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The Preservation of Subsidized Housing: What We Know and Need to Know

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Abstract

There is an abundance of research highlighting the lack of affordable rental housing in the U.S. Given this scarcity, it is all the more important to understand the future of the existing subsidized affordable rental housing stock.

The federal government has made a direct investment in increasing the supply of affordable housing through programs that have subsidized the development of more than 6 million units of rental housing. Some of these units receive ongoing rental subsidies that provide dedicated apartments for low-income households. When subsidies expire, both the affordability of the units and the public investment in the property and ongoing subsidy are at risk of being lost.

This report aims to analyze what we know about subsidy expirations and the preservation of supply-side affordable housing, and it identifies gaps in our knowledge about preservation.

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About Grounded Solutions Network

Grounded Solutions Network supports strong communities from the ground up. We are a national nonprofit membership organization consisting of community land trusts, inclusionary housing programs, and nonprofits that support affordable housing that lasts. We provide our members and cities with training, technical assistance, program design and management resources, research, and advocacy opportunities. Grounded Solutions Network champions evidence-based policies and strategies that work. We promote housing solutions that will stay affordable for generations so communities can stabilize and strengthen their foundation, for good. We help our members, partners and elected officials use them to establish inclusive communities that have diverse housing options for a variety of incomes, offering choice and opportunity for all residents – both today and for future generations.

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Executive Summary

There is an abundance of research highlighting the lack of affordable rental housing in the U.S. Given this scarcity, it is all the more important to understand the future of the existing subsidized affordable rental housing stock.

The federal government has made a direct investment in increasing the supply of affordable housing through programs that have subsidized the development of more than 6 million units of rental housing. Some of these units receive ongoing rental subsidies that provide dedicated apartments for low-income households. When subsidies expire, both the affordability of the units and the public investment in the property and ongoing subsidy are at risk of being lost.

This report aims to analyze what we know about subsidy expirations and the preservation of supply-side affordable housing, and it identifies gaps in our knowledge about preservation. The key findings from this report are:

- Subsidized rental housing represents a small but increasingly important share of the rental market as markets become less affordable, particularly for the lowest-income households.
- Properties developed through subsidy programs that finance the production of housing face three potential risks: expiration or exit, depreciation and appropriations risk.
- There is a large scale of units at risk of exit or expiration. There are over 590,000 units in Section 8 project-based rental assistance (PBRA) properties where an owner will have the option to renew their subsidy or exit the program; over 450,000 units in Low-Income Housing Tax Credit (LIHTC) properties; and 120,000 units in HOME-financed properties where the subsidy and affordability restrictions are due to expire over the next 10 years.
- While we know that over 1 million units have affordability restrictions set to expire, many of these properties will renew the subsidy, apply for a new one, or maintain their units as affordable absent any subsidy. How many units will remain affordable, and for how long, is unknown.
- Units targeting the lowest-income households are most likely to become less affordable when they exit a subsidy program. This is concerning when we consider that many municipalities have difficulty financing the development of new units for the lowest-income households because of the high level of subsidy required to do so.
- There are an additional 1 million LIHTC units approaching their 15-year disposition period over the next 10 years. While their affordability restrictions do not expire, many of these units will need rehabilitation as part of a normal life-cycle recapitalization.
- Funding for affordable housing production programs has not kept pace with the needs of existing units and the demand for additional affordable units. The LIHTC is the nation's largest subsidy program for producing affordable housing; however, there is increasing uncertainty about the future of the LIHTC due to recent tax reform.
- A large share of existing subsidy financing sources is spent on the preservation of existing affordable housing. As preservation needs increase, there will be further competition for resources that could force municipalities to decide between preservation and financing new affordable housing units.
- Existing research shows that many subsidized properties eligible to exit or expire are in high-opportunity areas where there are few remaining affordable units.

Evidence suggests that the preservation of affordable housing could ensure access to opportunity neighborhoods, but much more research is needed in this area. There is also evidence that subsidizing preservation may be less costly than developing new subsidized or unsubsidized rental units. However, preservation efforts only ensure existing subsidized units remain affordable and do not increase the overall stock of affordable units.

Further research is needed on whether preservation increases access to opportunity neighborhoods, promotes household stability, and minimizes the loss of investments in units. With the scale and scope of the potential demand for preservation going forward, it is imperative that federal government and local governments better understand and measure preservation needs, determine preservation and new construction priorities, and develop policies and programs that reflect and support those priorities. A broad suite of policy responses should be considered, particularly ones like proper lifecycle underwriting that acknowledge the depreciation risk in these programs.

The Preservation of Subsidized Housing: What We Know and Need to Know

Introduction

There is increased concern about the affordability of rental markets across the country. In 2015, 47 percent of the 44 million renter households in the U.S. spent more than 30 percent of their income on rent, thus qualifying them as rent burdened (Landis and Reina 2018). Furthermore, there were nearly 11 million renters who spent at least half of their income on housing, making them severely rent burdened (Joint Center 2017). This reality is even more striking for the lowest-income households, with 89 percent of households with incomes below \$20,000 qualifying as rent burdened (Landis and Reina 2018).

These rent burdens are a product of few affordable units in almost every rental market.ⁱ For example, across the country there are only 35 affordable units available for every 100 extremely low-income household,ⁱⁱ and this number is as low as 12 in Las Vegas and 16 in Los Angeles (National Low-Income Housing Coalition 2017). In fact, research shows that even if every household in the 238 largest metropolitan areas sorted into the unit on the rent distribution that matched where the household ranked on the income distribution (i.e. everyone sorted to the unit that was best priced for their relative income), low- and moderate-income householdsⁱⁱⁱ would still be rent burdened in almost every metropolitan statistical area (MSA) (Schwartz et al. 2016).

All these studies point to a shrinking affordable rental stock in most markets. This report focuses on a subset of the rental market that is meant to help alleviate rent burdens: federally subsidized affordable rental housing. Specifically, it focuses on what we know about the scope and magnitude of subsidized housing units that are at risk of losing affordability primarily due to expiring affordability restrictions, depreciation of properties, and reduced funding for almost all national housing programs.

The lack of affordable rental housing on the private market has placed increased demand on the relatively small stock of subsidized rental housing (Schwartz et al. 2016). Nationally, there are almost five times as many households who qualify for subsidized housing as those who receive it (Kingsley 2017), and there are almost three times more excessively cost-burdened renter households who qualify for rental assistance than those who receive it (Landis and Reina 2018). Households who do eventually access a unit developed with the U.S. Department of Housing and Urban Development (HUD) financing wait, on average, 27 months for the unit. However, we do not know how many households choose not to apply for a unit because of the wait or remove themselves from waiting lists.

The demand for rental subsidies has been well documented, but much less is known about the ongoing affordability of existing subsidized housing. A perfect storm for housing affordability may emerge in the coming years, with the demand for subsidized housing programs increasing as thousands of subsidized housing units reach the end of their affordability restrictions. In fact, over the next 10 years:

- Over 455,000 units, or almost 1/4 of the existing units in the LIHTC program, will reach the end of their affordability restriction periods;
- Almost 590,000 units in Section 8 project-based rental assistance (PBRA) programs, representing well over half of the existing units, will be in properties where the owner has the option to renew their subsidy or exit the program; and
- Almost 43,000 of the 360,000 units ever developed in the Section 202 program, and 11,000 of the 400,000 units ever developed in the Section 515 program, will reach the end of their subsidy period.

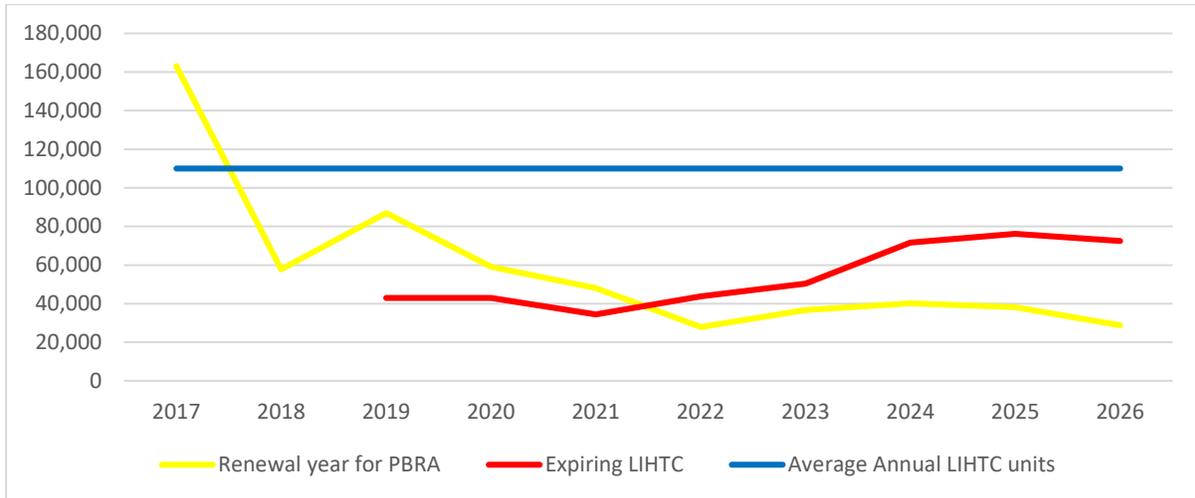
Further compounding this trouble is that many of those units where the subsidy term is not expiring will be in need of recapitalization. Specifically:

- There is at least \$26 billion in deferred maintenance on the 1 million public housing units in the country^{iv}
- there are 1.1 million LIHTC units approaching the year 15 mark, and many will be in need of recapitalization

This is not to say that all of these existing subsidized units will exit their programs, become unaffordable or fall into disrepair. However, it does mean that even if some of these properties need recapitalization, there will be increased competition for scarce resources between the preservation and recapitalization of existing subsidized housing properties and increasing the stock of affordable housing through the production of new units. There is evidence that this is already the case. For example, between 2003 and 2012, the annual share of units financed through the LIHTC that were existing affordable housing ranged 35-62 percent (Schwartz et al. 2015). The challenge going forward is that there are more subsidized affordable units that will be eligible to be preserved than in the past—including, notably, public housing units recapitalized through HUD’s Rental Assistance Demonstration (RAD) program.

As seen in Figure 1, there is a significant number of units where the Section 8 PBRA contract is eligible for renewal or the LIHTC 30-year affordability restrictions are due to expire over the next 10 years. If we map those units onto the average annual number of units placed in service through the LIHTC program from 1995 to 2015^{vvi}, we can see that preservation needs could equal almost all of the LIHTC financing in any given year going forward. Again, not all units in Figure 1 will need additional subsidy. However, these numbers do not include those LIHTC units approaching their 15-year mark that may need recapitalization, or the preservation demands of other existing subsidized units. As a result, we can expect that preservation will increasingly vie for resources.

Figure 1: Number of Units That May be at Risk of Losing Affordability by Year and Program Compared to the Number of Average Annual Units Developed through the LIHTC*



* Based on data from the National Housing Preservation database.

These numbers highlight the importance of determining what we know and do not know about the preservation of subsidized housing. This report:

- Represents a review of the existing literature about preservation
- Identifies what we know about the potential threat to the ongoing affordability of the existing stock of federally subsidized housing
- Examines what is known about the benefits and costs of preservation
- Determines what remains unknown about the preservation of subsidized housing

Programs and Affordability Risks

Federal support for affordable rental housing comes in two primary forms: supply-side subsidies and demand-side subsidies. Supply-side programs provide a subsidy that is meant to directly stimulate the production of housing units. Demand-side programs subsidize a household's demand for housing. In theory, a demand-side subsidy gives households purchasing power to acquire their desired level of housing services. This report focuses solely on supply-side programs, because they represent a direct infusion of capital into the housing stock over the last 70 years, with the goal of increasing the supply of affordable housing. However, little is known about whether, when and where units leave these programs and what that means for the overall stock of affordable rental housing in the U.S.

Historically, supply-side subsidies were given to semi-public local agencies, called public housing authorities (PHAs), which both developed and subsequently managed affordable housing. Over 2/3 of the 1.4 million units ever developed through this program were placed in service by 1973, and to this day over 1 million public housing units continue to receive operating and capital subsidies from HUD.

One of the oldest supply-side rental subsidy programs is the Section 515 program, developed in 1949 and administered by the U.S. Department of Agriculture. Over 400,000 units have been developed through the Section 515 program^{vii}, with the majority being placed in service prior to 1990. Since the 1970s, supply-side subsidies have been primarily provided to private market housing developers, both for-profit and nonprofit, to produce affordable housing units. These owners are expected to maintain the units developed with the subsidy as affordable for a fixed period of time. The Section 202 program was authorized in 1959 and financed over 360,000 units since its inception. Over 173,000 of those units were developed between 1975 and 1993 and also have a PBRA contract,^{viii} and 120,000 of those units were developed between 1990, when the form of the PBRA changed, and 2012, when the program no longer appropriated funding for new units (US GAO 2016).^{ix}

The other large supply-side subsidy programs include Section 8 PBRA, which began in 1974 and financed over 1.2 million units prior to being defunded in 1983; the LIHTC program (1986), which is administered by the Internal Revenue Service and has financed close to 3 million units of housing since its inception; and the HOME program, which began in 1990 and has financed over 300,000 units of rental housing.^x

This report focuses solely on the larger supply-side programs—public housing, Section 8 PBRA, Section 202, LIHTC, Section 515 and HOME—due to the size of these programs and their dispersion across the country.^{xi} The report also includes the National Housing Trust Fund, because if it is continuously funded going forward, it can serve as an important tool to increase the supply of subsidized housing. One common theme across all of these supply-side subsidy programs is that they represent a direct infusion of capital into the housing stock, and the units face three forms of risk with respect to long-term affordability: expiration or exit risk, depreciation risk and appropriations risk.

Expiration or Exit Risk

Privately owned supply-side properties are required to remain affordable for a specific period of time, after which owners have the following options: to renew the subsidy and affordability period if it is a renewable subsidy; apply for a new form of subsidy to maintain the affordability of the property; or forego the use of any subsidies.

In the case where owners choose to forego any subsidy, they have the option to alter rents as they deem fit. For renewable subsidies, an owner's ability to not renew the subsidy represents an exit risk. For nonrenewable subsidies, a property reaching the financing end date represents an expiration risk. In theory, publicly owned supply-side properties do not suffer from expiration risks, because the units do not generally have a defined subsidy end date. However, we know from the history of the public housing program that units can and do exit subsidized housing programs, even when the owner is a public entity. One study estimates that 9 percent of units exited the public housing program prior to 2010 (Finkel et al. 2010).

Depreciation Risk

Subsidized housing, like all other housing, depreciates over time. As properties get older, there is an increased need to replace basic systems and rehabilitate a property. Subsidized housing programs have different rules that govern whether, when and how properties can access public or private capital to make improvements. If a property is old, poorly managed or subject to an unforeseen event that affects the structure (such as a natural disaster), it may have rehabilitation needs that force it out of existing subsidy programs, or it could be deemed uninhabitable.

These dynamics represent a depreciation risk, meaning that the cost or level of rehabilitation forces a property to exit its subsidy program and affordability restriction, or makes it unviable for an owner to renew a subsidy on a project.

Appropriations Risk

All federally subsidized housing receives public resources at some point in its existence. Some programs infuse that money into the project at the development stage, in an effort to reduce development costs and allow the property to charge lower rents over the duration of the affordability restriction period. Other programs offer operating subsidies, meaning that the owner has a contract with the federal government, and the subsidy is received over the course of that contract.

For the former group, there is no appropriations risk, because the funding needed to make the property affordable enters at the development phase. If funding for the program is cut, no new units are developed through that program, but such funding cuts do not affect the viability of existing properties in the program until they need rehabilitation and/or their affordability requirements expire. For the latter category, there is a risk that the federal government could reduce or eliminate appropriations for the program, which would then affect the level of the ongoing operating subsidy. If that operating subsidy is reduced or eliminated, it may not be financially viable for the owner to maintain the property as affordable or could result in a foreclosure.

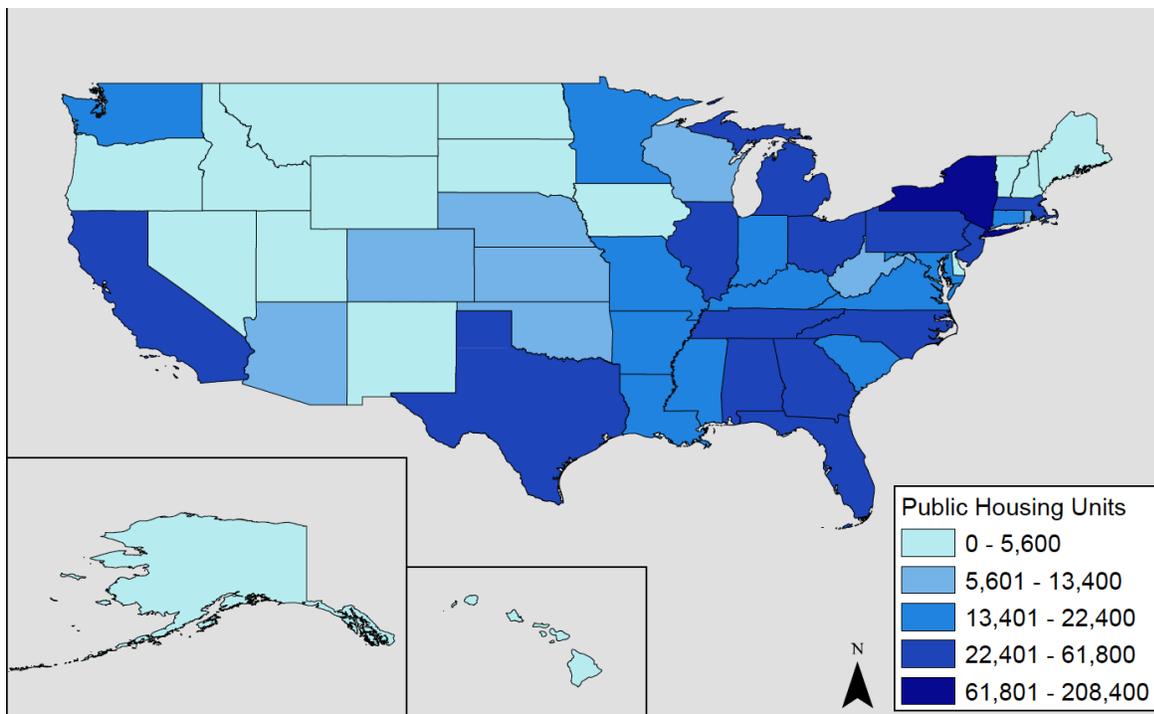
Risks by Program

The rules governing federal rental subsidy programs vary significantly. Sometimes there is further variation due to state and local restrictions that may be attached to whole programs or specific properties. This section provides an overview of the major supply-side programs and their preservation risks.

Public Housing

The public housing program began in the 1930s and is arguably the most well-known and studied form of subsidized housing. There are over 1.2 million public housing units across the country that are managed by over 3,300 PHAs. The income requirements for public housing vary by housing authority, but these units are targeted toward households below 80 percent of median income, and often to those below 50 percent of the median.^{xiii} Households in public housing are meant to pay 30 percent of their income in rent, and the difference between the tenant payment and the actual rent for the unit is then covered by an operating subsidy that HUD provides to the PHA. As seen in Figure 2, public housing units are distributed across the country, but range from fewer than 1,000 in Wyoming and Idaho, to more than 200,000 in New York.

Figure 2: Existing Public Housing, 2017*



* Based on data from the National Housing Preservation database.

Public Housing Risk

Public housing faces both depreciation and appropriations risk. It is the oldest form of subsidized housing, and by virtue of age alone, has high rehabilitation needs. For example, 23,783 units were placed in service in 1941, and over 1.1 million units were in place by 1976, the first year that any units were placed in service through the Section 8 PBRA program (Collinson et al. 2015). In fact, according to a comprehensive report on the capital needs of public housing that was completed in 2010, there was roughly \$21 billion in capital needs in the public housing stock, and an additional \$4.1 billion of energy and water efficiency improvements required for the public housing units that were inspected (Finkel et al. 2010).

HUD currently cites a deferred maintenance backlog of \$26 billion, which represents a lower bound estimate due to additional deferred maintenance accrued since the study was conducted.^{xiii} Traditionally, these needs were addressed through operating and capital funding from HUD, but such funding decreased by 43 percent between 2005 and 2015 (Schwartz 2017). The funding shortage highlights the appropriations risk in the public housing program and contributes to deferred maintenance of public housing properties, which creates increased depreciation risk. While funding is still appropriated for the program, the steady decline in funding, despite demand for public housing units, raises concern that there will be even less support going forward.

HUD recently created the RAD program, which allows PHAs to convert some of their properties to project-based vouchers or PBRA.^{xiv} This subsidy conversion gives housing authorities the ability to access financing through capital markets and the LIHTC program.^{xv} Some advocates and scholars argue that the RAD program could represent a challenge to the public housing model, because it decreases the need to fund the program at adequate levels and will likely leave traditional public housing properties that are in the worst condition in the program (Schwartz 2017). Conversely, this program can be viewed as a way to get the properties with the most rehabilitation needs out of the program, so those properties can access the financing needed to make improvements. Regardless of which side one takes, RAD clearly reflects that there is appropriations risk and aims to ensure that lower funding levels for public housing do not increase the depreciation risk. However, this does open those properties converted through RAD to some of the same risks seen in Section 8 PBRA.^{xvi}

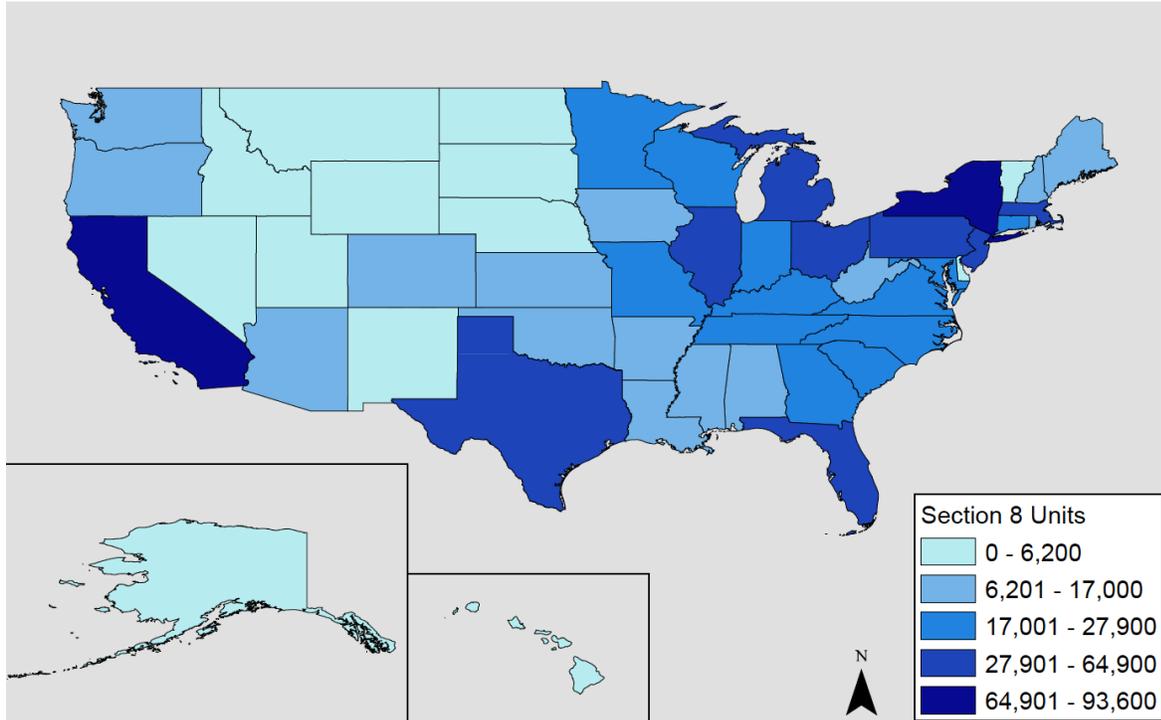
Section 8 Project-Based Rental Assistance (PBRA)

Section 8 PBRA programs have financed over 1.2 million units of privately owned subsidized housing since 1974. This program targets households below 50 percent of local median income^{xvii}, but in some cases, can serve those between 50 and 80 percent of the median.^{xviii}

PBRA owners enter into a contract with HUD whereby a tenant pays 30 percent of their income in rent, and HUD pays the owner the difference between the tenant payment and the HUD approved fair-market rent for the unit. A contract often covers the majority of units, if not all, in a multifamily property. Owners initially entered into these contracts for a 20- to 40-year period, and at the end of that period had the option to renew the contract for 1, 5 or 20 years, depending on federal policy and local interpretation of that policy.

While existing PBRA contracts can be renewed, appropriations for new contracts were defunded in 1983. In 2017, PBRA units were distributed across the country, with fewer than 2,000 in Alaska and North Dakota, to over 50,000 in California, Ohio, Pennsylvania and New York, as seen in Figure 3.

Figure 3: Existing PBRA Units, 2017*^{xix}



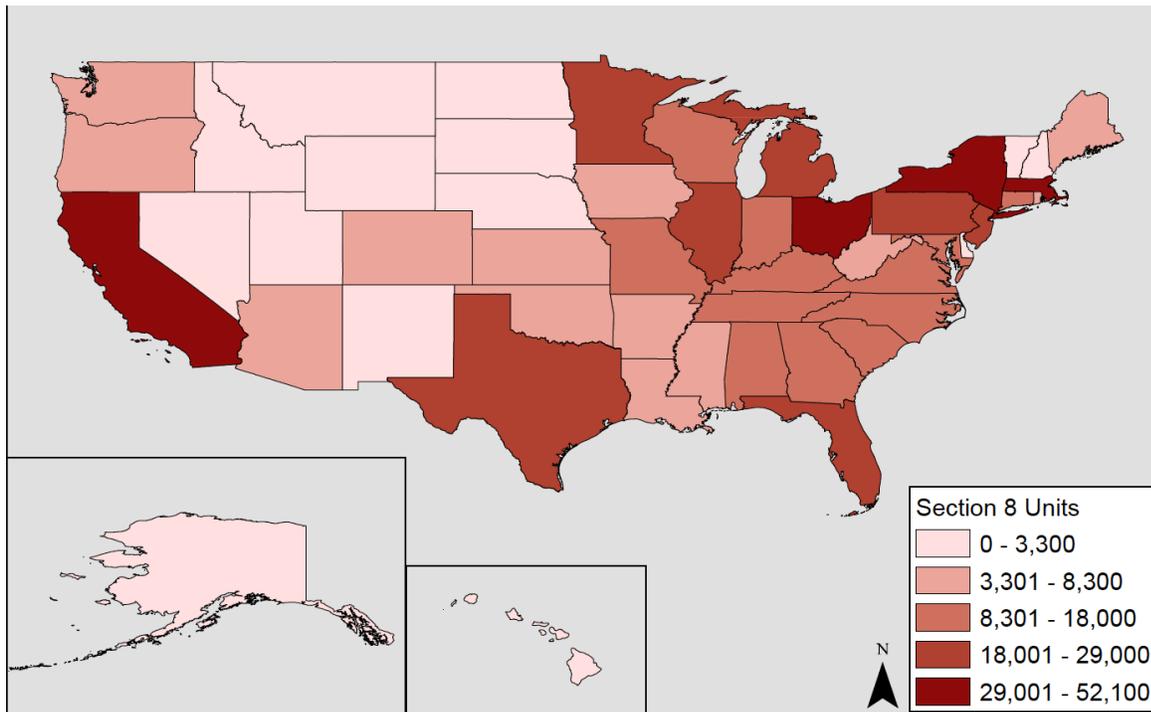
* Based on data from the National Housing Preservation database.

PBRA Risk

The PBRA program is subject to all three risk factors: expiration, depreciation and appropriations risk. Exit risk is the highest level of risk to PBRA properties. The private owners of these properties are subject to affordability restrictions that are coterminous with the length of their subsidy contract with HUD. This means that owners have the option to exit the program or renew the subsidy at the end of their initial contract period. Those owners that renew can do so for a term of 1-20 years, and at the end of that term they again have the option to renew the subsidy or exit the program. If an owner exits the program, tenants are offered a voucher that can be used to rent their existing unit or to rent a unit elsewhere. However, once that contract ends, the subsidy is no longer tied to the property.

Figure 4 shows the distribution of the almost 590,000 units in properties where an owner will be eligible to exit the program between 2017 and 2026. It is important to note that some of these units are in properties with short-term contracts, meaning that the units are being counted once here, but an owner may have multiple points where they can decide to remain in the program or exit over the next 10 years. For example, there are 899 properties where the Section 8 contract is due to expire in 2018, and these owners may sign a 1-, 5-, 10- or 20-year contract, depending on the owner preferences and willingness of their local office to offer a longer-term contract. It's important to note that almost all of these owners already passed their initial affordability period in the program, meaning they have renewed their contract at least once. Finally, just because an owner is eligible to exit the program does not mean they will. Further discussion of what we know about owner exits is provided later in the report.

Figure 4: Expiring PBRA Units, 2017-2026^{*xx}



* Based on data from the National Housing Preservation database.

Properties with a PBRA contract also have depreciation risk. There are two ways that depreciation risk can cause a property to exit the program: the property fails out because the building does not meet HUD’s housing quality standards, or the property fails out due to the property going into foreclosure.

We know that there were over 11,000 units in properties that failed out between 2000 and 2010 because of housing quality issues (Reina and Winter 2017). It is unclear why over 10,000 units were in properties that went into foreclosure during that period, but the costs of operating the properties could be a factor. In addition, this could point to limitations in the incremental tools HUD provides to incentivize owners to make investments in their properties. In theory, owners of these properties can access private capital and LIHTC funding, which means they can meet the rehabilitation needs of their properties. In addition, HUD allows owners to mark their rents up to market levels, which means that owners can attract roughly the same level of financing as an unsubsidized development. As a result, the depreciation risk is not as large in this program as it is in others, like public housing. However, the risks are still significant and relevant, particularly when we consider that over 85 percent of the units developed through these programs were placed in service prior to 1980.

There is also appropriations risk in the PBRA program. Every PBRA contract, regardless of the term, has a clause stating that it is subject to annual appropriations. As a result, a contract could be defunded by the federal government if adequate funding is not appropriated for the program in any given year. In the past, that risk was minimal compared to other programs. Between 2005 and 2015, appropriations for PBRA increased by 47 percent, even though no new units were

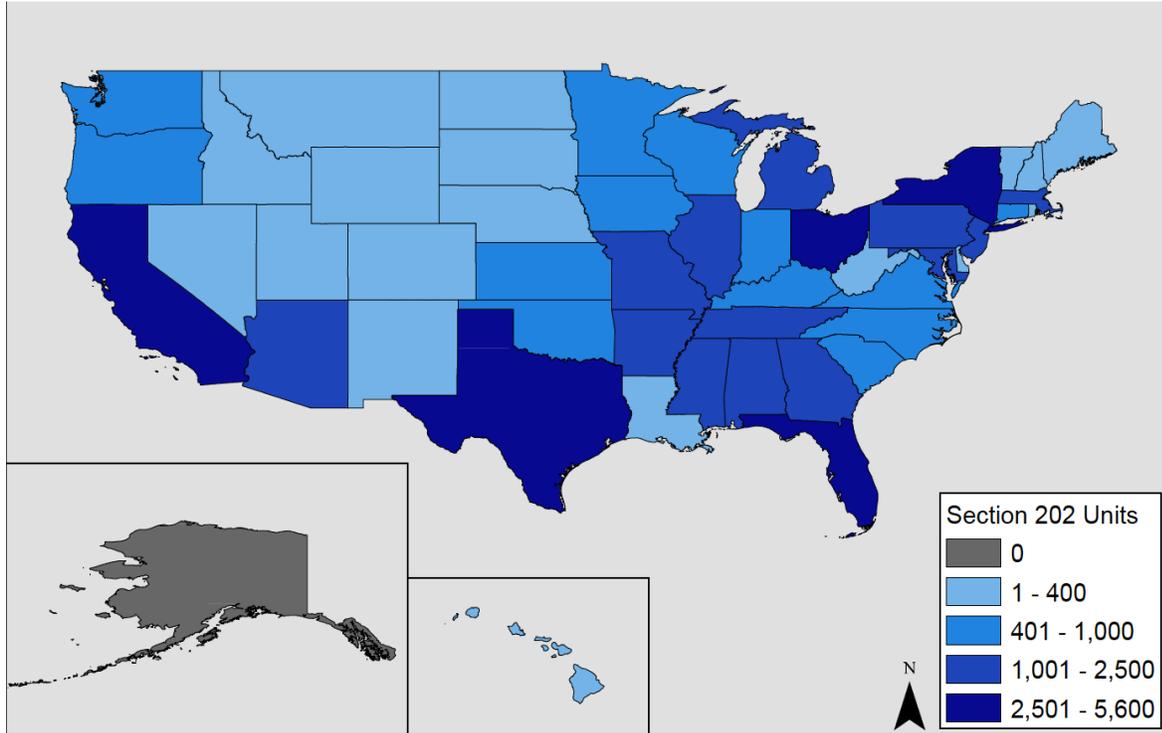
being developed through the program (Schwartz 2017). This increase was due to several factors. First, the program allows owners to receive annual rent adjustments to keep up with local market rents and maintain their property to HUD standards. Because tenant incomes in these properties have remained relatively flat, HUD must increase its operating subsidy to cover the rent increase. In addition, the number of PBRA units is due to increase over time, as properties use the RAD program to convert properties from public housing to the PBRA program. Combined, this cumulative effect on nominal appropriations levels is increasingly worrisome to appropriators, and, as a result, appropriations risk has increased. Since 2015, funding has remained flat, while market rents and operating costs continue to increase as more units enter the program.

Section 202

The Section 202 program was developed in 1959, and through its various iterations, has produced over 360,000 units of housing.^{xxi} From 1959 to 1974, over 40,000 units were developed through the Section 202 program, which at that time, offered below market loans to nonprofit developers to create moderate income housing for the elderly. Beginning in 1974, Section 202 loans were coupled with Section 8 PBRA so that the units could serve low-income households who were at or below 80 percent of the local median income.^{xxii} Over 170,000 units were developed through this version of the program between 1974 and 1993.^{xxiii}

The 150,000 units developed through the program since 1993^{xxiv} received an upfront capital advance that is forgiven if the property remains affordable for 40 years, along with a form of rental assistance called a project rental assistance contract (PRAC). The PRAC covers the difference between the tenant rent payment and the contract rent, which is a function of operating expenses and must be approved by HUD. These rental assistance contracts are usually three years long and renewable. The Section 202 program targets households below 50 percent of median income where at least one member is over the age of 62.^{xxv} As seen below in Figure 5, the Section 202 PRAC units are distributed across the country; however, there are no units in Alaska and more than 2,500 units in California, Florida, New Jersey, New York, Ohio and Texas.

Figure 5: Existing Section 202 Units, 2017*^{xxvi}

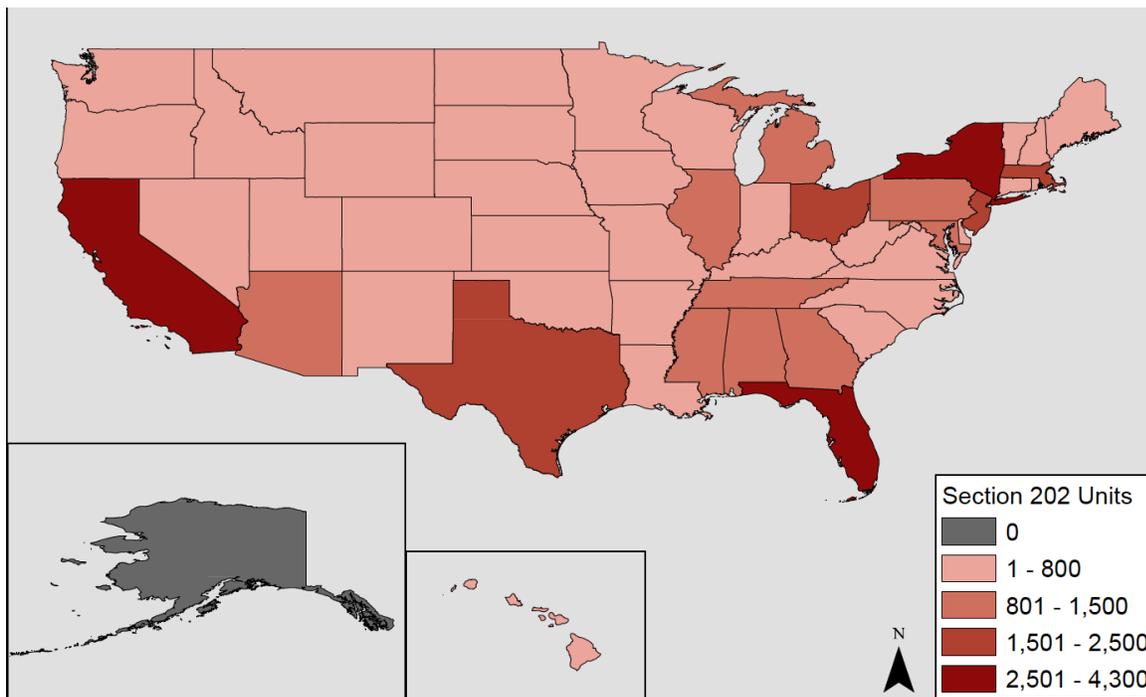


* Based on data from the National Housing Preservation database.

Section 202 Risk

There are almost 43,000 units in Section 202 properties where an owner will be eligible to exit the program between 2017 and 2026, but the risk is functionally different for those properties with a PBRA contract and those with a PRAC. Section 202 properties with a PBRA contract have little exit risk, with evidence showing that these properties are less likely to opt out of the Section 8 program (Ray et al. 2015). Those units with a PRAC, however, are at a greater risk, because the PRAC subsidy is only renewable for three years and is not as deeply subsidized as a PBRA contract.

Figure 6: Expiring Section 202 Units, 2017-2026*



* Based on data from the National Housing Preservation database.

All Section 202 properties have appropriations risk, although this risk is higher in properties with a PRAC contract. Funding for renewal of PRAC contracts increased between 2008 and 2012 but has leveled off since then, which reduces the ability of owners to increase their PRAC rents (GAO 2016).^{xxvii} The Section 202 units with a PRAC contract are subject to the same appropriations risk as the other units in the PBRA program. Finally, properties with a PRAC traditionally did not have a source for recapitalization, but the FY 2018 appropriations bill makes it possible to convert a unit with a PRAC contract to a PBRA unit under the RAD program, which creates a significant new preservation tool that reduces the depreciation risk of this portfolio.

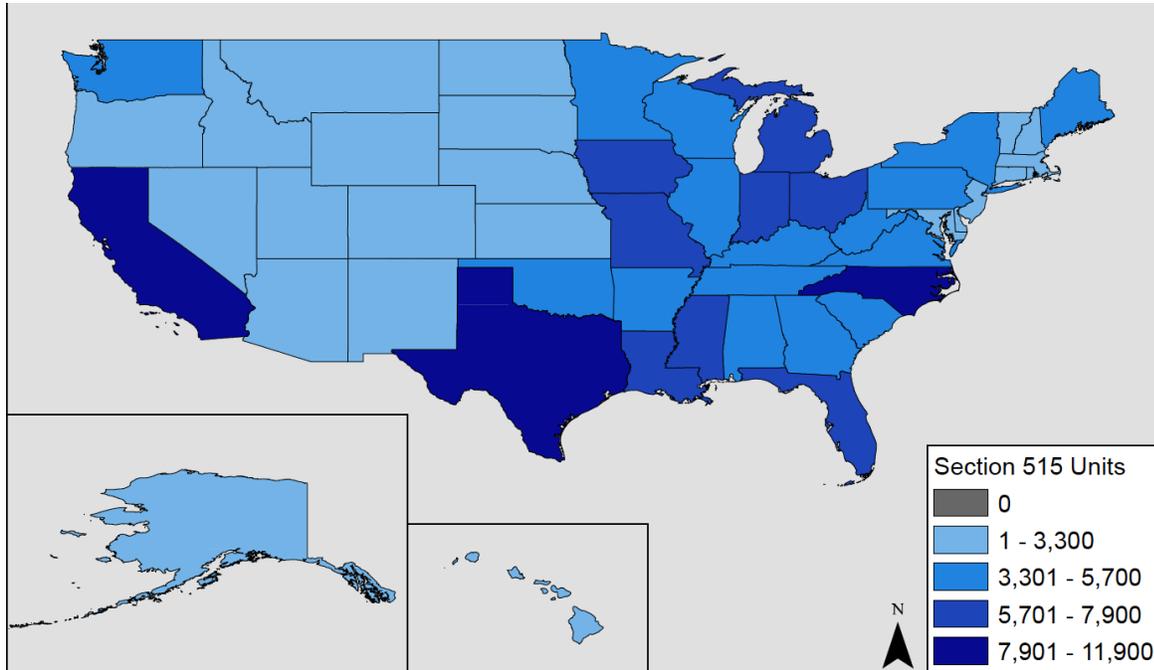
Section 515

The Section 515 program is a rural housing loan program administered by the Department of Agriculture that has financed over 400,000 units of housing. The Section 515 program offers developers who create or rehabilitate multifamily rental housing properties 30-year loans that amortize over 50 years at a 1 percent interest rate. The units in this program are targeted toward households below 50 percent of median income as well as to moderate income households.^{xxviii}

All properties developed before 1979 through the Section 515 program do not have any prepayment restrictions, whereas those developed between 1979 and 1989 are required to remain in the program for at least 20 years; those developed after 1989 cannot be prepaid, which translates to a 30-year affordability period^{xxix}. As shown in Figure 7, the largest number of 515

units are in California, North Carolina and Texas, while the fewest are in Alaska, Delaware, Hawaii and Rhode Island.

Figure 7: Existing Section 515 Units, 2017*^{xxx}



* Based on data from the National Housing Preservation database.

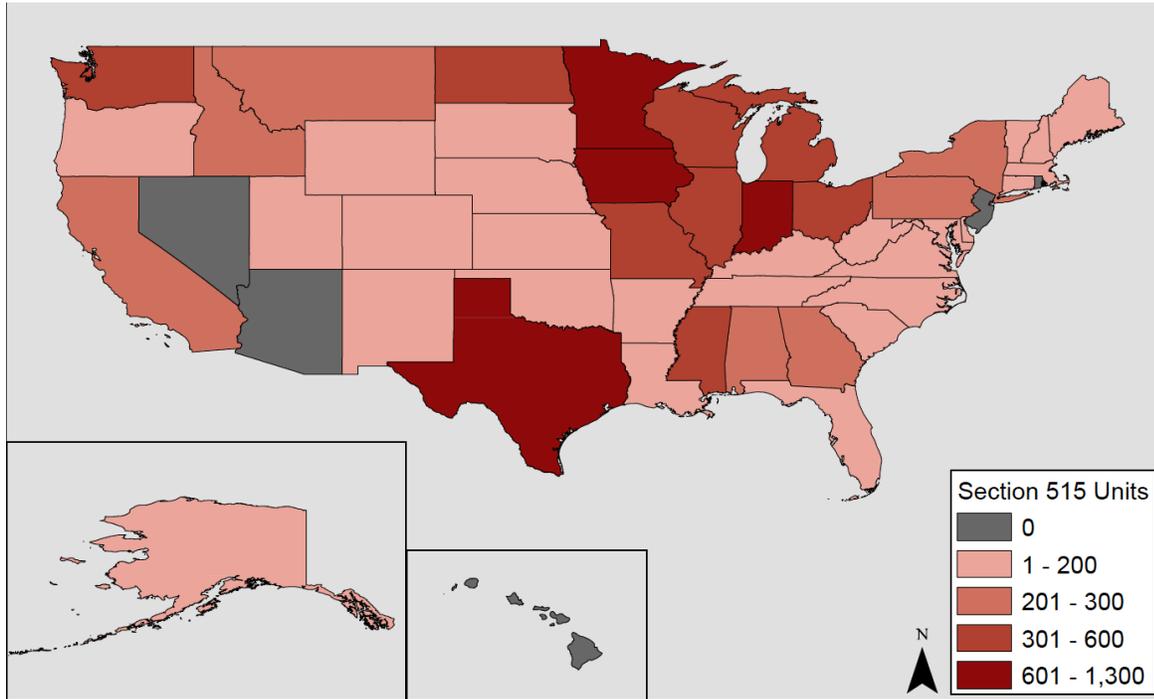
Section 515 Risk

The Section 515 program has expiration, depreciation and appropriations risk. The most significant risk to Section 515 properties is depreciation risk (ICF 2004).^{xxx} As of 2004, none of the existing properties in this program had adequate reserves or cash flow to make needed repairs, and there is no evidence to suggest this situation has changed. A large number of 515 units have no federal rental assistance and receive low tenant rents for unassisted units, thus limiting the amount of available funding for debt service to finance any improvements. In addition, some of those properties have rental assistance from the U.S. Department of Agriculture, which does not provide market-based rents, and therefore also limits the ability of owners to make improvements to their properties.

The expiration and appropriations risk in the Section 515 program are fairly intertwined. There are roughly 11,000 Section 515 units in properties that will reach a loan maturation date over the next 10 years. Owners who want to remain in the program would need to apply for a new round of financing. However, funding for the Section 515 program was cut by more than half between FY 2012 and 2013,^{xxxii} which means there could be increased competition for these resources. While funding levels have since stabilized, this program will need to balance between the desire to finance new units with the need to preserve existing ones, which could lead to some units exiting the program.

Upcoming Section 515 expirations are not concentrated in the states with the most units. For example, Minnesota has the highest number of units in properties where the mortgage will end over the next 10 years, while it has a relatively moderate number of units ever developed through the Section 515 program.

Figure 8: Expiring Section 515 Units, 2017-2026*



* Based on data from the National Housing Preservation database.

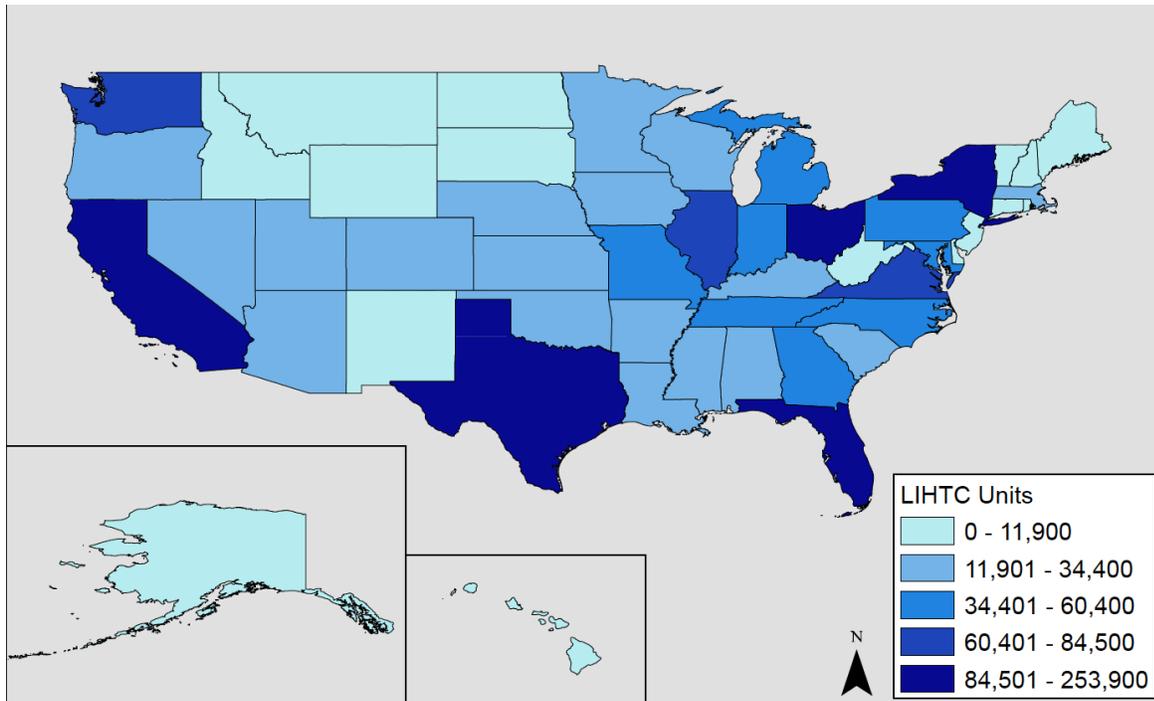
Low-Income Housing Tax Credit (LIHTC)

The LIHTC program is the largest federal program financing the development of new affordable rental units. The LIHTC program has financed nearly 3 million units of housing nationally since 1986 and is administered by the Internal Revenue Service. Through this program, owners receive tax credits that they sell on the private market. The capital that owners obtain from selling these credits is then used to reduce the permanent loan size on the property, which makes it feasible for the owner to charge lower rents.

The LIHTC program requires that owners lease either a minimum of 40 percent of their units to households earning 60 percent or less of area median income (AMI), or a minimum of 20 percent of their units to households earning 50 percent or less of AMI. LIHTC rents are then set at what someone who earns 50 or 60 percent of AMI would pay if they were only spending 30 percent of their income on rent.^{xxxiii} This means that a resident's rent in the LIHTC program is tied to local median income levels as opposed to most other programs where it is based on a household's actual income. As a result, low-income households below 50 or 60 percent of median income will spend more than 30 percent of their income on rent.^{xxxiv}

States are allocated \$2.35 of tax credits per capita, with a minimum of \$2.71 million per state.^{xxxv} As a result, the distribution of units, as seen in Figure 9 largely reflects the population of each state.

Figure 9: Existing LIHTC Units, 2017*



* Based on data from the National Housing Preservation database.

LIHTC Risk

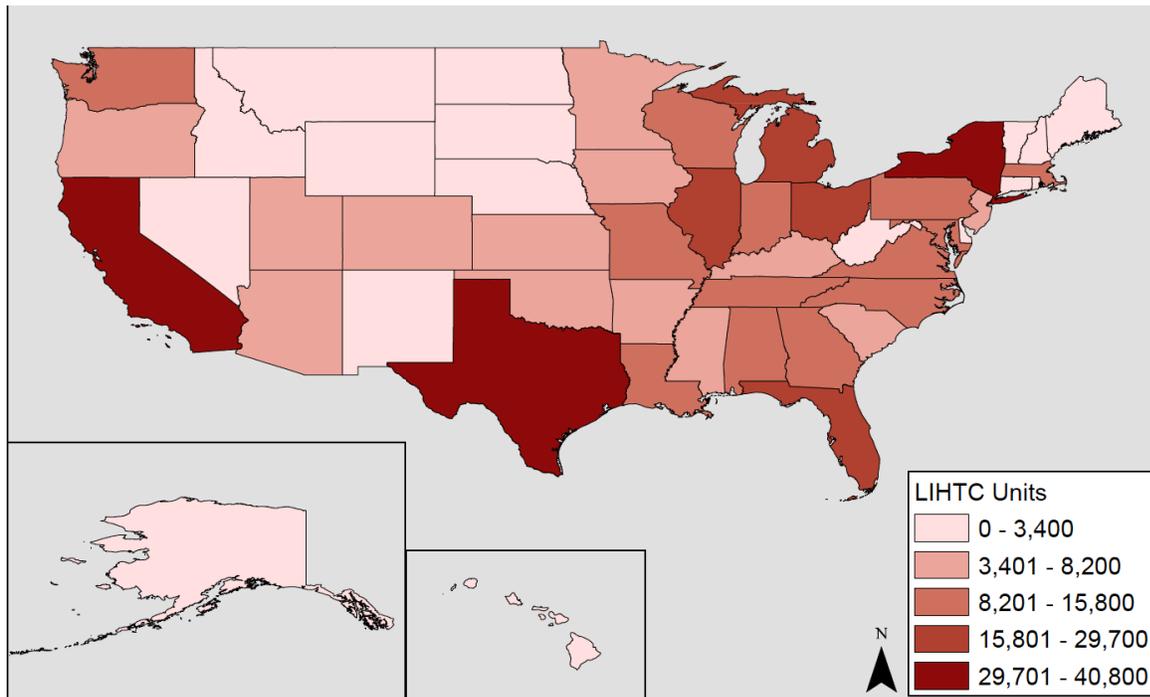
The three main sources of risk for the LIHTC program are expiration, depreciation and legislative risk. The LIHTC subsidy is not renewable, which means that owners need to apply for a new round of LIHTC financing or apply for other financing if they want to remain in the program at the end of the compliance period.

Properties placed in service before 1989 were only subject to a 15-year affordability restriction period, meaning that after 15 years, these owners could either exit the program or apply for a new round of tax credits. Owners who did not apply for a new round of credits could still rent their units at LIHTC rent levels, but they also had the option to raise rents. For properties placed in service after 1989, owners have at least a 30-year affordability restriction period (some states set longer restriction periods). Again, at the end of this 30-year period, owners can apply for a new round of LIHTC financing, if they have not done so already, or they can exit the program. As of 2013 there were at least 13 states that required affordability restriction periods longer than 30 years (Nelson and Sorce 2013).

The LIHTC program is relatively new, which means that properties are approaching the 30-year mark (Y30) for the first time starting in 2019. As shown in Figure 10, there will be over 450,000

LIHTC units across the country reaching Y30 by 2026, with the largest number of units in California, New York and Texas. It is important to note that these properties are not governed by extended affordability restrictions that go beyond 30 years, because states did not begin to introduce those additional restrictions until much later in the program.

Figure 10: LIHTC Units Reaching Year 30, 2017-2026*



* Based on data from the National Housing Preservation database.

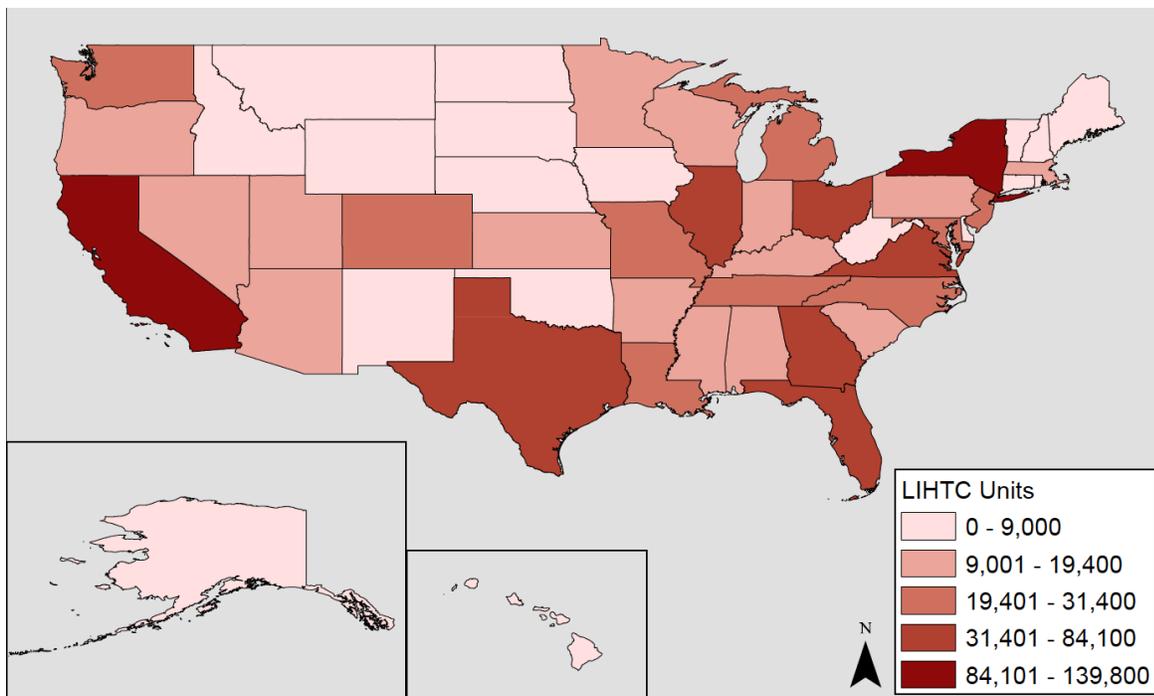
Many LIHTC properties approaching Y30 may also need substantial recapitalization to remain viable, which presents a depreciation risk. In fact, the depreciation risk in this program likely enters well before Y30, because most major systems in a building need to be repaired or replaced much earlier.

For all LIHTC properties, the ownership structure changes by the 15-year mark (Y15), because that is when owners can exit the partnership they entered with the investors that purchased the credits. This means that at Y15, almost all LIHTC properties go through an ownership restructuring. While owners of properties that were developed after 1989 cannot technically exit the program at Y15, they may choose to apply for a new round of credits if their properties need recapitalization. This Y15 point, where the ownership is decoupled, presents a distinct opportunity for owners to recapitalize their properties.

As seen in Figure 10, over 1 million LIHTC units across the country are in properties approaching Y15 over the next 10 years. The Y15 number is significantly larger than Y30, because the LIHTC program received more per-capita funding as it aged, and competition for these credits increased the value of the credits, resulting in both more credits and more units being produced per credit.

The number of LIHTC units approaching Y15 in the coming years highlights one of the challenges with the depreciation risk in this program. At some of those Y15 properties will need recapitalization by virtue of age alone. In addition, because LIHTC allocations are competitive, some projects may underestimate their operating costs or capital reserves in order to increase the odds of being awarded credits, which raises the probability that those projects will need recapitalization later in the property lifecycle. As a result, localities will be forced to decide whether to allocate new LIHTC allocations to the development of new units or the recapitalization of existing ones. This raises a broader and more important concern with the program, which is that if properties developed through this program are designed to need recapitalization at the Y15 mark, then going forward housing agencies may spend more resources preserving existing units as opposed to increasing the overall stock of affordable housing.

Figure 11: LIHTC Units Reaching Year 15, 2017-2026*



* Based on data from the National Housing Preservation database.

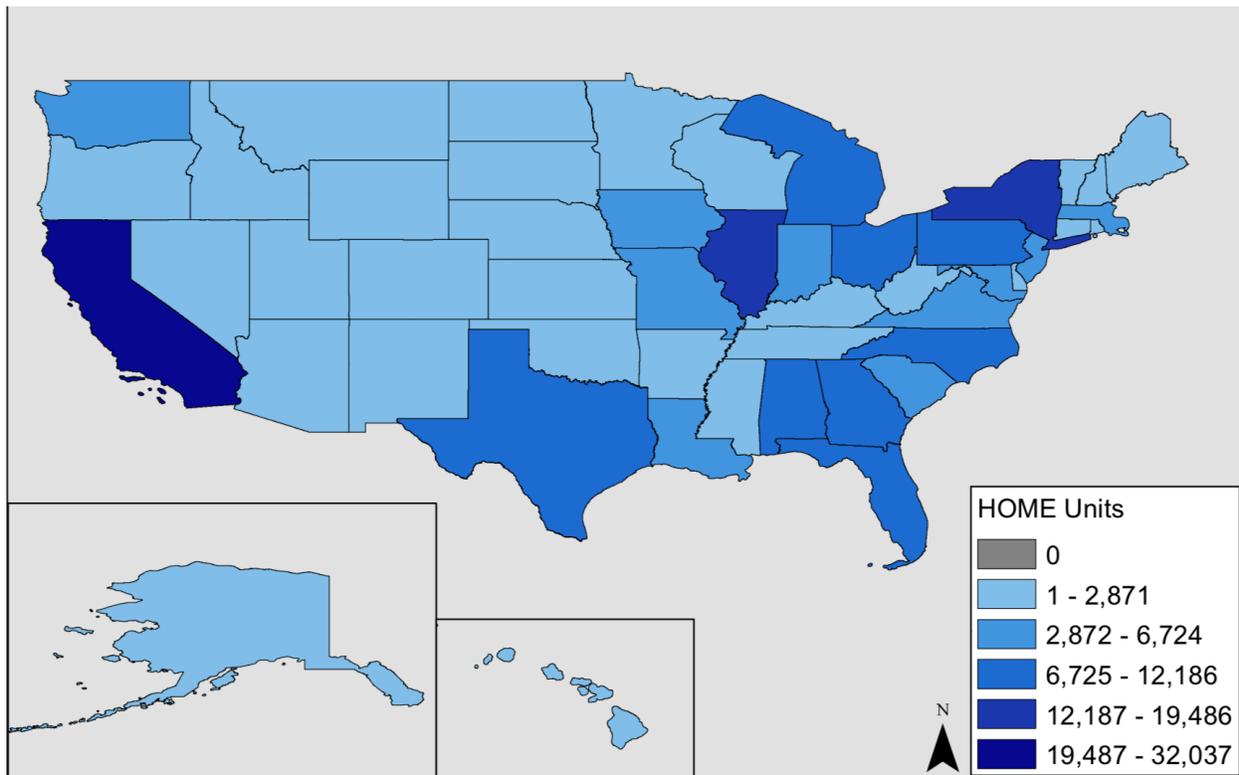
While the LIHTC program is technically not appropriated funds, the viability of the program is dependent on the tax code, and reforms to the tax code could alter the viability of this program.^{xxxvi} As a result, the program is subject to legislative risk as opposed to appropriations risk.^{xxxvii} For example, the recently enacted tax reform act reduces corporate tax rates, which could decrease the demand for tax credits and drive down the price per credit, thus reducing the number of units produced through the LIHTC program. In addition, eliminating the tax exemption of bonds used for multifamily housing undermines the viability of that 4 percent bond product that financed nearly 60 percent of LIHTC developments in 2016.^{xxxviii}

HOME

The HOME program was created in 1990, and between 1992 and 2015, it contributed to the development or rehabilitation of over 1.2 million homeownership units and over 270,000 rental units.^{xxxix} The program is set up as a federal block grant that can be used for an array of housing-related activities, including financing new units, rehabilitating existing affordable housing units, or providing direct rental or homebuyer assistance.

When HOME funds are used for rental housing, 90 percent of the units must be targeted to households below 60 percent of AMI.^{xl} The HOME program mandates a 20-year affordability restriction period for new rental housing, and 15 years for the refinancing of rental housing. As we see in Figure 12, the number of HOME rental units is proportional to the population in each state, however, some states like Texas likely use this program more for homeownership than rental housing.

Figure 12: Existing HOME Rental Units *



HOME Risk

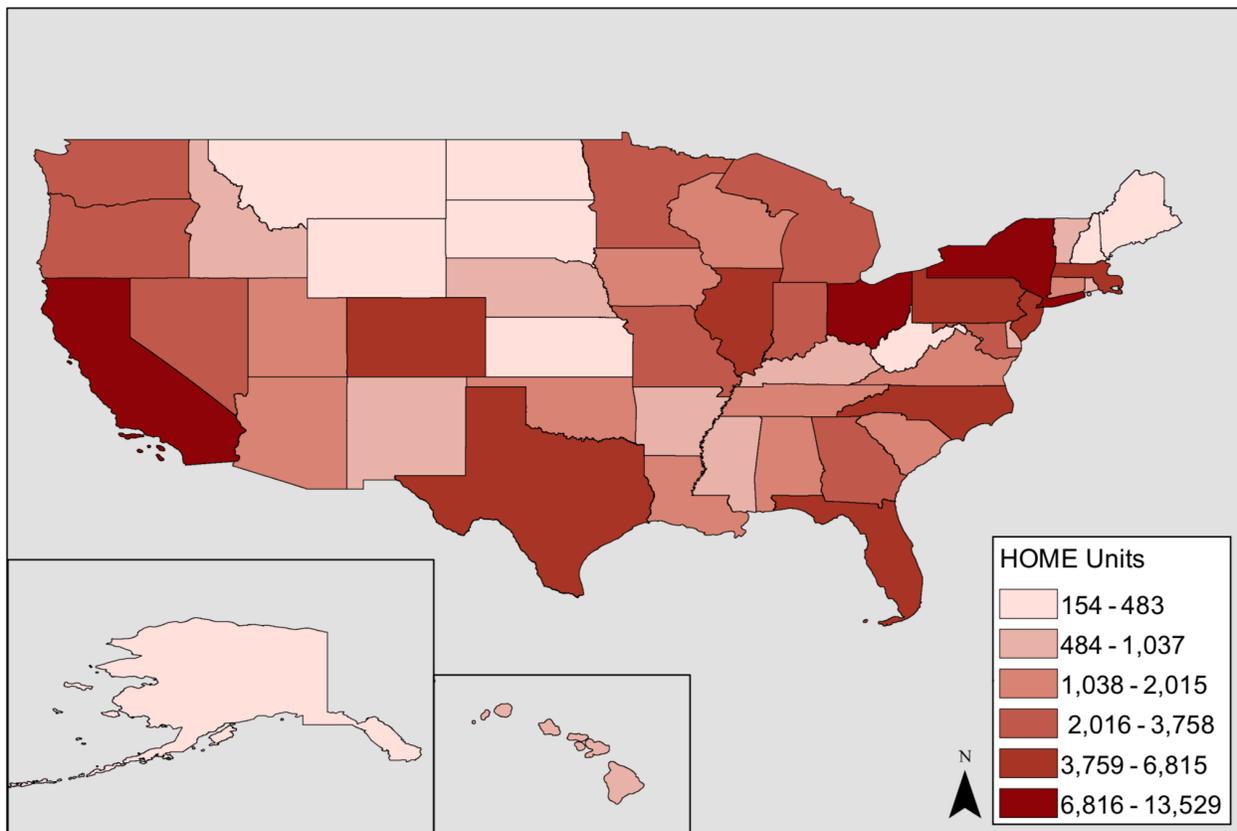
The risk associated with the HOME program is much more nuanced than other programs. On its own, the HOME subsidy is not that deep relative to its affordability requirements, which means this subsidy is often layered onto other forms of public subsidy for multifamily housing. The expiration risk in the HOME program is often a function of the expiration risk associated with other programs. In addition, the subsidy is not renewable and enters at the beginning of the

project lifecycle, as opposed to serving as an ongoing operating subsidy. As a result, the affordability restrictions associated with the HOME subsidy are often shorter than those of other programs. Specifically, all new construction of rental housing is accompanied by a minimum 20-year affordability restriction period, all refinances are accompanied by a 15-year affordability period, and there are affordability restrictions of:

- 15 years for all other properties with HOME assistance below \$15,000;
- 10 years for those with \$15,000-\$40,000 of HOME assistance; and
- 15 years for those with more than \$40,000 of HOME assistance.^{xli}

As seen in Figure 13, there are slightly over 120,000 units in properties financed with HOME funds where the affordability is due to expire over the next 10 years, and where there are no additional federal subsidies that require the units to remain affordable. There is significant expiration risk in HOME-financed properties going forward.

Figure 13: Expiring HOME Units, 2017-2026*



* Based on data from the National Housing Preservation database.

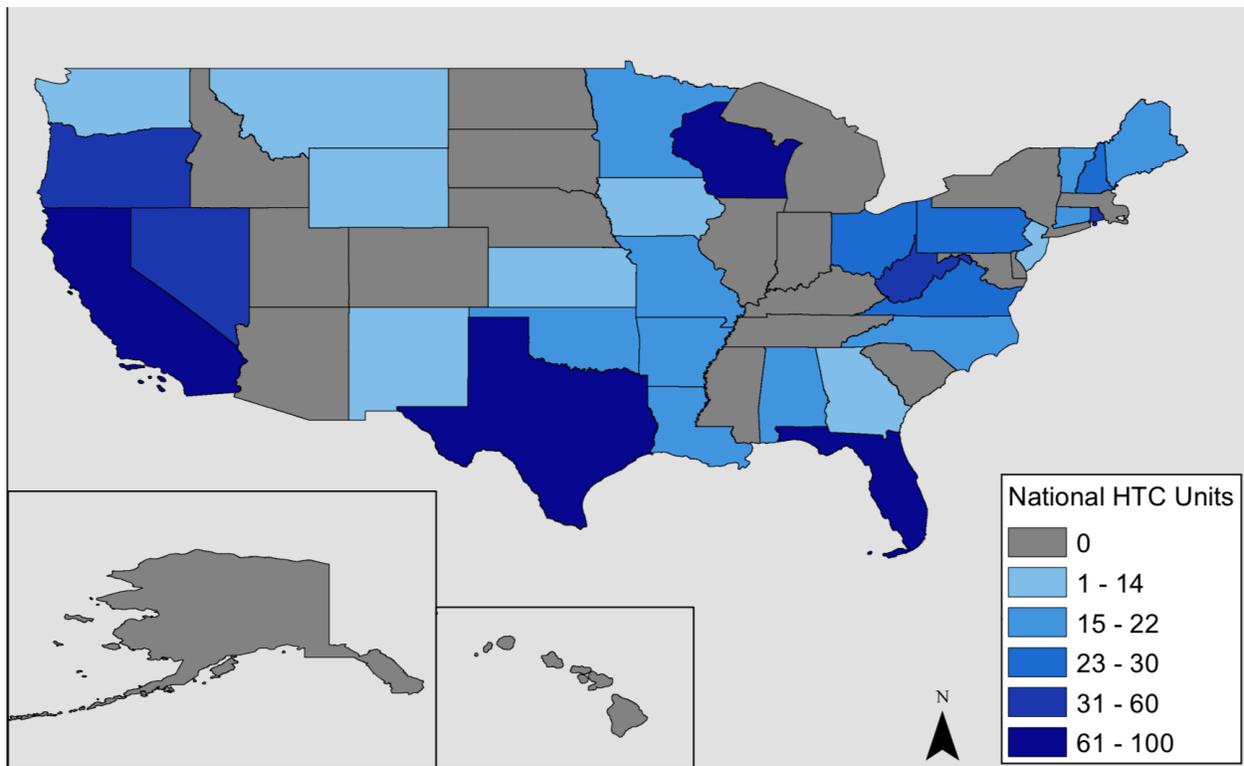
Because the program is relatively new, the properties financed through the program likely do not have as high of depreciation risk as the older HUD programs. And finally, while appropriations for the program has decreased from \$1.2 billion in 2010 to \$950 million in 2016, this funding decrease does not present a threat to the existing stock of HOME units, but rather to the financing of new units through the program.

National Housing Trust Fund

The National Housing Trust fund was authorized in 2008, but states were not allocated funds through the program until 2016. As a result, no units have been created through the program yet, but as seen in Figure 12, states anticipate developing 995 units with the initial round of funding.

The program is operated as a block grant, and 80 percent of the funds must be used for rental housing. In addition, at least 3/4 of each state grant must target households at or below 30 percent of AMI, and the remainder must target those below 50 percent of AMI. All units developed through this program have a minimum 30-year affordability requirement.^{xlii}

Figure 13: National Housing Trust Fund Units Expected, 2017



National Housing Trust Fund Risk

There are currently no threats to the units being developed through this program because they are not yet complete, the affordability restrictions will last for at least 30 years, and the funding offered through the program is not an ongoing operation subsidy—any changes in funding will only affect the program’s ability to produce new units going forward.

Having provided an overview of the existing forms of supply-side subsidized housing, and the potential risks to this portfolio, in the text above, and Table 1 below, the report will now focus on what we know about the actual risk and implications of expirations.

Table 1: Summary of Preservation Risks

Program	Risk(s) affecting existing units, in order of significance	Brief explanation of risk
<i>Public Housing</i>	Depreciation	Over \$26 billion in deferred maintenance needs
	Appropriations	Funding has decreased over time despite high levels of deferred maintenance
<i>PBRA</i>	Exit	590,000 units are in properties with contracts up for renewal over the next 10 years
	Depreciation	Over 11,000 units were in properties that failed out between 2000 and 2010 because of housing quality issues
	Appropriations	Funding has been stable for this program, but additional support will be needed if owners mark their rents up to market to either remain in the program or recapitalize
<i>Section 202</i>	Exit	Almost 43,000 units are in properties where an owner could exit the program between 2017 and 2026
	Appropriations	The PBRA contract budget has not been cut, but it requires additional funding if properties are to keep pace with their operating needs
<i>Section 515</i>	Expiration	Roughly 11,000 units are in properties that will reach a loan maturation date over the next 10 years
	Depreciation	Prior evidence shows a lack of adequate reserves in existing properties
<i>LIHTC</i>	Exit	Over 450,000 units of LIHTC are reaching the 30-year point across the country over the next 10 years
	Depreciation	Over 1 million LIHTC units are in properties approaching Y15 across the country over the next 10 years, many of which will need recapitalization
	Legislative	The Tax Cuts and Jobs Act has important implications for how this program may function going forward
<i>Home</i>	Expiration	Over 120,000 units are in HOME-financed properties where affordability restrictions are due to expire over the next 10 years
<i>National Housing Trust Fund</i>	N/A	N/A

Literature on Preservation

There are four key advantages to the preservation of existing subsidized housing: 1) it preserves affordability in markets; 2) it is more cost-effective to preserve existing subsidized housing than develop new affordable rental units; 3) it ensures that subsidized housing located in opportunity neighborhoods is not lost; and 4) it promotes housing stability.

Preserving Affordability in Rental Markets

Preservation preserves affordability in markets. There is a concern that once an owner exits a subsidy program, there are fewer affordable rental units in the market. Also, once an owner exits a subsidized housing program, the public benefit from the federal subsidy that went into that property may end because the owner is no longer obligated to rent those units to low-income households, absent affordability restriction not tied to the financing. As a result, most of the expiration literature focuses on who is likely to exit subsidized housing programs and what these expirations mean for the number of subsidized rental housing units going forward. However, there is still very limited evidence about what happens to subsidized units that are not preserved and what subsidy exits mean for the affordability of rental markets.

The first challenge with studying expirations is understanding which subsidies will expire and when, and whether subsidies already expired. Traditionally, the former question was difficult to determine because most subsidized properties receive more than one form of subsidy (Reina and Williams 2012). In fact, in cities like New York, close to 1/3 of subsidized rental units receive more than one form of government subsidy (Reina and Williams 2012). This means that to understand the scale of potential expirations, one must develop a database that accounts for every subsidy on a property, and when each of those subsidies is due to expire. Over the early 2000s, there was a significant growth of local and national databases that catalogued existing and expiring subsidized housing, largely due to investments in data infrastructure made by the MacArthur Foundation (Schwartz et al. 2016). The National Housing Preservation Database, maintained by the Public and Affordable Housing Research Corporation and the National Low Income Housing Coalition, is the largest and most robust of these national databases.

Historically, it was also difficult to know how many units have already expired from subsidy programs due to data limitations. Between 1992 and 2004, 82 percent of properties remained in the Section 8 PBRA program (Finkel et al. 2006)^{xliii}, and between 2005 and 2014, over 95 percent of the properties remained in it (Ray et al. 2015).^{xliv} While this represents a large retention rate, it still means that roughly 150,000 units were in properties that exited the PBRA program prior to 2015 (Reina 2017).

Surprisingly, there is little clarity about the number of Section 202 or Section 515 properties, where a subsidy has expired. There is information about expirations of properties from these programs when the property also has Section 8 PBRA. When combining data provided by Finkel et al. 2006 and Ray et al. 2015, we can discern that roughly 10 percent of Section 515 properties that also had Section 8 contracts have exited. And while only 4 percent of Section 202 properties with Section 8 contracts have exited the PBRA program, most of the Section 202 loans on these

properties were terminated (Ray et al. 2015). As a result, those properties remain affordable, but the affordability mandate is now only tied to the PBRA contract.

Few units have exited the LIHTC program so far, due to the 30-year affordability restriction on all properties developed through the program since 1989. A 2010 study found that for the portfolio of LIHTC properties it analyzed, only 5 percent of LIHTC properties that approached Y15 were no longer affordable (Ernst and Young 2010). Although, this study does not differentiate between the properties developed before 1989 that only had a 15-year affordability restriction period, and those developed after 1989 that were still mandated to be affordable at the time of the study. However, these results are confirmed in other studies that find a small share of the older LIHTC with only 15-year affordability restrictions have become unaffordable (Khadduri et al. 2012). While rents may remain affordable after properties exit the LIHTC program, this does not guarantee that the households who rent those units are low income, because there is no requirement to income certify new tenants who may enter these units.

Determining why an owner does not renew an expiring subsidy is key to understanding the potential scale of future subsidy expirations. There is evidence that owners exit the Section 8 program due to HUD fatigue (Finkel et al. 2006; GAO 2007); owners no longer want to deal with the administrative burden of certifying their units and obtaining rent payments from HUD, and therefore decide to leave the program.

There is also evidence that the most affordable properties are the ones least likely to remain in a subsidy program (Blanco et al. 2015). The implications of this finding mean different things depending on the context. For example, if all properties that are the most affordable are also in neighborhoods that are the most affordable, then the owner could be choosing to reduce the administrative burden of engaging in the program to receive the same level of rent, and the counterfactual for the resident could be a unit that is similarly priced.

However, there could be a quality tradeoff, meaning that the unsubsidized unit at the same price is of lower quality because owners do not have to meet HUD's housing quality standards. If owners of these properties are more likely to exit because rents in the market where the property is located are high and exiting the program provides them an opportunity to maximize profit, the counterfactual for residents could be a much costlier unit (or relocation to a less desirable neighborhood). Evidence points to the latter scenario, with research showing that PBRA properties in strong markets are more likely to opt out (Finkel et al. 2006; GAO 2007; Ray et al. 2015). There is evidence that nonprofits were more likely to renew their subsidies than for-profit owners (Finkel et al. 2006; GAO 2007; Ray et al. 2015). However, the prevalence of nonprofits in the opt-out category increased between 2005 and 2014, because fewer nonprofits were eligible to opt out prior to then. Finally, there is evidence that properties in the best financial condition are more likely to remain in the program (Ray et al. 2015).

These findings are important as we think about the implications of expirations and whether, when and how to intervene to preserve affordability. In particular, there is concern that once a property exits a subsidy program, the unit will no longer be affordable. In Florida, after subsidy exit, 73 percent of units remained rental units, of which 79 percent remained affordable to households at their original target level (Blanco et al. 2015). One clear trend, however, was that

the most affordable units, targeted toward households below 30 percent of AMI, were the ones that were least likely to remain affordable to their original target group (Blanco et al. 2015). There is little data nationally on what happens to PBRA properties after subsidy expiration, which represents an important area for further research.

There are several studies that analyze LIHTC expirations. These studies are largely limited to properties developed between 1986 and 1989, because all properties developed since are subject to 30-year affordability restrictions that are not due to expire until at least 2019. LIHTC properties owned by nonprofits and those with other affordability restrictions have a decreased risk of losing affordability (Melendez et al. 2008). LIHTC properties with low capital needs have higher odds of losing affordability (Melendez et al. 2008), which suggests that properties in the best condition and those with the smallest depreciation risk may be more likely to become unaffordable.

However, most LIHTC properties do have some depreciation risk and require major capital improvements after Y15 (Melendez et al. 2008; Schwartz and Melendez 2008), which means the majority of these properties are likely to seek recapitalization and thereby extend the affordability period. The resulting challenge is that LIHTC properties are often recapitalized with a new round of tax credits (Schwartz et al. 2016), which places a strain on the existing pool of tax credits (Khadduri 2012). In fact, one study estimates that 42 percent of LIHTC received another round of tax credits after Y15 (Ernst and Young 2010).

The depreciation risk associated with LIHTC properties underscores the increasing tension between the goal of preserving existing subsidized housing and producing new affordable housing (Melendez et al. 2008; Schwartz and Melendez 2008). In fact, many states prioritize preservation in their tax credit allocation plans, which gives those units priority over a similar new construction application (Schwartz et al. 2016).

The third challenge to understanding subsidy expirations is concluding how to generalize findings about subsidy expirations across programs. For example, a paper studying the likelihood of properties exiting the Mitchell-Lama program in New York City finds that those properties with for-profit owners and properties in areas with above average price appreciation are more likely to exit (Reina and Begley 2014). These findings are consistent with those that focus on other subsidized housing programs, but can we apply such program-specific findings to our understanding of subsidy expirations across all programs? This is particularly important because there are no studies that focus on who exits the Section 202 or Section 515 programs absent those properties also having project-based Section 8 contracts. There is reason to believe that, by virtue of property location alone, the factors that affect expiration from the Section 515 program are functionally different than those in programs that focus on urban markets.

What becomes clear from these studies is that we have data about expirations, but we do not know the true impact of expirations on preserving affordability in the market. In theory, if a subsidy expires, a property may become less affordable, but is that always true? The Blanco et al. (2015) study finds that almost 21 percent of PBRA units in Florida where a subsidy ended became unaffordable, but is that number larger or smaller in other markets, and does it vary

based on local price appreciation and ownership? In addition, did those units that remained affordable still lease their units to low-income households?

Cost

There is evidence that preserving existing subsidized housing is less costly than developing new affordable housing.^{xlv} According to a study from the MacArthur Foundation, developers who financed through its Window of Opportunity Initiative (WOI) preserved 450,000 affordable rental homes. On average, these WOI units cost \$81,000 per unit, which the foundation argues is half the cost of building a new rental unit in the U.S. (MacArthur 2008). Another study that looked at preservation between 2000 and 2010 finds evidence that across all LIHTC properties, preservation appears to cost less per unit than new construction (Schwartz et al. 2016). Finally, a study that looks at the lifecycle cost of 250 multifamily affordable properties finds that new construction generally costs 25 to 45 percent more per unit than acquisition-rehab development (Brennan et al. 2013), even if we consider that the operating costs for rehabilitated properties tend to be higher than for new construction (Novogradac 2017).

One concern across all these studies is that the sample used may not be representative of the larger world of properties. For example, the MacArthur Foundation's sample is comprised of organizations it funds, which are more likely the high-capacity organizations that can develop housing more efficiently, thus explaining some of the variation in cost. However, it is unlikely that these organizations are twice as efficient as the average developer.

We would expect preservation to cost less than new construction. Regulatory cost is a major development cost that is minimized through preservation. Regulations can add a significant level of cost to developing a property because of the transaction and time costs associated with navigating the development process (Glaeser, Gyourko, and Saks 2005). Preserving an existing subsidized housing development reduces this cost. Naturally, there are other regulations that preservation can trigger, such as green-building requirements on an LIHTC-qualified allocation plan. However, those additional regulations are likely not universal, and in the case of green-building requirements, they should generate a return on investment.

Preservation and new construction can also have very different cost consequences for local governments. Federal supply-side subsidy programs offer federal dollars that get operationalized at a local level. In 2016, the federal government provided, on average, \$508 per unit per month in rental assistance to public housing residents, \$738 to PBRA tenants, and \$364 to those in a Section 202 property.^{xlvi} This ongoing operating subsidy is lost when a property expires from a subsidy program, which means the local government must provide additional subsidy at that level to ensure that the unit remains affordable going forward. Local governments are unable to offer a subsidy as deep as those covered by federal programs and at that scale. As a result, subsidy expirations present a real financial cost to local governments.

Subsidy expirations also jeopardize past investments in subsidized housing. Over time, the federal government has invested billions of dollars to directly increase the supply of affordable housing. If a subsidy expires and rents do in fact increase, then the resources the government spent on the previous acquisition and development of the site are essentially lost. We know very

little about the overall dollar value of the aggregate investment in the production of subsidized housing, particularly because many properties receive subsidies from multiple programs, but we do know it is at least as high as the current value of the land on which all these properties are built.

One study estimates the federal government spends \$40 billion on means-tested rental housing programs and \$6 billion in tax expenditures through the LIHTC program annually (Collinson, Ellen, and Ludwig 2015). That study uses the historic tables from the Office of Management and Budget back to 1980,^{xlviii} and the means-tested spending amount includes all HUD housing programs, including vouchers. These data go back to 1962 and show that the average annual spending on means-tested housing programs was \$26 billion per year from 1962 to 2016.

In 2017, voucher programs accounted for half of the HUD budget, which translates to even more than half of the funding for means-tested housing programs, because there are administrative costs in the budget. Therefore, if we conservatively assume that half of the historic financing for means-tested programs went toward vouchers (even though iterations of the voucher program did not begin until the 70s and the modern-day voucher program did not begin until 1987), then there is a lower bound of \$750 billion that has been spent financing supply-side programs since 1962, not including the tax expenditure costs from the LIHTC program. Again, these numbers are not perfect, but they do highlight the magnitude of investment in supply-side properties over time, which is important to consider in the context of preservation.

Preserving Access

Another justification for preservation of subsidized housing is that it promotes access to opportunity neighborhoods. There is strong evidence that access to higher-opportunity neighborhoods improves household outcomes (Chetty et al. 2016; Ellen and Turner 1997). As a result, subsidy preservation is important if it increases access to opportunity neighborhoods.

There is only one study that analyzes subsidy expirations within the context of neighborhood opportunity. Lens and Reina (2016) looked at neighborhoods where PBRA units have expired, where PBRA and LIHTC properties are due to expire over the next 10 years, and where existing subsidized housing is located. They found that properties with a PBRA contract that expired between 2000 and 2010 were often located in low-opportunity neighborhoods, but those neighborhoods were dramatically improving. In addition, PBRA properties eligible to expire between 2010 and 2020 are in higher-opportunity neighborhoods, and those due to expire from the LIHTC program are in slightly higher-income neighborhoods than other subsidized housing. Expired PBRA units were also in neighborhoods where it is now more difficult to develop new subsidized housing units, and those due to expire are in neighborhoods that are largely already high opportunity.

The study's findings suggest that subsidy expirations may affect neighborhood access considerably. The main limitation of this study is that it does not catalogue how many private-market affordable units remain in these markets. As a result, we do not know whether past subsidy exits and potential future exits affect a low-income household's ability to access these opportunity neighborhoods.

Preserving Stability

The final and least-studied case for preservation is that it promotes stability. There is only one study that analyzes the impact of subsidy expirations on households who live in these properties. Reina and Winter (2017) identified all households who lived in a property where the PBRA contract expired between 2000 and 2010, and they determined which households used their tenant protection vouchers and what that meant for their outcomes.

They found that only 48 percent of households used the voucher they were offered, and those who did not use their voucher lost approximately 41 percent of their effective income by virtue of no longer having rental assistance. Those households who used the voucher often moved, and while each move was associated with accessing a slightly lower-poverty neighborhood, few households made multiple moves, and the benefits of these moves were muted if the head of household was black or elderly.

The study does not provide any insight about whether preservation increases stability, and in turn, improves a household's welfare. However, the study does show that there are profound negative welfare implications for the majority of households who live in a property where a subsidy expires, even when a tenant is offered a voucher as a form of protection.

The impact of the HOPE VI redevelopment program also sheds light on household stability. Most households in the HOPE VI program moved close to their original public housing units (Kingsley et al. 2003; Buron et al. 2002), but it is unclear whether the relocation affected their housing stability. Evidence suggests that many households in HOPE VI developments had strong ties to their community that made the move less desirable, particularly as households were seeing their friends and neighbors move (Kleit and Manzo 2006), and that many families had difficulty rebuilding such ties after they moved (Clampet-Lundquist 2004). Combined, this means that even if the moves were close, they were disruptive to social networks. Evidence suggests the moves represented a significant source of stress for these households (Keene and Geronimus 2011).

Remaining Questions

Many questions about preservation are yet to be explored. This section aims to highlight some of these key questions in the interest of promoting future research on preservation.

Macro questions

There are several key research questions that are important to our understanding of both preservation and subsidized housing more broadly:

What happens to units after a subsidy expires?

One of the main benefits of preservation is that it should preserve affordability in rental markets. While we can assume that a subsidized unit is an affordable one, we cannot as easily assume a

one-to-one correlation between the loss of subsidized units and affordable units. Based on existing evidence, we know that there are at least some formerly subsidized units that become unaffordable. However, understanding how many units, where these units are located, why units remain affordable or become unaffordable, and how they compare to similar unsubsidized affordable housing is essential to estimating the value of preservation.

What is the tenant profile of units after a subsidy expires?

It is just as important to understand who rents a formerly subsidized unit as it is to discern whether that unit remains affordable. One of the primary benefits of a supply-side subsidy is that it targets households at certain income levels, thereby ensuring affordable units are being leased by low-income households. A formerly subsidized unit remaining affordable but now being leased to a higher income household still represents a problematic shift when we consider that the lowest-income households already have the fewest units available to them at an affordable price point and are more likely to be rent burdened.

In addition, it is important to understand who rents the unit, because some supply-side programs, such as the Section 202 program, target vulnerable populations that may have a more difficult time navigating the private market. Similarly, some PBRA properties target families, who often have a more difficult time finding a unit on the private market. This all highlights the need to better understand who accesses units that exit subsidized housing programs and what that means for the lowest-income households and most vulnerable populations.

Does preservation promote stability, access to opportunity neighborhoods, and choice?

A goal of subsidized housing programs is to ensure access to opportunity neighborhoods. Many of the old supply-side subsidized properties are in neighborhoods that once suffered from disinvestment but are increasingly becoming neighborhoods of opportunity. These are also neighborhoods where there are likely fewer affordable private market rental units, and where it is costlier to develop new housing units with a supply-side subsidy. As a result, preservation could increasingly become a tool for promoting access to opportunity neighborhoods.

Preservation can also become a tool for ensuring that households in rapidly changing neighborhoods can remain in place without their housing quality and costs being affected. However, we still need to better understand where expiring subsidies are located, how many of these properties are located in higher-opportunity neighborhoods, and whether preserving these subsidies improves a low-income household's ability to access or remain in such neighborhoods. Finally, we need to understand whether preservation promotes stability or choice and how that affects a household's overall welfare.

Who owns subsidized housing?

Literature suggests that ownership structure affects whether an owner opts out of a rental subsidy program. Studies that analyze ownership often use very basic measures that place owners into two categories: nonprofits and for-profits. However, we know that not all nonprofits are the same. For example, a housing development fund corporation, which is set up as a nonprofit

single asset entity, is much different than a community development corporation. Similarly, a for-profit affordable housing developer is much different than a private equity investment fund. More information about property owners is essential, because it provides important insight into the drivers and challenges of investment in and the preservation of subsidized housing.

What is the cost of expired subsidized housing?

Properties developed through supply-side subsidized housing programs represent a direct investment aimed at increasing the supply of affordable housing. We know very little about the amount spent on these properties over time across all programs and the aggregate value of those investments. The initial capital outlay in some supply-side program is a sunk cost, but considering the properties and the land on which these properties are built have value, we would expect the loss of these investments to represent real costs. As we consider the overall cost and benefit of preservation, it is important to quantify the scale and meaning of such investments and the asset value of current subsidized developments.

How do longer-term affordability restrictions impact the production and preservation of subsidized housing?

There are discussions about the need to mandate lasting affordability on subsidized housing units. While there are examples of these extended restrictions working, as evidenced by the demand for LIHTC despite extended restriction periods in California, we still know very little about the impact of affordability restriction periods on the production and preservation of housing units.

For example, do extended affordability restriction periods change the type of owners who develop affordable housing, with those interested in affordability being more likely to engage in these programs? Do properties developed with longer affordability requirements have underwriting standards that reduce the depreciation risk associated with remaining affordable for a longer period of time? If so, how does that impact the cost per unit and number of units produced? If not, does that just mean that the government has committed itself to providing additional subsidy at a later date to ensure the property does not fall into disrepair prior to the end of the negotiated affordability period? These questions are important to understand as we think about tools to address exit risk, and whether the odds of exiting are worth the potential other risks these tools introduce.

Micro questions

There are important questions that are more specific to subsidized housing programs and the preservations of properties in these programs. These micro questions represent potential points of intervention and policy response to expiration, depreciation and appropriations risks. For example, does offering a longer-term PBRA contract reduce the odds that an owner will exit the program? Do preferences given in LIHTC allocations for preservation decrease subsidy exits? The importance of understanding the actual implementation of preservation is essential to the larger questions previously discussed.

Discussion and Policy Implications

Several clear themes emerge from this report:

- The number of units that will be in need of preservation or recapitalization is going to be higher over the next 10 years than ever before. Evidence suggests that many of these units will not exit their programs if the subsidy is renewable. A more real concern is that many properties developed through HUD programs are older and will need recapitalization to stave off depreciation risk. Additionally, there are over 1 million units approaching Y15 in the LIHTC program, many of which will need refinancing. The expiration and recapitalization problems highlight two realities: we are already spending a significant share of resources on keeping existing subsidized housing affordable rather than creating new units; and going forward, preservation of units will be competing increasingly with new construction projects for these limited resources.
- The funding for supply-side affordable housing is shrinking while the demand for it is increasing. Almost all of the programs cited in this report have suffered from decreased funding over the past 10 years. At the same time, the recent tax bill presents challenges to the value of the LIHTC and the ability to couple this subsidy with bonds. Combined, this means that the preservation versus new construction tradeoff may become even more fierce, if resources continue to dwindle.
- Units targeted toward the lowest-income households are the ones most likely to become less affordable after a subsidy ends. This is concerning, because it is increasingly difficult to develop new affordable units for the lowest-income households. As a result, the preservation risk is greatest for the lowest-income households who have the fewest alternate options on the private market.
- The costs associated with preservation are difficult to quantify, but evidence suggests that unit preservation costs less than new construction.
- The loss of a subsidized unit reflects the loss of significant government resources spent on the acquisition and development of the site.
- Some of the older subsidized properties are located in higher-performing neighborhoods, which means that preservation could increasingly become a tool for promoting access to opportunity neighborhoods. Preservation can also become a tool for ensuring that households in rapidly changing neighborhoods can remain in place without their housing quality and costs being affected.

Policy Recommendations

There are several distinct policy recommendations that arise from this analysis. First, we have more data available to track subsidy expiration risks going forward than ever before; therefore, government officials should use existing data to determine their local preservation threats and needs.

Even with more data, there are many tough decisions ahead. One key decision is how resources should be allocated for preservation versus new construction. Several important factors should inform this decision, including the depth of the subsidy that is at risk of being lost and the location and population being served by the units. As previously stated, many of the older

subsidized housing units are now located in higher-opportunity neighborhoods, where it is difficult to develop new subsidized housing. If a goal is to increase access to higher-opportunity neighborhoods, then a municipality will need to determine how it defines high opportunity and whether preserving units in high-opportunity areas, as opposed to building new units, helps achieve this goal.

One of the clearest findings about preservation is that subsidy expirations likely have the largest impact on the lowest-income households. In addition, there are few protections in place for these households, and the one existing safety net—the tenant protection voucher—does not appear to offer all that much protection from a loss of subsidy. As a result, the federal government and municipalities must also develop ways to minimize the downside of subsidy expirations for the lowest-income households if a subsidy does expire.

In many ways, the preservation challenges going forward reflect a larger challenge to our current model of financing supply-side subsidized housing. If we are going to create affordable units that will likely need recapitalization later on to remain affordable, then are we just creating an affordable housing loop that serves the same properties over and over? This question is fundamental to the discussion of lasting affordability. Specifically, if a unit has a long term of affordability, then is the government establishing an expectation that there will be resources to ensure the unit can remain suitable and affordable?

In general, extending affordability restrictions has not appeared to dampen developers' interest in the LIHTC program, but that does not mean it is costless. As a result, we cannot view extending use restriction periods alone as the only policy response to preservation risks. We should also consider important measures like lifecycle underwriting that ensures properties have adequate reserves, and energy efficiency upgrades that reduce operating costs and extend the lifecycle of a property in a way that may reduce the need for additional supply-side subsidies to remain affordable.

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Endnotes

ⁱ According to the U.S. Department of Housing and Urban Development, households who spend more than 30 percent of household income on rent and utilities are considered rent burdened.

ⁱⁱ Defined as households earning 30 percent of area median income

ⁱⁱⁱ Defined as households at the 20th, 40th, and 60th percentile [LI is <= 80 percent; VLI is <= 50 percent; and ELI is <= 30 percent. LIHTC serves <=60 percent] of the area median income distribution

^{iv} This cost estimate is likely conservative and should be considered lower bound due to additional capital needs deferrals, and cost inflation, since the study was conducted.

^v <https://www.huduser.gov/portal/datasets/lihtc.html>

^{vi} LIHTC allocation are estimated to increase by 12.5 percent for 2018-21, but normal production cost inflations could reduce the number of additional units produced each year due to the funding increase. As a result, there may still be a slight increase in the number of LIHTC units produced in the next 3-5 years.

^{vii} All of which have rent-restricted units and direct low-cost mortgages, and some of which have ongoing rental assistance

^{viii} https://www.hud.gov/sites/documents/DOC_12821.PDF

^{ix} There is no clear reason provided for why the funding for new Section 202 properties was cut. Concerns about excessive cost are often cited as a justification for eliminating funding, as was the case with the defunding of new Section 8 project-based rental assistance contracts, but a similar justification was not publicly provided for the defunding of new Section 202 developments.

^x The HOME program has also financed almost 1.2 million homeownership units.

^{xi} There are other supply-side programs that exist such as the Housing Assistant for People with Aids, Section 236, and Section 22(d)(3) programs. They are not included in this report, because they are smaller (often producing less than 30,000 units), more spatially concentrated in fewer states, and often lack good historical and current data. Many of the risks discussed in this report apply to these properties as well, which means that this report represents the lower bound of preservation challenges going forward.

^{xii} In addition, 40 percent of new admissions each year into to Public Housing must have incomes below the higher of 30 percent of AMI or the federal poverty rate

https://www.hud.gov/topics/rental_assistance/phprog; http://nlihc.org/sites/default/files/AG-2017/2017AG_Ch04-S04_Public-Housing.pdf

^{xiii} <https://www.hud.gov/RAD>

^{xiv} <https://www.hud.gov/RAD/program-details>

^{xv} <https://www.hud.gov/sites/documents/TOOLKIT1WHYRAD.PDF>

^{xvi} The major difference being that PHAs still own these properties, and the public ownership aspect minimizes but does not eliminate the risk that the owner will chose to exit the program.

^{xvii} In addition, 40 percent of new admissions each year into Public Housing must have incomes below the higher of 30 percent of AMI or the federal poverty rate

http://nlihc.org/sites/default/files/AG-2017/2017AG_Ch04-S04_Public-Housing.pdf

^{xviii} <https://www.hud.gov/hudprograms/rs8pbra>

^{xix} This map includes properties that have Section 8 and some other form of subsidy, i.e. both PBRA and Section 202 or Section 515 financing.

^{xx} This map includes properties that have Section 8 and some other form of subsidy, i.e. both PBRA and Section 202 or Section 515 financing.

^{xxi} The program ceased to have funding for the creation of new units as of 2013

<https://www.gao.gov/assets/680/677564.pdf>

^{xxii} This highlights an important aspect of these programs, which is that many properties receive more than one form of subsidy. For the sake of this report, all 202 properties with PBRA are represented in the PBRA section, because that is the renewable form of subsidy.

^{xxiii} https://www.hud.gov/sites/documents/DOC_12821.PDF

^{xxiv} <https://www.gao.gov/assets/680/677564.pdf>

^{xxv} https://www.hud.gov/program_offices/housing/mfh/progdesc/eld202

^{xxvi} This map represents Section 202 properties without a Section 8 contract, which means it largely reflects those 170,000 units developed since 1990, in order to isolate the location of these units, and because all those with properties with PBRA are represented in Figure 2.

^{xxvii} <http://nlihc.org/sites/default/files/2014AG-145.pdf>

^{xxviii} Defined as households with incomes that are no more than \$5,500 above 50 percent of median income: https://www.hud.gov/sites/documents/19565_515_RURALRENTAL.PDF

^{xxix} https://www.hud.gov/sites/documents/19565_515_RURALRENTAL.PDF

^{xxx} This map represents Section 515 properties without a PBRA in order to isolate the location of these units, and because all those with properties with PBRA are represented in Figure 2.

^{xxxi} http://www.carh.org/wp-content/uploads/2016/01/RD_CompPropAssesStudy_2004.pdf

^{xxxii} <http://nlihc.org/sites/default/files/2014AG-152.pdf>

^{xxxiii} Many states give preferences or require a deeper level of affordability than mandated by the LIHTC program. As a result, it is common for LIHTC properties to also receive other subsidies

that allow a property to serve lower-income households. In fact, one study estimates that as many as 46 percent of LIHTC properties receive some other form of rental assistance (O'Regan and Horn 2013)

^{xxxiv} One study finds that 42 percent of LIHTC tenants are rent burdened, while 17 percent are severely rent burdened (O'Regan and Horn 2013)

^{xxxv} <https://fas.org/sgp/crs/misc/RS22389.pdf>

^{xxxvi} Because LIHTC developments often include other sources of federal funding, the number of units produced by the program is subject to the appropriations risk associated with this program.

^{xxxvii} The risk levels is currently high, due to changes in the tax code being instated under the Tax Cuts and Jobs Act that affect the LIHTC program.

^{xxxviii} http://www.housingfinance.com/policy-legislation/houses-private-activity-bond-repeal-harms-housing-production_o

^{xxxix} <http://www.coscda.org/documents/BuildingHOME.pdf>

^{xl} <http://nlihc.org/issues/other/home>

^{xli} <https://www.hudexchange.info/resources/documents/HOME-CDBGGuidebook.pdf>

^{xlii} <https://www.hudexchange.info/programs/hf/about/>

^{xliii} 49.5 percent of these properties were ones where owners renewed their subsidy, 32.2 percent of these properties were one where an owner was likely ineligible to exit the program.

^{xliv} This estimate includes 71 percent of properties where an owner renewed their subsidy, and 24 percent of properties where an owner was likely ineligible to exit the program.

^{xlv} This does not attempt to claim that supply-side subsidy in general is an efficient way of increasing the stock of affordable housing, but rather seeks to compare the costs of rehabilitation to new construction.

^{xlvi} Based on HUD's Picture of Subsidized Housing database.

^{xlvii} <https://www.whitehouse.gov/omb/historical-tables/>

^{xlviii} These numbers are adjusted to 2016 dollars