower than in the more densely populated hub of the metro area, the PHA's units are less likely to compare favorably with the metro-wide FMR, meaning that, if the PHA were to rent the units to anyone walking off the street, they would have a harder time getting a rent equal to the FMR.

What would it Take to Fund all Public Housing Projects at 100% of the FMR?

Another advantage of the RAD Rent File is that, by publishing local FMRs for each project, it also allows us to estimate what it would cost to fund all public housing units at 100% of the FMR. As shown in the table below, if we subtract the median RAD rent from the median FMR, we come up with a difference of $168 PUM, i.e., RAD rents (public housing funding) are, on average, $168 PUM less than FMRs. Then, if we multiply that number by the number of units in the public housing program (920,828), and by 12 months, we can determine the incremental cost to fund all public housing projects at 100% of the FMR (above and beyond current public housing funding levels), which comes to $1.9 billion.

Incremental Cost to Fund all Public Housing Projects at 100% of FMR, 2023

2023 FMR	2023 RAD Gross Rent	Monthly Difference	Annual Difference	Number of Public Housing Units	Additional Cost
$1,292	$1,124	$168	$2,016	920,828	$1,856,389,250

Of course, the above estimate only shows what it would cost to fund each public housing project at 100% of FMR. It doesn't account for two additional factors:

- We don’t know what the actual market rent is for any public housing community. That information is simply not required in the public housing program and, as such, is not captured in any system. Purely anecdotally, I would say that most stable public housing projects would command a street rent slightly below FMR and that most substantially rehabilitated or newly constructed properties tend to support reasonable rents between 100-110% of FMR. But properties that have not been recapitalized or are in less desirable neighborhoods would support rents at well below FMR; and
- It assumes that all projects that have funding above FMR are brought down to FMR. About one-third of all public housing properties have rents above FMR. Just to get a sense of things, if we held those rents constant (if we grandfathered in all projects with current funding above FMR), then the incremental cost would rise to about $3.1 billion.

Should Public Housing be Funded Similarly as Other Federally-Assisted Housing?

We’ve ascertained that, more-or-less, other Federally-assisted housing is funded today at market rents, with certain caps. Should public housing?

Purely from a fairness standpoint, one would be inclined to say that, indeed, public housing should generally be funded in the same manner. But there are two caveats:

- First, PHAs don’t pay the same amount in property taxes as others who operate assisted housing (except in those rare cases where state or local government may exempt affordable housing from property taxation). PHAs pay a “Payment in Lieu of Taxes”, or PILOT, which is on the order of about $16 PUM nationally, an amount that, depending on the locality, could be $50-$100 PUM less than local property taxes.
- Second, the Federal government mostly paid to construct the public housing. Thus, the vast majority of public housing projects have no associated debt and, therefore, no debt service payments, which is one of the largest expense items of any traditional apartment complex. That said, the public housing inventory is aging fast and, as a result, suffers from an enormous backlog of physical repairs. Yes, the Federal government paid to construct the units, but this inventory needs to be refreshed and PHAs should be accessing private capital to address these needs, i.e., if they don’t now, most PHAs should be leveraging their assets to raise first mortgage proceeds and, therefore, there should be room in the contract rents to afford reasonable debt service payments.

Even with the above important caveats, it does seem that PHAs should be treated similarly. But, at least for now, the only way that a PHA is going to get a market rent, if the current public housing funding is below market, is to convert to Section 18 or SVC, where there’s the opportunity to command a rent up to 110% of FMR.[7]

[7] There are three exceptions: (1) PHAs can “rent-bundle” among two or more RAD conversions (raising rents at one project and lowering rents at another, as long as the total HUD funding does not increase); (2) PHAs can trade in current and future Demolition, Disposition, and Transition Funding (DDTF), which is earned for buildings that are removed through Section 18, to boost the RAD rents; and (3) PHAs can earn up to $100 PUM for projects converting to PBRA that are undertaking substantial repairs and located in an Opportunity Zone. However, there is a limited amount of funds for these O-Zone Boosts.

What Does 110% of FMR Get You?

Today, at least, Section 8 TPVs (which accompany Section 18 and SVC actions) are the "golden ring" for most PHAs in terms of converting to Section 8. If a PHA were to project-base the TPVs – to create PBVs – it would see an increase, on average, of around $300 PUM over current public housing levels, subject to rent reasonableness.[8] Indeed, most public housing redevelopment projects today utilize just that tool, i.e., the project-basing of TPVs. Because FMRs are today pegged at the 40th percentile of rents for recent movers, 110% of the FMR is still not a rent that, alone, can support new construction. However, in some markets, 110% of FMR, coupled with 4% low-income housing tax credits, can get you much closer. The key is that, for any new construction or substantial rehabilitation project, you will have a much easier time getting the numbers to work, and leveraging debt and equity, with rents at/near 110% of FMR than if the rents were based on current public housing funding.

When Current Public Housing Funding Already Exceeds Market

Remember, the current formula-determined public housing funding has nothing to do with market rents. No one knows for certain how many public housing projects today receive funding that exceeds what the units would rent for in the market. We know how many have funding above FMR, but not the true market value for the unit. We can use the FMR only as a proxy. That said, my guess is that it would be on the order of 25%. What can we say to these agencies?

On the one hand, projects with public housing funding that is already above the market rent for the units don't have the opportunity for the large rent increases that other PHAs may enjoy when they convert via Section 18 or SVC. Their funding is not going to improve. On the other hand, these agencies/projects are already receiving funding that is higher than the rents obtained by other owners in the surrounding markets for "comparable" product. Theoretically, they should be able to provide standard quality housing for that price, including a reasonable amount each month for debt service payments to cover a decent level of repairs. As with everyone else, these amounts won't be adequate if the project needs to be demolished or substantially rebuilt, but they are advantageous, nonetheless, as compared with others looking to create subsidized housing. Indeed, PHAs with above-market funding should be thinking of converting to RAD PBRA to lock in that above-market funding.[9]

The Small and Very Small PHA Problem

In recent years, HUD has gone to great lengths to make it easier for very small (50 or fewer units) and small (51-250 units) PHAs to convert to Section 8. In addition to the standard RAD and Section 18 programs, HUD has introduced:

- Section 18 for Scattered Sites (many small and very small PHAs will qualify),
- Streamlined RAD for Very Small PHAs,
- RAD/Section 18 Small PHA Close-out Blend,
- RAD/Section 18 Construction Blend, and
- Streamlined Voluntary Conversion (SVC).

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[8] Figure derived from earlier tables. Assumes a rent reasonable determination of 110% of FMR.

[9] To repeat, under RAD PBRA, a PHA keeps its current funding up to 120% of FMR with no rent comparability study.

In fact, there are more options for smaller PHAs to convert to Section 8 than for medium and larger agencies.

Getting these smaller PHAs onto the Section 8 platform should help to better preserve the assets long-term. But conversion should also help simplify the administration of HUD's housing subsidy programs. HUD benefits in that it gets to consolidate programs. Smaller PHAs substantially benefit from regulatory streamlining, especially when they convert to PBVs, where the voucher administrator will now be responsible for all functions related to applicant eligibility and reexamination of tenant rents, which greatly eases the task of owning housing that serves subsidized households. For this reason, it does seem that HUD should be trying to get these small and very small agencies to convert, overall, but also to convert to PBVs.

Still, smaller agencies face at least two unique hurdles:

- One, unlike larger agencies, smaller agencies don't have any real opportunity under RAD to "rent bundle", i.e., to spread rents across properties to balance out projects with above-market funding with projects with below-market funding. Of course, they could convert to RAD PBRA, where PHAs are allowed to retain current funding up to 120% of FMR without any market test (a thoughtful grandfathering provision); however, for reasons outlined above, there is a compelling reason for smaller agencies to convert to PBVs and, under RAD PBV, a PHA is capped at the lower of current funding or 110% of FMR.
- Two, at least as current guidance goes, a PHA cannot carry over any of its operating reserves, outside of RAD, when it converts to Section 8. Again, larger agencies are better able to move these project-level reserves around as they reposition. Having to spend down those funds prior to conversion can be a real deterrent for these smaller PHAs if they are otherwise eligible for, or prefer to convert to, Section 18 or SVC.

Addressing these two issues (below) could greatly help get more smaller agencies converted.

What PHAs Should Do Now

I like to think that a PHA has a fiduciary responsibility to recommend to its board the program options that are in the best interests of the agency and its mission to preserve and enhance affordable housing opportunities. And, fundamental to making that recommendation is understanding how your current public housing funding compares with the market rent for your units and with 110% of FMR, which, I argue, is public housing's new math. Answering those questions will greatly shape which conversion programs are most advantageous, whether that means converting via RAD and keeping your current funding or converting via Section 18 or SVC and increasing your funding.

Some Modest Policy Proposals

Among other matters, this paper raises the question as to whether public housing projects, as they convert to Section 8, should get the same treatment as other Section 8 projects, which is a rent at market, up to some agreed-upon standard. Today, that mostly works for projects that happen to qualify for Section 18 or SVC, but not all projects qualify. Graduating to a more universal program of market-based funding, and deciding such issues as how best to grandfather projects with above-market funding, will take some years to play out. In the meantime, under the current set of tools that are available, the

following two proposals would, at least, make it easier for smaller PHAs to convert, which I hope that everyone could agree would be a good thing:

1. Provide some form of grandfathering of current funding for smaller agencies who may be above market or even above 110% of FMR and want to convert to RAD PBV. HUD has no statutory authority to change the PBV rent-setting rules for non-RAD transactions; however, the RAD statute allows HUD at least to waive the PBV rent rules to facilitate RAD PBV conversions. HUD could use this flexibility to grandfather in these projects, much as it has done for PBRA conversions (where there is no market test up to 120% of FMR).
2. Allow smaller PHAs, if they are converting their last project under Section 18 or SVC, to carry over their operating reserves. Amounts held by PHAs in their operating reserves are, in the parlance of Federal appropriations regulations, already “obligated” or “expended.” They are no longer held by Treasury. As such, when a PHA exits the public housing program, these operating reserves should be treated as other surplus property, which, in this case, means they should be allowed to be used for affordable housing, including repurposing as reserves for the converted property.

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