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POST-CONVERSION OVERSIGHT OF RAD PBV PROJECTS

By Greg Byrne

The Rental Assistance Demonstration (RAD) program allows PHAs to convert public housing projects to two forms of long-term Section 8 assistance – Project-Based Rental Assistance (PBRA) or Project-Based Vouchers (PBVs).

The question of this paper is, "How should public housing projects that convert to Section 8 PBVs under RAD be monitored?" This issue is one of the great, unfinished pieces of business in the RAD program. At the time that RAD was first implemented, standard PBV projects were not subject to "asset oversight" (see more below). Therefore, rather than create a new and untested framework for RAD projects, HUD punted this issue to a later time.[1] Since that time is getting near, this paper suggests an outline for what such an oversight model might look like – and why.

The PBRA Model

To begin, let's first examine what asset oversight means for Section 8 PBRA projects, administered by HUD's Office of Housing. The PBRA program has been around since 1974 and has long-established protocols governing such issues as asset oversight and monitoring. At its core, asset oversight of PBRA projects includes three main elements:

- Submission (and HUD review) of annual financial statements,
- Physical inspections, generally once every three years unless conditions trigger more frequent inspections[2], and
- Annual on-site management reviews, which include an element of "performance" (is the site clean, is preventive maintenance being performed, etc.?) as well as "compliance" (are admissions limited to income-eligible families, are tenant rent calculations properly performed, etc.?).

[1] Footnote 42 of the RAD Notice reads: "For PBV conversions that are not FHA-insured, a future HUD notice will describe project financial data that may be required to be submitted by a PBV owner for purposes of monitoring and evaluation, given that PBV projects do not submit annual financial statements to HUD/REAC." See Rental Assistance Demonstration – Final Implementation, Revision 4, PIH Notice 2019-23, published September 5, 2019.

[2] Conducted under the Uniform Physical Condition Standards, or UPCS, protocol administered by the Real Estate Assessment Center.

In other words, HUD monitors the financial, physical and management condition of each PBRA project. With this data, HUD then assigns a "risk" rating, which then determines additional levels of monitoring and intervention. Some of this monitoring is done remotely and some is performed on-site.

The Standard PBV Model

Now let's look at the oversight model for standard (non-RAD) PBVs. Unlike PBRA projects, there is no annual management review of the project; there is no UPCS-like physical inspection; and there is no review of project-level financial statements. Not surprisingly, there is no such thing as a national database that captures the performance of PBV projects. Really, the only oversight that is performed on a PBV project is whether the units meet Housing Quality Standards (HQS) and whether the rents are reasonable. Remember, also, that in the PBV program it is the voucher agency, i.e., the contract administrator, and not the project that administers the waiting list, establishes applicant eligibility, and determines tenant rent levels; hence, there are fewer areas to monitor from a perspective of program compliance.

Taking Perspective

At first blush, particularly in contrast to PBRA, the PBV oversight model seems remarkably thin. What's the deal here? Has HUD lost its mind? Why don't we look at the management or financial performance on standard PBV projects?

It would be helpful to examine an example:

> Assume that a local voucher agency (the PHA), having participated in a homeless task force, decides to make available 10 units from its voucher program as PBVs for formerly homeless veterans leaving transitional facilities. The PHA issues a solicitation and, after reviewing proposals, selects Vets for Housing, or VFH, as the sponsor. VFH owns an existing residential building that it plans to repurpose as permanent assisted housing and enters into a 15-year Section 8 PBV Housing Assistance Payments (HAP) contract with the PHA. In exchange for this 15-year HAP contract, VFH agrees to provide decent, safe, and sanitary housing for the residents of these 10 units. The PHA has no obligation to this project other than to provide assistance payments in exchange for the units being in decent physical condition. If VFH fails to own up to its end of the bargain, the voucher agency can enforce the contract to get VFH to comply, which ultimately could mean, if conditions do not improve, terminating the contract and providing the existing households with free-standing vouchers. The financial condition of the project (say, whether it generates cash flow) or the effectiveness of its management (say, how quickly it turns around vacant units) really makes no difference to the voucher agency – in fact, it would never even know. The primary importance to the voucher agency is whether the units are decent, safe, and sanitary.

I believe that HUD actually got it right when it came to the design of the PBV program and the oversight of PBV projects. HUD has no financial role with these projects. Instead, one should really think of the PBV program as more like an extended leasing arrangement, where a PHA (the voucher administrator) is tying up a property for a length of time (say, 10-20 years). "I'll give you these Section 8 units as long as you maintain them in decent order." That's it. It is someone else's job (lender, investor, funder, etc.) to look after the management and financial performance of the project. It's a very simple arrangement. The voucher agency is making no commitment other than the HAP subsidy. Hence, the financial condition of the project is of no concern to the PHA. If the owner cannot keep the premises in decent shape, the voucher agency simply terminates the HAP contract and the assisted families receive a housing voucher. The voucher agency is no worse off than before the project was designated for PBVs, i.e., the vouchers get returned to the regular voucher program and the residents are protected (issued vouchers).

A Substitute Model for RAD Projects

As indicated, I believe HUD made the right choice here and should never "asset-manage" a standard PBV project. RAD PBVs, however, are different in that RAD is a "preservation" program. It is intended to preserve, in perpetuity, the hard units of assistance that were once public housing (mostly by preserving the assistance in-place but sometimes resulting in a transfer of assistance or new construction). Therefore, we can't apply the same approach where, if a project goes belly-up and fails to provide decent housing, we simply terminate the HAP and issue the households vouchers. First, it will be extremely challenging, once failure occurs, to transfer the assistance elsewhere to preserve the "hard" units.[3] Second, RAD PBV projects were also often given either public housing Capital Funds and/or Operating Funds (operating reserves) to facilitate conversion. These are scarce public resources. Hence, there's a reason to treat RAD PBVs differently from standard PBVs in terms of oversight.

If we can agree that RAD PBVs should receive a higher level of oversight than standard PBVs, the three follow-on questions are: what should that oversight look like, who should perform that function (HUD or the voucher agency), and, if HUD, where in HUD (the Office of Housing or PIH)?

In terms of the form of oversight, it seems logical that we would approach RAD PBVs much the same as we handle Section 8 PBRAs, which would be:

- Regular physical inspections of the property [4],

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[3] By intervene, I mean here to require the owner to improve conditions and that, if conditions do not improve, to seek other remedies, including possession of the asset or termination and transfer of the HAP contract.
[4] Notice that I do not say that we should necessarily conduct UPCS inspections. I'm not sure that this is the appropriate model and I much prefer that the physical condition of properties be something evaluated alongside of the on-site management review. I'll likely take on this issue in a forthcoming paper.

- Regular management reviews of the property, and
- Submission and review of annual financial statements to determine basic financial feasibility.

In fact, our task is even easier than for Section 8 PBRA projects because, as mentioned earlier, most of the tasks of subsidy administration are performed by the voucher agency. Hence, we can really concentrate our oversight on more traditional real estate measures regarding whether the asset is being appropriately managed and preserved.

Then, in terms of who should perform these oversight functions, it would seem inappropriate for the voucher administrator to play that role, not just because the PHA might have an ownership interest in the project but also because the voucher agency is getting a fee to administer the vouchers, which could create conflicts of interest. That leaves HUD, which could either perform this work in-house or assign it to subcontractors, much like HUD contracts out HAP oversight of PBRA projects to Performance Based Contract Administrators (PBCAs).

Finally, in terms of where, in HUD, these tasks would be performed, it seems logical and practical that, since PBVs are just a component of the voucher program, and since PIH oversees the voucher program, PIH would have the responsibility for overseeing RAD PBV projects. That said, PIH does not have the institutional history of asset-based oversight, meaning that there would be a significant learning curve.

MUDDLING THROUGH

It will take several years for HUD to roll out a new model of oversight for RAD PBV projects, especially if these requirements are subject to formal notice-and-comment rulemaking. What, then, should HUD do in the interim?

Fortunately, at least 60% of all closed RAD transactions have been financed with either debt or tax credits, which means that there are lenders, investors, and other players who have skin in the game and should be watching over these assets. Indeed, even when a more robust program is implemented, we should find a way to piggy-back on these third-party monitoring efforts rather than duplicating them. Still, although closely aligned, the interests of lenders and investors are not always the same as HUD.

Assuming that HUD were constrained, prior to any formal rulemaking, in the type and amounts of data that it could collect, the following items seem like a reasonable, modest collection of data that could feed a national RAD PBV performance database:

- The occupancy rates of all RAD PBV projects (which are available via HUD's Section 8 Voucher Management System, although they could also be gathered via annual financial statements, below),
- Confirmation that the PHA's Board has actually approved the project's budget (i.e., one of the few oversight "requirements" stipulated in the RAD Notice regarding RAD PBVs),
- A copy of the project's HQS Inspections results,
- Information related to the status of the project's replacement reserve account, including whether the required annual contributions are being made, and
- An annual financial statement.

The above would at least begin to identify the most obvious outliers in terms of at-risk projects, absent a more robust system and absent some future on-site management review, where HUD or its agent actually walks the project.

Comment

It is amazing the growth of the PBV program in recent years. When RAD began in 2011, the number of PBVs nationally numbered less than 80,000 units. The program has now tripled in size, to about 240,000 units, about half of that growth fueled by non-RAD PBVs. The PBV program is no longer just a niche program.

Under RAD, one of the reasons some PHAs have preferred PBVs over PBRA is the much lighter regulatory touch, including oversight, which makes a lot of sense for any standard PBV and I wouldn't change any of that. However, for RAD PBVs, because of the requirement to preserve the assistance in perpetuity, it makes sense to provide a higher level of oversight so that intervention, if needed, can occur sooner, when it will be less costly. This paper suggests that one should look to the PBRA program for clues on how to develop such a model. Fortunately, if we begin now, there is time to work it out.

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