

Multifamily Market Commentary – March 2014

Public Housing Presents New Opportunities for Private Capital

Public housing is perhaps the most well-known type of affordable multifamily housing. It is rental housing that has traditionally been both publicly funded and publicly owned. As shown in the table below, public housing provides the third-highest number of subsidized units, with the Low Income Housing Tax Credit (LIHTC) and the Project-Based Section 8 programs being first and second, respectively. Typically, most Public Housing Authorities (PHAs) receive ongoing subsidy funding directly from the federal government through the Public Housing Operating and/or Capital Funds, leaving no role for private financing firms.

However, in November 2011, Congress authorized the U.S. Department of Housing and Urban Development (HUD) to establish the Rental Assistance Demonstration program (RAD). RAD allows public housing to be converted to long-term Section 8 rental assistance contracts. This makes it possible for private capital to enter the market due to Section 8 subsidy providing a monthly stream of income available to repay debt.

Multifamily Subsidized Affordable Housing Stock by Type of Subsidy		
Subsidy Program Name	Number of Projects	Number of Units
LIHTC	35,000	2.0 Million
Project-Based Section 8	22,500	1.6 Million
Public Housing	7,000	1.2 Million
Rural Housing - 515	14,600	420,000
HOME	11,000	386,000
Section 236	1,300	138,000
Section 202	2,600	134,000
Section 221 Below-Market Interest	300	31,000
Rural Housing Service 538	400	20,000

Source: National Low Income Housing Preservation Database as of December 31, 2013

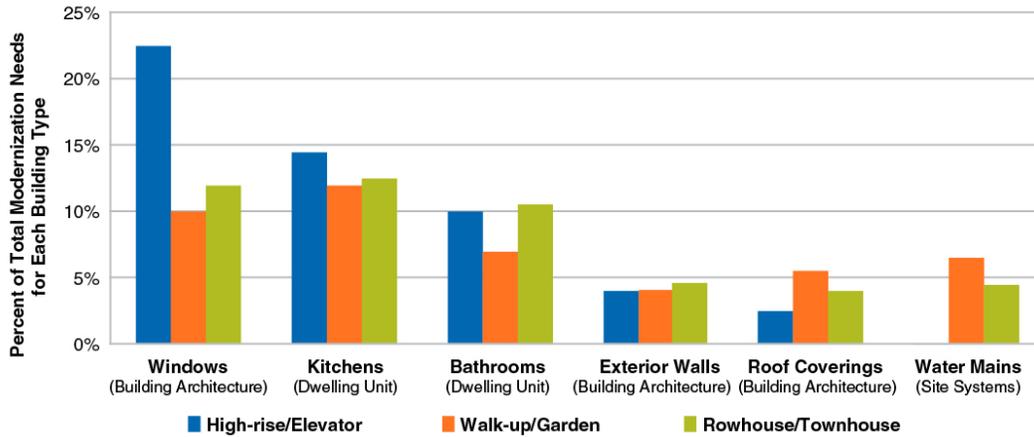
Public Housing is Aging and Needs Repairs

The majority of public housing units were built 30 years ago. Consequently, the housing stock needs a wide range of repairs, including roof, elevator, heating, ventilation, and air conditioning repairs. HUD estimates that capital repairs across its public housing portfolio would cost \$25.6 billion, or about \$24,000 per unit.

The estimate also includes approximately \$5 billion in costs associated with making the units more easily accessible, energy- and water-efficient, and free of lead paint.

As shown in the chart below, windows account for 23 percent of existing modernization needs in public housing high-rise properties, with kitchens and bathrooms accounting for roughly 15 percent and 10 percent, respectively. As a result, these three renovations alone account for nearly half of the existing needs in public housing high-rise properties. By contrast, these same three items account for only 29 percent of costs in public housing garden-style properties and 34 percent in row-house properties.

Key Renovations Needed by Public Housing Property Type



Source: Abt Associates, *Capital Needs in the Public Housing Program*, November 2010

Public Housing is Losing Units at an Alarming Pace

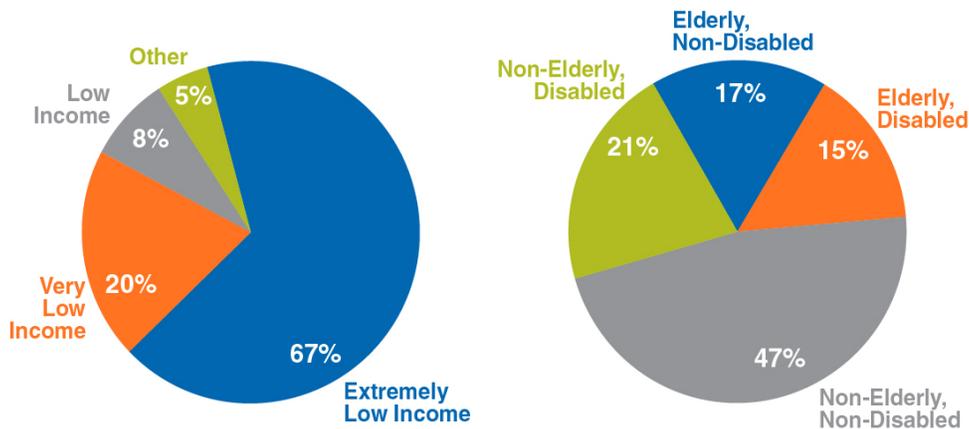
Leveraging private capital to help fund a portion of these capital improvements via the RAD program is important because the recent recession – coupled with the subsequent budget sequestration – have made it difficult for the federal government to fund necessary improvements of public housing on its own. As a result, HUD estimates that it is losing 10,000-15,000 units annually due to obsolescence. In fact, from 2000 to 2012, public housing fell to 1.16 million units from 1.28 million units, resulting in a 9.8 percent decrease in the nation’s public housing stock.

Public Housing Serves the Most Vulnerable Citizens

Nationally, HUD reports that 2.1 million Americans live in public housing, with an average of 2.2 residents per household. Public housing residents earned an average of \$13,800 per year and approximately 70 percent are minorities.

As illustrated in the chart below, at 67 percent the vast majority of public housing residents fall within extremely low-income parameters, defined by HUD as earning less than 30 percent of the Area Median Income (AMI) for their locality. Another 20 percent of public housing residents earn more than 30 percent of AMI but less than 50 percent of AMI for their locality. As a result, nearly 87 percent of all public housing residents earn less than half of AMI for their locality.

Public Housing Resident Characteristics



Source: HUD Public Housing Resident Characteristics Report based on data as of December 31, 2013

The Elderly and Disabled Comprise a Significant Percentage of Residents

As shown in the right-hand chart at the bottom of page 2, more than half of public housing residents are disabled and/or elderly. A total of 36 percent of residents report being disabled, and 32 percent are elderly. Of these, 15 percent are reported as being both elderly and disabled.

In addition, 36 percent of residents report being the female head of a household with children. For these residents, affordable housing is especially important since less money spent on housing likely equates to more money spent on their children.

The Average Length of Stay in Public Housing Has a Wide Distribution

Only 13 percent of residents report having lived in public housing for more than 20 years. Another 17 percent of residents have lived in public housing for between 10 and 20 years, and 19 percent report living in public housing for between 5 and 10 years. Interestingly, 31 percent of residents report having lived in public housing for no longer than two years. The wide distribution in tenure of public housing residents suggests that occupants are not entrenched in public housing. Clearly, a number of residents move out after a period of time, and new residents move in. Nevertheless, demand for units is high, with applicants spending an average of 11 months waiting for units to come available.

Project-Based Section 8 Subsidies Keep Rents Affordable

Currently, 83 percent of public housing residents pay less than \$501 per month in rent. Female-headed households with children pay approximately \$300 per month. As is the case with other subsidized housing programs, capping a low-income resident's rent at 30 percent of their income enables them to afford other essentials such as food, clothing, and health care. A key feature of RAD is that it allows public housing to be converted to long-term Section 8 rental assistance contracts. Administered by HUD, the Section 8 program ensures that residents pay no more than 30 percent of their income toward rent by providing a direct subsidy to the property owner of up to a HUD-defined Fair Market Rent (FMR) level. This should allow current residents to keep their low rents.

The RAD Program Forms a Public-Private Partnership to Preserve Affordable Units

RAD was launched by HUD in January 2013 to stem the loss of critically needed public housing, as well as other forms of subsidized housing, due primarily to the severe backlog of capital improvements needed. By allowing public housing agencies to convert their current form of direct federal assistance to long-term Section 8 contracts, RAD provides a steady stream of payments that can, in turn, be leveraged by private capital.

Such contracts could allow owners to leverage millions of dollars in debt and equity to better address immediate capital needs and preserve these affordable housing units available for the most vulnerable of residents. Indeed, HUD anticipates RAD will leverage more than \$650 million in private capital to address the estimated \$26 billion backlog in capital needs faced by public housing authorities in the U.S.

Preliminary Results for RAD Program Promising

While still finalizing contracts with the PHAs, HUD has released some preliminary results for the RAD program as of December 31, 2013. As seen in the table to the right, the top three public housing applicants by units include Chicago, El Paso, and Nashville. While 81 percent of projects were considered urban, another 19 percent are considered rural.

Top Ten Applicants by PHA	Number of Projects
Chicago	10,900
El Paso	6,100
Nashville	5,400
Birmingham	5,000
Baltimore	4,600
San Francisco	4,600
Charlotte	3,400
Mobile	3,400
Tampa	3,100
Greensboro	2,200

Source: HUD RAD Program Update as of December 31, 2013

Most PHAs Have Fewer than 1,250 Units

As seen in the adjacent chart, approximately 45 percent of RAD applicants are medium-sized PHAs with between 250 and 1,250 multifamily units. Another 40 percent are considered small PHAs, with fewer than 250 units. Only 15 percent of applicants were considered to be large PHAs, with more than 1,250 units.

Type of Permanent Project Financing Varies

Based on applications received, HUD reported on the permanent financing options proposed by the PHAs. As shown in the chart below, for projects not using tax credits, the vast majority intended to use FHA debt while only 26 percent intended to use conventional debt.

For projects with deeper capital needs, some applicants planned to use LIHTC. As seen in the chart below, permanent financing results were reversed, with 58 percent intending to use conventional financing and 42 percent planning to use financing through FHA. Of those projects planning to use LIHTC, 72 percent intended to use 4 percent tax credits while only 28 percent intended to use 9 percent LIHTC.

Interest in RAD Far Exceeds the Current Allocation

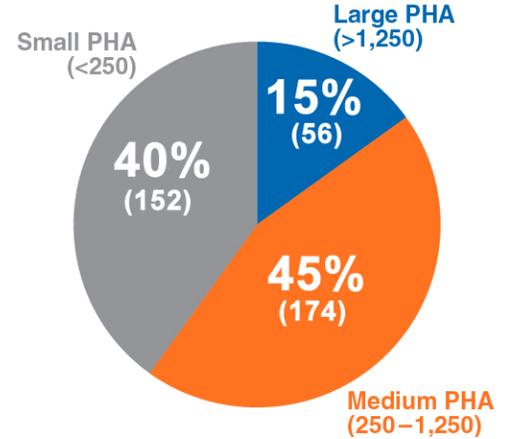
HUD reports that, as of December 31, 2013, it had received applications under the RAD program for more than 176,000 units. However, HUD currently only has authority to award 60,000 units, of which approximately 57,000 units have now been reserved. As a result, HUD has a waiting list of 116,000 public housing units, representing roughly 10 percent of the public housing stock, which could end up in a public-private partnership.

HUD appears to be working with Congress and stakeholders to lift the 60,000-unit cap in order to make additional awards. In the event that HUD is successful, this would allow the entrance of additional private capital to preserve the subsidized affordable housing stock.

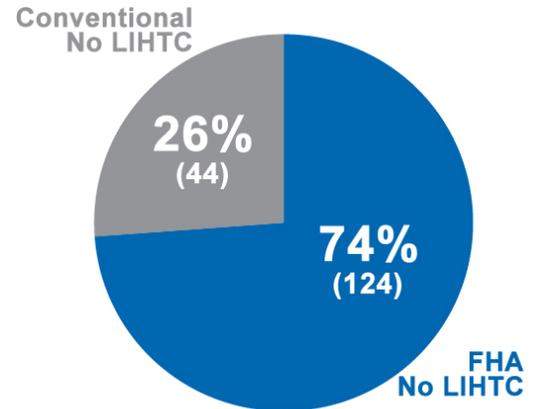
Tatyana Zahalak
Economist
Multifamily Economics and Market Research
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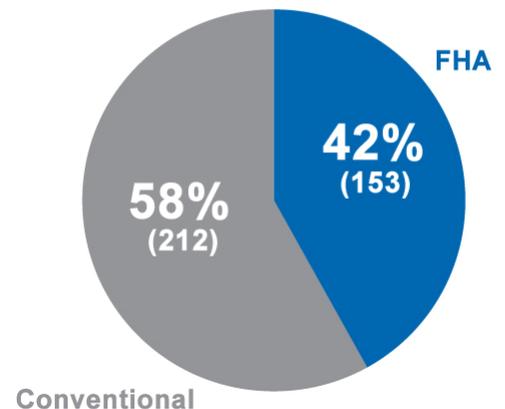
Distribution of Applicants by Size of PHA



Type of First Mortgage Financing (No Tax Credits)



Type of First Mortgage Financing (With Tax Credits)



Source: HUD RAD Program Update as of December 31, 2013