PUBLIC HOUSING IN THE COMPETITIVE MARKET PLACE: DO AFFORDABLE AND PUBLIC HOUSING DEVELOPMENTS BENEFIT FROM PRIVATE MARKET AND OTHER FINANCING TOOLS?

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERALISM
AND THE CENSUS

OF THE

COMMITTEE ON
GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

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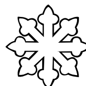

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PUBLIC HOUSING IN THE COMPETITIVE MARKET PLACE: DO AFFORDABLE AND PUBLIC HOUSING DEVELOPMENTS BENEFIT FROM PRIVATE MARKET AND OTHER FINANCING TOOLS?

TUESDAY, MAY 23, 2006

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FEDERALISM AND THE CENSUS,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2154, Rayburn House Office Building, Hon. Michael R. Turner (chairman of the subcommittee) presiding.

Present: Representatives Turner, Dent, Foxx, Clay, and Maloney.

Staff present: Shannon Weinberg, counsel; Juliana French, clerk; Adam Bordes, minority professional staff member; and Cecelia Morton, minority office manager.

Mr. TURNER. A quorum being present, this hearing on the Subcommittee on Federalism and the Census will come to order. Welcome to the subcommittee's hearing entitled, "Public Housing in the Competitive Marketplace: Do Affordable and Public Housing Developments Benefit From Private Market and Other Financing Tools?"

This is the third in this series of hearings in the Federalism and the Census Subcommittee which we are holding on public and low-income housing. The purpose of today's hearing is to learn how financiers and developers in the multifamily affordable housing industry obtain structure of the various forms of capital used in the development of low and mixed-income housing developments.

The Federal Government, through the Department of Housing and Urban Development, and ultimately through the various public housing authorities, plays a significant role in developing affordable housing by providing seed money for these projects. Federal funds provided to the low-income tax credit help fix grants, the Public Housing Capital Fund, and the Capital Fund Financing Program have all been heavily used to leverage additional private sources of capital for these projects.

Developers have also successfully used other Federal programs, such as the Home Investment Partnerships Program, the Community Development Block Grant, and CDBG Section 108 loan guarantees to raise capital funds for development projects.

Congress has recently decreased funding for many of these programs in recent years. At the same time, many of the statutory and

regulatory requirements of these Federal programs often encumber the use of Federal moneys, creating significant delays and project closings. The complex nature of these programs has caused some would-be investors and lenders to walk away from certain projects. Our goal here today is to learn from those in the industry and investigate ways in which Congress can streamline the use of the Federal Government's various sources of project capital so they can be more easily integrated into mixed or multi layered financing packages.

Your comments will help us shape any recommendations that we make to our colleagues in Congress as well as to the administration on how we could improve the current system and attract even greater private investment in affordable housing projects.

The panel that we have today consists of three witnesses from the private sector who will share with the subcommittee their experiences with the financing of large low-income and mixed-income housing projects. First, we will hear from Patrick Clancy, president and CEO of the Community Builders Inc. Community Builders is a nonprofit developer of low and mixed-income housing projects over the Boston area. Next we will hear from Wendy Dolber, managing director of tax exempt financing, Standard & Poor's Rating Services. Finally we have Brian Tracey, community development banking market executive for Bank of America's Atlantic region.

With that, I welcome each of you here today, and I look forward to your comments. Each witness has kindly prepared written testimony which will be included in the record of this hearing. Witnesses will notice that there is a timer light at the witness table. The green light indicates that you should begin your prepared remarks, and the red light indicates that the time has expired. The yellow light will indicate when you have 1 minute left in which to conclude your remarks.

Our ranking member, Mr. Clay, has notified us that he does intend to join us today, and we'll be looking for his attendance and his opening statement at a later time, perhaps. It is the policy of this committee that all witnesses be sworn in before they testify. Will the panel please raise your right hands and stand?

[The prepared statement of Hon. Michael R. Turner follows:]

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RANKING MINORITY MEMBER

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Congress of the United States

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SUBCOMMITTEE ON FEDERALISM AND THE CENSUS
Congressman Michael R. Turner, Chairman

OVERSIGHT HEARING
STATEMENT BY MICHAEL R. TURNER, CHAIRMAN

Hearing topic: *"Public Housing in the Competitive Market Place: Do Affordable and Public Housing Developments Benefit from Private Market and Other Financing Tools?"*

Tuesday, May 23, 2006
10:00 AM
2154 Rayburn House Office Building

OPENING STATEMENT

Welcome to the Subcommittee's hearing entitled, "*Public Housing in the Competitive Market Place: Do Affordable and Public Housing Developments Benefit from Private Market and Other Financing Tools?*"

This is the third in a series of hearings the Federalism and the Census Subcommittee is holding on public and low-income housing. The purpose of today's hearing is to learn how financiers and developers in the multifamily affordable housing industry obtain and structure the various forms of capital used in the development of low- and mixed-income housing projects.

The Federal Government, through the Department of Housing and Urban Development (HUD), and ultimately through the various Public Housing Authorities (PHAs), plays a significant role in developing affordable housing by providing seed money for these projects. Federal funds provided through the Low-income Housing Tax Credit, HOPE VI grants, the

Public Housing Capital Fund, and the Capital Fund Financing Program, have all been heavily used to leverage additional private sources of capital for these projects. Developers have also successfully used other federal programs such as the HOME Investment Partnerships Program, the Community Development Block Grant (CDBG), and CDBG Section 108 Loan Guarantees to raise capital funds for development projects.

Congress has decreased funding for many of these programs in recent years, prompting some in the private sector to question the certainty and soundness of their equity investments and loans in affordable housing development projects.

At the same time, many of the statutory and regulatory requirements of these Federal programs often encumber the use of federal monies, creating significant delay in project closings. The complex nature of these programs has caused some would-be investors and lenders to walk away from certain projects.

Our goal here today is to learn from those in the industry, and investigate ways in which Congress can streamline the use of the Federal Government's various sources of project capital so that they can be more easily integrated into mixed- or multi-layered financing packages. Your comments will help us shape any recommendations we make to our colleagues in Congress, as well as to the Administration, on how we can improve the current system and attract even greater private investment in affordable housing projects.

Today we have three witnesses from the private sector who will share with the Subcommittee their experiences with the financing of large low-income and mixed-income housing projects. First, we will hear from Patrick Clancy, President and CEO of The Community Builders, Inc. The Community Builders is non-profit developer of low- and mixed-income housing projects out of the Boston Area. Next, we will hear from Wendy Dolber, Managing Director of Tax Exempt Financing. Standard & Poor's Rating Services. Finally, we have Brian Tracey, Community Development Banking Market Executive, for Bank of America's Atlantic Region.

Thank you and I look forward to your testimony.

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[Witnesses sworn.]

Mr. TURNER. Will the record show that all witnesses have responded in the affirmative. And I want to thank Mr. Clay for his support and his continued interest in community development and recognize him for his opening statement.

Mr. CLAY. Thank you, Mr. Chairman. Mr. Chairman, I thank you for holding today's hearing on the role of private capital financing in our Nation's public housing. As we continue in our work to improve public housing, today's hearing will allow us to examine how both Congress and the private sector can work in tandem to meet the need for public housing nationwide.

Since the enactment of the Low-Income Housing Tax Credit Program in 1986, the role of private capital in public housing has afforded increased options to local housing authorities facing significant building and restoration needs. This partnership is sorely needed as our Nation's affordable housing stock is decreasing, and public housing faces capital improvement needs approaching $20 billion annually. Nevertheless, Federal resources for capital improvements remain inadequate while local agencies face daunting approval processes for proposed projects that are funded.

As in previous years, the President's budget for fiscal year 2007 provides no funding for the HOPE VI Program that is essential to the revitalization programs of dilapidated public housing complexes. In addition, the budget costs are shrinking the amount of funding for the Public Housing Capital Fund by nearly $250 million from fiscal year 2006 funding level. This is sending the wrong signal at the wrong time to our capital markets.

I suggest to you, Mr. Chairman, that inconsistent support for these programs will only lessen the commitment to public housing from the private sector. If our PHAs cannot depend on long-term capital commitments from the Federal Government, it makes little business sense for the private sector to hold up their end of the bargain. While we in Congress will often step in at the 11th hour to fund these programs, these solutions lack a firm commitment to private market participants seeking to provide favorable lending terms or adequate resources to our PHA.

This concludes my remarks, and I look forward to our testimony today. Thank you, Mr. Chairman.

Mr. TURNER. Thank you, Mr. Clay. And with that, we'll begin with Mr. Clancy.

STATEMENTS OF PATRICK CLANCY, PRESIDENT AND CEO, THE COMMUNITY BUILDERS, INC.; WENDY DOLBER, MANAGING DIRECTOR, TAX EXEMPT FINANCING, STANDARD & POOR'S RATING SERVICES; AND BRIAN TRACEY, COMMUNITY DEVELOPMENT BANKING MARKET EXECUTIVE ATLANTIC REGION, BANK OF AMERICA CORP.

STATEMENT OF PATRICK CLANCY

Mr. CLANCY. Thank you, Mr. Chairman. Good morning. My name is Pat Clancy. I lead an organization that has been building affordable housing and transforming neighborhoods for over 40 years. I'm proud of the Community Builders' record of producing over 20,000

units of affordable and mixed-income housing in cities across the Northeast, the mid-Atlantic and the Midwest.

Let me start by stating the key value proposition. The value of the housing investment in new mixed income housing that is replacing devastated public housing lies in changed lives and changed neighborhoods, not simply in the new housing. As the community development field has evolved, change agents such as my organization have increasingly come to take a holistic view of neighborhoods and markets and to propose comprehensive neighborhood revitalization efforts [CNR], rather than small-scale rehabilitation or new construction.

In our view, public investment and public-private development activity must operate on a scale sufficient to reposition a neighborhood in its regional market and to stimulate broader economic activity.

Prior to the HOPE VI program, the ability to mount large-scale redevelopment initiatives capable of transforming neighborhoods was a critical element missing from our urban policy. By now, the ingredients behind the success of HOPE VI are well known, scales sufficient to change neighborhood markets, leveraging private sector capital and development capacity, high-quality design, construction and amenities, comprehensive intervention across sectors, and careful attention to both physical development and human development, with particular emphasis on jobs and improved schools. We focused our energies on over a dozen redevelopment efforts under HOPE VI to reach these broader goals, and I've included information on Louisville and Chicago as an appendix to my testimony.

From our experience I want to offer some recommendations for your consideration. No. 1, I would propose to make a larger share of public housing capital funding available in a competitive basis rather than by formula. There's $2.5 billion in public housing capital allocated by formula, and only $100 million this year competitively via HOPE VI. If Congress wants housing authorities to use more of their capital funding in more leveraged and comprehensive efforts as I am urging, it should make a higher proportion of that funding available competitively.

No. 2, reward leverage and comprehensive approaches in competitive allocations. The HOPE VI administrative way does that now. There would be considerable value in embracing leverage and comprehensiveness in a legislative framework. For example, Senator Mikulski, in her proposed reauthorization bill, requires partnerships with local schools, and that's one example of that type of approach.

No. 3, recognize that you get what you pay for. The early HOPE VI program allowed for a $250,000 planning grant so authorities could put teams together, go out and really think through and map out a long-term revitalization plan before coming in and competing for the grant itself. That program should be reinstituted, and more comprehensive efforts should not be penalized but should be rewarded as long as they make consistent progress against ambitious goals.

There is a funding issue that needs to be addressed in one of two ways. Either housing authorities who get grants need to be able to draw that money down and make interim investments with it or

the budget outlays need to be planned over multiple years so that there's no unreasonable pressure on getting all the money committed in 1 year because these are just not that kind of programs. With the scope of so many of these efforts being so broad with multiple phases in most instances, the idea that the program should be curtailed because the money isn't being spent fast enough is nuts.

No. 4, we need to explore the next financial frontier. Let me make it simple. We're taking the worst environments in neighborhoods and putting them in a position where they become the best housing, and that creates enormous value. We need to capture that value both by acquiring additional land for future development and by capturing the tax revenues that are going to come out of those increased values. Both of those areas represent a next critical frontier for these efforts, and it's a critical frontier because it takes leverage beyond tax credits, beyond home, beyond mortgage financing, and it takes us out into capturing the future value and bringing that forward so we can invest today.

I appreciate, as somebody out there for the last 35 years working at rebuilding neighborhoods, the attention that this committee is putting on this important topic, and I appreciate the opportunity to be here in front of you today. Thanks very much.

Mr. TURNER. Thank you.

[The prepared statement of Mr. Clancy follows:]

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Testimony of Patrick E. Clancy
President & Chief Executive Officer
The Community Builders, Inc.

before the

House Government Reform Subcommittee on Federalism
and the Census on

Public Housing in the Competitive Market Place: Do Affordable and Public Housing Developments Benefit from Private Market and Other Financing Tools?

Rayburn Housing Office Building
Room 2154

Tuesday, May 23, 2006

Good morning.

My name is Pat Clancy. I lead an organization that has been building affordable housing and transforming neighborhoods for over 40 years. I am proud to say The Community Builders has produced over 20,000 units of affordable and mixed-income housing in cities across the Northeast, MidAtlantic and Midwest. Over the years, we have worked with nearly every HUD program and the full spectrum of tax incentives put in place to spur urban revitalization. We have been a consistent innovator in real estate finance, and a partner with HUD and Congress in shaping new initiatives to confront the challenges of our cities.

I welcome the opportunity to come before you today. Community development today is at a crossroads. Cities are rebounding, retailers are rediscovering the purchasing power in urban markets, and developable land is increasingly scarce. Cities are now faced with solving difficult development challenges, rezoning former industrial areas, remediating brownfields, and undoing the harm caused by poor public housing siting, design, and management policies. Housing authorities, their land, capital, and operating resources are increasingly being re-integrated into the larger system of urban development through innovative public/private partnerships and mixed-finance transactions. A new generation of housing programs and strategies is required to address current challenges, stimulate urban economies, unlock real estate value, and generate tax revenues to support vital public investments and public services.

As this Committee has heard, the HOPE VI program has over the past decade proven remarkably successful in removing the most glaring failures of public housing and spurring dramatic revitalization in areas long thought to be some of the worst pockets of intractable poverty in America. Community Builders has been involved in 16 of these projects across the country, in diverse locales and markets ranging from Louisville, Kentucky to Cincinnati, Ohio to Chicago, Illinois, to Norfolk, Virginia. We have also been partners with HUD and local housing agencies in numerous other efforts to transform public housing outside the HOPE VI context and to preserve assisted housing resources at risk of loss.

Let me start by stating a key value proposition: The value of this housing investment lies in changed lives and changed neighborhoods, not simply new housing. As the community development field has evolved, change agents such as Community Builders have increasingly come to take a holistic view of neighborhoods and markets, and to propose comprehensive neighborhood revitalization strategies, what we call CNR, rather than the small-scale rehabilitation or new construction of a building here and a building there. While laudable for providing a few units of affordable housing, or addressing discrete instances of urban blight, piecemeal development does not trigger real change in the economics of an urban marketplace or in the lives of families. In our view, public investment and public/private development activity must operate on a scale sufficient to reposition a neighborhood in its regional market and stimulate broader economic activity in a neighborhood. Bold investment strategies should aim to rejuvenate the engine of value creation and economic progress that was made dormant by changing economic

circumstances and housing policies that produced extreme physical and social isolation of very poor families in public and assisted housing.

Despite the economic prosperity of the 1990s, enclaves of concentrated poverty continue to plague urban neighborhoods. Often dominated by large, distressed housing complexes, these neighborhoods struggle with high unemployment, drugs, crime, failing schools, disinvestment, and limited economic opportunities.

Resources typically available for community development projects - such as federal HOME, CDBG, Low Income Housing Tax Credits, and City and State Capital funds - have fallen short in addressing concentrated poverty. Prior to the HOPE VI program, the ability to mount large-scale redevelopment initiatives capable of transforming these neighborhoods was a critical missing element in our urban policy.

HOPE VI has provided the resources to make meaningful change possible. Comprehensive neighborhood planning and large-scale housing developments replace blight with attractive new mixed-income housing assets, spurring further investment in housing, retail/commercial amenities, and community facilities. More and more leaders in our cities have seen the potential to adopt bolder visions, moving beyond physical redevelopment to:

- Engage employers, workforce development service providers, local school administrators, youth development organizations, and family support providers in developing an integrated service delivery system at the neighborhood level;
- Make systemic change in neighborhood service delivery - with an outcomes orientation, use of proven program models, and consistent performance measurement; and
- Enable community building, with growing capacity for effective advocacy to protect neighborhood gains and advance plans for continued improvement.

By now the ingredients behind the success of HOPE VI are well-known:

- Scale sufficient to change neighborhood markets
- Leveraging private sector capital and development capacity
- High quality design, construction and amenities
- Comprehensive intervention across sectors
- Careful attention to both physical development and human development (jobs, schools, quality after-school programs, etc.)

We have focused much of our energies on insuring that these redevelopment efforts reach these broader goals. In the Appendix to this testimony, I describe the fruits of those labors as we see them unfolding in our work in Louisville, Kentucky and Chicago, Illinois – two examples of broad and comprehensive efforts with strong local leadership and support.

Bearing in mind the lessons of HOPE VI, I offer the following recommendations for your consideration:

I. Make a larger share of public housing capital funding available on a competitive basis rather than by formula.

In recent years, total capital funding for public housing has been reduced from approximately $3B a year to approximately $2.6B a year. This reduction has been focused almost exclusively on the HOPE VI program – the only part of public housing capital funding that is competitively allocated according to criteria that encourage leverage, public/private partnerships and more comprehensive efforts. There is a well staffed capacity in the Public and Indian Housing section of HUD that is still utilized to process annual competitive allocations – just for much smaller amounts of money. If Congress wants housing authorities to use more of their capital funding in more leveraged and comprehensive efforts – as I am urging - it should make a higher proportion of that funding available competitively. Maximum award amounts in HOPE VI should also be increased back to the original $50M from the recently reduced $20M maximum to expand the range and scope of feasible projects.

II. Reward leverage and comprehensive approaches in competitive allocations.

The HOPE VI administrative process has been developed to score applications according to a broad set of criteria that reward more leveraged and comprehensive efforts. However, there would be considerable value in embracing leverage and comprehensiveness in a legislative framework that sets broader parameters for large-scale efforts, thereby stimulating HUD as well as local authorities and their partners to reach beyond the real estate to the broader impacts critical to the neighborhoods and to peoples' lives. Senator Mikulski's proposed reauthorization bill requiring partnerships with local schools is an example of this approach.

III. Recognize you get what you pay for.

One feature of the HOPE VI program in earlier years was allocation of initial planning grants in amounts ranging up to $250,000 to enable authorities to put a development team together and do a thoughtful plan for a comprehensive revitalization effort before formally submitting for competitive funding. This process recognized the significant upfront investment needed to appropriately design these comprehensive efforts and should be reinstituted.

More comprehensive efforts take time: to bring a wider set of stakeholders together, to get a coherent set of decisions made in a variety of different places, to align complex forces and additional funding resources and to implement the appropriate sequence of residential and other real estate,

economic and social programs. Robust efforts should be rewarded, not penalized, as long as they make consistent progress against ambitious goals. Longer time frames should be allowed and planned for in one of two ways:

- Authorities could be allowed to draw down funds and earn money on careful interim investments, with earnings treated as program income and added to the resources of the undertaking: or
- The budgetary treatment of awards could be modified so that an award is perhaps treated like a five year grant contract rather than as a one year budgetary matter, lessening expectations for unreasonably rapid progress.

IV. Explore the next financial frontier.

As I have indicated, the value of large-scale housing investments is in changed lives and changed neighborhoods, not simply new housing. This value unleashes a tremendous economic potential in our urban neighborhoods. Yet investment in changing lives and changing neighborhoods goes beyond the housing investment and needs broader resources to be successful. We need to find ways to capture value created and harness it to make broader public investments critical to comprehensive efforts.

Let me put it in simple economic terms: you take the most distressed housing with (often) the most severe physical and social problems in a neighborhood and you transform it into vibrant new housing meeting current market standards that will be (often) the best housing in the neighborhood. Property values around this site are highly likely to increase significantly. This increase will be even more dramatic if in fact the effort is a more comprehensive one, improving educational outcomes for kids and connecting neighborhood residents to better jobs. A truly strategic approach, acquiring additional land that can support additional development and capture increased property values, is almost always beyond the reach of the available resources and attention. Utilizing early acquisitions and borrowing against future property value increases to fund investments in critical dimensions of a broader effort can create a "virtuous cycle" that enables more families to succeed and increases neighborhood values further.

We are currently working to acquire privately substantial additional property in one city for precisely these reasons. We are in the process of arranging financing through a combination of conventional bank financing and philanthropic and public support. A similar effort, more broadly focused, has recently been launched in New York City with the support of both city government and local and national foundations to support property acquisition by both for-profit and non-profit community development entities. These carefully designed acquisition loan facilities provide essential capital financing to secure land and assemble parcels in highly competitive markets, realizing opportunities for mixed-income development at scale that could easily be lost without structured interventions. Housing authorities, in

partnership with other actors, could play a critical role in providing funding or credit enhancement to such loan facilities.

Another part of the future revenue stream from comprehensive efforts is increased tax revenues from properties that formerly have not generated any tax revenues. In some cities, like Chicago, tax increment financing is widely used to capitalize future tax streams to support current investments in redevelopment. Most localities, however, are not in the position to take advantage of tax increment financing, either because state enabling legislation is not in place or because they lack the technical sophistication or fiscal health to take such front-end risk. Housing authority resources could be helpful in addressing these gaps.

Both of these areas – land acquisitions and borrowing against future values and borrowing against future revenue streams from increased property tax revenues – represent a critical next frontier for funding comprehensive neighborhood revitalization efforts in urban areas. HUD should be encouraged to utilize up to 10% of its competitively allocated public housing capital to support pioneering efforts to create new vehicles to capture future value to support vital investments.

V. **Make some midcourse corrections to the HOPE VI program.**

My three specific suggestions would be:

a) Separate annual contribution contracts for units that are part of tax credit investments from other operating subsidy streams. Currently, due to the common expectation of consistent underfunding of public housing operating budgets, syndicators require that millions of dollars of investment capital be set aside in reserves in case anticipated streams of operating subsidies to mixed finance projects do not materialize. Such an event would not only impose financial hardship on projects, but could result in a wrenching, disruptive, and costly need to substantially repopulate the properties with higher income tenants if subsidies are inadequate. Separate ACCs with prescribed provisions for changes to annual allocation amounts for increased expenses and with recognition from Congress of the investor reliance on these contracts would, I believe, enable the marketplace to reduce reserve requirements and, therefore, make tax credit equity investments significantly more efficient.

b) Create incentives for increasing tenant rent payments from public housing units in mixed finance developments and neutralize housing authorities from the impact of those incentives. Currently, successful efforts to increase tenant

incomes and tenant rent payments in revitalization efforts result in a reduction in overall operating subsidy funds flowing from HUD to the housing authority. Housing authorities therefore have no choice but to insure that subsidies are reduced to the unit that generates the additional income. It's critical to create an incentive structure in mixed income developments that supports investing in the earning potential of low income families and enables additional revenues from rising incomes to support further investments in family supports, employment success, and asset building.

c) Make breakthroughs and efficiencies in the highly cumbersome processing of individual components of large public housing revitalization efforts. Most of these efforts have four or five or six phases. Each phase ends up going through a time-consuming and cumbersome process with HUD staff. This process will become even more difficult as competitive allocations expand.

   HUD has attempted to expedite processing beyond first phases by allowing, in certain cases, the same documents to be used and modifications to be reviewed on an expedited basis. While a good idea, this approach has not worked terribly well in practice. Expedited processing should be taken to another level: I would propose that beyond the first phase of a revitalization effort compliance with program requirements be audited on a post closing basis. That is, housing authorities and developers would be able to proceed with closing on subsequent phases, honoring the same framework establishing with HUD in their initial phase documentation, with HUD compliance review of later phase documents after the transaction has closed. Such an innovation would cut transaction time and cost significantly. It would take significant work on HUD's part to put such a change in place and it would need Congressional impetus to take it on - but the savings for everyone involved would be tremendous.

Before closing, I'd like to make one point that reaches beyond the public housing arena directly. As a leading non-profit developer and owner/operator of mixed income housing, we worked extensively with the administration and Congress in creating a mixed finance program for public housing and have utilized it in 20 locations. We have played an active and pioneering role in these transactions because we saw the great potential to undertake real community building. The incredibly positive results speak for themselves and the approach has been widely embraced.

We also advocated for a similar approach to distressed Section 8 properties – privately-owned properties receiving Section 8 project-based assistance but in need of similarly comprehensive revitalization, often including their demolition and replacement with new mixed income housing. At one point, when HUD was asked before Congress about its opposition to our efforts to undertake path-breaking assisted housing preservation projects in Indianapolis and Pittsburgh, HUD Secretary Martinez characterized the effort as trying to "put a HOPE VI spin on Section 8."

I am pleased to report that the transfer of project based assistance from an obsolete development to another development is now possible, authorized under Section 318 of the FY'06 HUD Appropriations Bill. As a result, we now have a vital new tool to implement creative HOPE VI-style strategies to preserve affordable housing assets that are in private hands. This tool has an initial life that only extends to September 30, 2007 and we are busily working with HUD to seek to make it a tool that will be effectively utilized. While the tool does allow for the operating subsidy available through Section 8 to be transferred, and often times those rent levels can support some debt, it does not include a capital source that can facilitate the kind of redevelopment often necessary. Congress could substantially advance the use of Section 318 to support comprehensive neighborhood revitalization anchored by distressed assisted housing redevelopment, and achieve HOPE VI-like neighborhood transformations, by enabling local housing authorities to use their capital resources and take oversight of the project based Section 8 contracts in connection with these efforts.

I'd like to close on a personal note. I have spent my working life, the last 35 years, in this work and with this organization caring about our cities and trying to support those in need in them in the best way I know how. Policy and funding issues critical to our success rarely get the airing they deserve in Washington DC. I want to say I deeply appreciate the interest that this subcommittee has shown – and particularly the leadership of Chairman Turner. I hope your interest in these matters will continue and I thank you for the opportunity to talk with you today.

Appendix

Park DuValle HOPE VI, Louisville, Kentucky

The Park DuValle HOPE VI project in Louisville, Kentucky, built on and around the site of the former Cotter and Lang public housing project, is recognized as one of the most successful HOPE VI projects. Community Builders was the developer of all but the first rental phase. A case study by Mindy Turbov and Valerie Piper for the Brookings Institution Center on Urban and Metropolitan Policy found the following:

> Originally envisioned as the basic modernization of 1,116 units of dilapidated public housing, Louisville's Park DuValle redevelopment has instead created a new urban community of renters and homeowners with a wide range of incomes. Based on new urbanist principles, Park DuValle's design and layout has dramatically changed the physical landscape of Louisville's West End. The development also represents a dramatic shift in how Louisville provides public housing: embracing private construction, management, and ownership; promoting the inclusion of public housing rental units within market-rate rental and homeownership units; and providing the amenities and public services that low-income households need and middle-income households expect. The Park DuValle redevelopment's success is shown not only by the changes in the public housing provided at the site but also by the revitalization it has engendered in the surrounding neighborhood.
>
> Some illustrative statistics:
> Rents at Park DuValle, formerly one the worst areas in the city, are now only about 5% lower than competitive regional development and 2003 housing prices for three-bedroom, two-bath houses range from $78,217 to $244,429.
>
> Within the development area, census data reflects these changes. Household median income nearly tripled to an average of $22,701 in 2000 (all income figures used in this case study are trended to 2002 dollars). The poverty rate fell nearly 50 percentage points to 28.5 percent. The neighborhood workforce participation rate was up, and its unemployment rate dropped to 7.2 percent—a rate lower than the city's rate of 7.4 percent. Crime also fell dramatically—from an average overall crime report rate of 541 a year from 1990 to 1996 to an average of 64 a year from 1997 to 2002.
>
> All of the major public facilities adjacent to the development have been modernized, and third-party commercial activity has increased. A vacant neighborhood shopping center was purchased and remodeled as a mixed-use facility, a new fast-food franchise recently opened, and a parcel across from the Park DuValle development is being targeted for a supermarket.

Census data for the two tracts to the north and east of the development show that Park DuValle essentially caught up to its surrounding neighborhood market area in terms of income and employment between 1990 and 2000... The area to the north of the development is dominated by small homes; it shows the most dramatic changes with the redevelopment of the Park DuValle area. Median income for the neighborhood to the north increased 17 percent between 1990 and 2000, to approximately 94 percent of the city's median income. The rate of increase outperformed that of the city (7 percent) and the region (10 percent).

Median income in the area to the east of the development increased by 5 percent, to approximately 76 percent of the city's. Park DuValle's median income is approximately 73 percent of the city's, appropriate for a mixed-income development that includes low-income housing in both the rental and ownership components.

Percent of population below the poverty line in 2000 tells a similar story: in the tract to the north, the poverty rate was 25 percent, to the east it was 31 percent, and in the Park DuValle area it was 29 percent, roughly in line with and reflecting the mix of incomes in the development. The overall city poverty rate in 2000 was 22 percent. In terms of unemployment, Park DuValle's 7.2 percent outperforms the neighboring areas, which show rates of 10 percent and 12 percent, in the north and east respectively. In each of the census tracts covering Park DuValle and the areas to the north and east, decreases in unemployment from the 1990 census were much greater than the decrease for the city as a whole.

The Park DuValle redevelopment demonstrates the effectiveness of using public housing dollars as an engine for neighborhood revitalization. It was accomplished by turning the four problems of Cotter and Lang Homes on their head: (1) by designing public housing units that were quality places to live and integrated with the surrounding neighborhood, (2) by partnering with private companies with experience in providing quality management in the ownership structure of the development, (3) by attracting middle and moderate-income households to live in the development, and (4) by framing the development within a more comprehensive strategy for neighborhood redevelopment that included important public services.

Park DuValle transformed Louisville's public housing, and it helped revitalize one of Louisville's most distressed neighborhoods.

The rent structure for market-rate units in the newer phases of rental development indicates that Park DuValle is competitive regionally. Twenty-nine percent of total rental units in Phases II through IV are market-rate, creating a significant need to attract higher income renters to the development. Initially, rents in the market-rate apartments were set 10 to 20 percent below the regional average for developments with similar unit sizes and amenities. Since the initial lease-up in 1997 and 1998, these market-rate rents have been raised several times, for a total

increase of between 13 and 19 percent, depending on the type of unit (see table below). Rents in Low-Income Housing Tax Credit units have also been raised, within the limits set by affordability guidelines for households earning 60 percent or less of AMI.

The homeownership units established and have since maintained a mix of incomes, seeking to appeal to middle-income households while retaining a commitment to low-income households. The stated income mix target for the for-sale component of the development is one-third low income (at or below 80 percent of AMI), one-third middle-income (81 to 115 percent of AMI), and one-third higher-income (greater than 115 percent of AMI). The first phase of for-sale development roughly realized this goal, with the early sales establishing desirability for buyers in the higher portion of the income range.

The home sale prices were also higher than originally expected, further indicating the market confidence in Park DuValle among a range of homebuyers. For instance, many participants in the planning process doubted that Park DuValle home ownership units would achieve price points over $100,000. In Phase I, 52 percent of actual sales prices fell between $100,000 and $150,000, and 13 percent were higher than $150,000. The highest sales price achieved in Phase I was over $217,000. These were impressive values in a neighborhood where such market activity was less than robust.

The prices at which the homeownership units have sold demonstrate the viability of the new community for middle-income households. In 2003, housing prices offered at Park DuValle for three bedroom, two+ bath homes range between $78,217 and $244,429. Since 1999, of the 122 completed sales and 17 pending sales, the lower-quartile price for Park DuValle units was $99,193, the median price was $111,203, and the upper-quartile price was $137,381.[12] Pending sales in the 2002–2003 pipeline have a median purchase price of $100,412.[13] This lower median price reflects the recent shift in emphasis to subsidize lower-income groups. Median prices paid for the lot and structure—including construction costs, upgrades, and builder profit—increase somewhat by income group. All sales prices have been trended to 2002 dollars.

The value of these units has appreciated; a city official involved with the project and subsequent individual refinancings using city-funded second mortgage incentives estimates that values have increased by 10 to 15 percent over approximately the past three years. The Park DuValle area's concentration of poverty decreased precipitously. In 2000, individuals in households with incomes below the poverty line made up 28.5 percent of the population. This decrease of nearly 50 percentage points brought the area's poverty rate roughly in line with those of adjacent neighborhoods. The poverty rate was still higher than the city's overall rate, but the gap had diminished from 55 percentage points to seven. Over the same period, the neighborhood's labor force participation rate increased 6.8

> percentage points (to 56.8 percent), rising to a level greater than that of adjacent neighborhoods and close to the city rate of 60.8 percent.
>
> The Park DuValle area's unemployment rate also improved dramatically... a drop of 27.4 percentage points to 7.2 percent, a rate lower than the city rate of 7.4 percent.
>
> Housing values as reported to the census for the tract containing Park DuValle show the effects the new development had on the neighborhood's existing stock. In the Park DuValle development itself, 15 homes were sold in 1999, 29 in the first half of 2000, and 40 in the second half of 2000. That most were not captured in the census sample is shown in the number of owner-occupied units in the sample, which increased by only four between 1990 and 2000. Even though most of the new homes were not captured, the impact of the enormous changes underway due to the Park DuValle development is evident.
>
> Values of units in the census tract containing Park DuValle came into line with the surrounding neighborhoods. They and homes in the surrounding neighborhood outperformed housing across the city in value appreciation. They also kept pace with or outperformed the region as a whole. A comparison of the Park DuValle's homeownership sales prices and the neighborhood's prices demonstrates that the development raised the value of property in the neighborhood. All dollar values were trended to 2002 dollars for purposes of this analysis...Rents reflect the mixed-income public housing nature of the Park DuValle development—lower quartile rents remain the same in 2002 dollars, but median and upper quartile rents are in line with the surrounding neighborhood. The growth of rents in the three neighborhood census tracts outperforms the growth of city and regional rental rates, and places median and upper-quartile neighborhood rents close to those charged elsewhere in Louisville.

Taken together, these descriptive statistics paint a picture of how comprehensive neighborhood revitilization, driven by a bold vision for change, can improve both lives and neighborhoods.

Oakwood Shores HOPE VI, Chicago, Illinois

Redevelopment of the Madden Park, Ida B. Wells, and Clarence Darrow public housing projects has sparked a dramatic transformation in Chicago's MidSouth area. Demolition of these former distressed housing projects, coupled with substantial public and private investment in new mixed-income housing, innovative school improvements, and emerging commercial/retail opportunities, promises to unlock significant value in underutilized properties in the area.

Concerted efforts are underway to ensure that sites are assembled strategically so as to realize the highest and best use for the land and to capture a portion of the value created

to serve broad public interest in creating a viable mixed-income community with opportunities and supports for residents of all incomes.

Current redevelopment plans call for construction of 3,000 new mixed-income rental and for-sale homes in five phases over 5-10 years. Over one-third of this development will take place off-site, in areas adjacent to the former Madden/Wells site. Total development cost for the residential components will exceed $900 million. Related investments in schools, community facilities, and retail/commercial amenities bring the total anticipated investment to over $1.1 billion.

Community Builders as lead developer has been intimately involved in extensive and wide ranging discussions around components of the revitalization strategy with the Chicago Housing Authority, the City of Chicago and many of its agencies, local neighborhood political leadership, the University of Chicago, the MacArthur Foundation, and many constituencies in the broader community. What has emerged is a broad and ambitious vision that reflects both the depth of leadership supporting comprehensive revitalization in Chicago and the evolution of the "state of the art" in large scale mixed income redevelopment.

Elements of the vision for Oakwood Shores include:

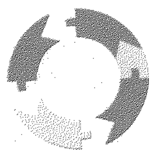
- **Charter Schools**
  Under the Mayor's plan for change in public education, the University of Chicago has opened a pre-K to 8 charter school this past fall immediately adjacent to the new mixed-income housing we are creating. Attached to this Appendix is a table showing the dramatic progress in test results over the first months of operation of this school. New high quality public education for this mixed-income community is a central component of its long term strength. Our belief in its importance has us designing a complex financial plan that we hope will enable an additional charter high school to be created in the new community.
- **Quality Civic Spaces**
  With broad public support, we are beginning a planning process for what we hope will be a top quality, state of the art civic building including recreational resources, arts, library, social and community program spaces and a smattering of small commercial uses. A collective effort to plan for such a facility and to make its funding a broad objective has wide public and institutional support.
- **A "New Deal" with Public Housing Families**
  The Chicago public housing transformation effort sets significant work and other requirements for public housing families to be able to reside in new units in the mixed-income developments. These standards are matched by a huge investment in supporting families in working to meet the requirements, and we and others are hugely focused on that effort – working with what are often second generation public housing families in developing a path to employment and achieving success on that path. This needs to be a long term effort and is a component critical to our long term success.

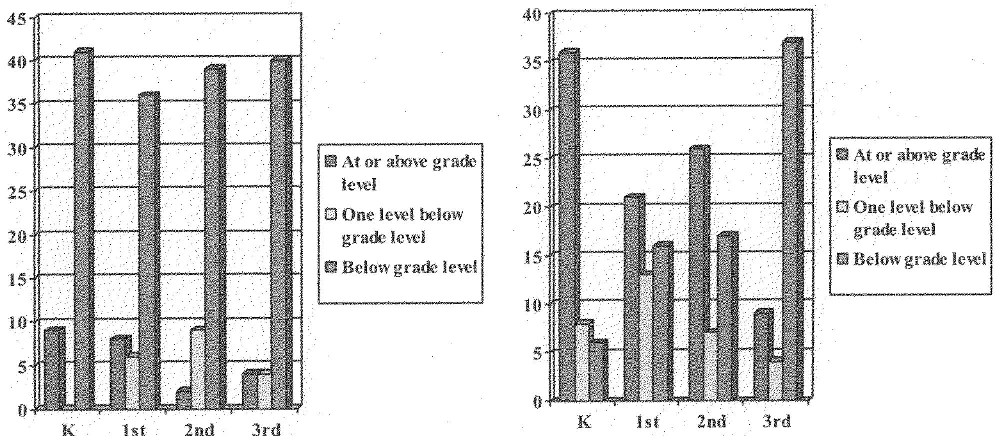
- **An Array of Housing Types to Capture Market Value**
  From single family homes to condominiums with lake views, the mixed-income community being created at Oakwood Shores has enormous potential which we are collectively working to maximize to achieve full economic diversity and strong market impetus from that achievement.
- **Expanded Commercial Activity**
  With commercial development typically lagging the "rooftops", the local Quad Community Development Corporation has undertaken an early and intensive effort to attract commercial development to a corridor adjacent to this community for expanded commercial activity to support the new community. Here again, more intensive efforts to assure that these amenities are available earlier in the revitalization process will bear huge fruit in market acceptance and the strengthening of values in the new neighborhood.

How does an effort of this scope get done today? The environment at Oakwood Shores in Chicago is a strong basis for efforts to take comprehensive neighborhood revitalization to another level. The key elements that create this potential include:
- A strong, vibrant city with substantial prospects for increasing market values;
- Strong city leadership and management and alignment of a wide range of departments;
- A wealth of neighborhood stakeholders engaged and focussed collaboratively on a shared vision; and
- Major institutional support, including the University of Chicago, the MacArthur Foundation and the corporate community organized in a support vehicle called The Partnership for New Communities.

This ambitious collective vision combined with an environment of high potential are propelling this effort forward. As lead developer, The Community Builders is challenging itself to play a catalytic role to serve the broader visions in two ways:
- overall coordination of the multiple processes involved in the many different dimensions of activity; and
- design and management of a truly integrated neighborhood wide financing strategy so that:
  - The buildout can be supported even with potentially diminishing public resources;
  - The array of critical physical development can be implemented in a manner that "cross subsidizes" critical components; and
  - Critical civic investments can be made that help to create the strong community and the future values that in turn can create the return on those investments.

Progress to Date: University of Chicago Donoghue School





The **Community Builders**, *Inc.*

Turning Vision into Reality

Mr. TURNER. Ms. Dolber.

STATEMENT OF WENDY DOLBER

Ms. DOLBER. Mr. Chairman, members of the subcommittee, good morning. I'm Wendy Dolber, managing director of Standard and Poor's Rating Services. I manage the public housing tax—public finance tax exempt housing group where we rate that in connection with affordable housing. I'd like to focus today on our experience in rating capital funds securitizations as well as talk more generally about key factors that could enhance a PHA's acceptance in the marketplace and help them obtain and maintain strong credit ratings.

S&P has worked with PHAs for decades, rating debt supported by multifamily properties or loans. Generally speaking, these transactions achieve low to high investment grade ratings and do well on the marketplace. The passage of QHWRA and subsequent capital funds securitizations introduced two new risks that we needed to look at. The sufficiency and timeliness of Federal appropriations and the impact of PHA performance on its funding levels. PHAs and their financing teams work diligently with HUD and the rating agencies to address these risks and ultimately we were able to assign ratings ranging from A to AAA if they had bond insurance on 22 capital funds securitizations totaling almost $2 billion. Key elements of our rating analysis were the strong history of capital fund appropriations, predictable allocation mechanisms and excess coverage of capital funds to bond debt service.

We also look for insulation against potential PHA performance that could negatively impact their receipt of HUD funding. HUD addressed performance risk to a large degree through written acknowledgement on every transaction that if a PHA were saying through poor performance the same thing would not reduce the funding level below needed to make debt service payments, and we also allowed PHA capital funds to be paid directly to the bond trustee. These insurances and processes among other things allowed high investment grade ratings, as long as S&P could analyze the PHA's general readiness to carry out its obligations under the bond program, especially its ability and track record in obligating and expending HUD funds.

To date, we've been able to affirm all outstanding ratings, but capital fund appropriations have been cut every year since we did the first rating in 2001, which has resulted in a reduction of debt service coverage in many cases. We're concerned that future cuts could compromise a PHA's ability to pay debt service. That would result in lowered ratings, income, and would whittle away investor confidence. It is possible that more predictability and stability in the level of annual appropriations could decrease the need for such high levels of coverage and stretch the Federal dollar as a leveraging tool. Alternatively, some type of backstop funding mechanism not subject to Federal appropriations could greatly enhance investor confidence and rating agency confidence.

I'd like to say a few words about our observations in working on PHAs on the securitizations while more PHAs are testing the waters and many have been very successful in accessing the capital markets, PHAs as a group do seem reluctant to move forward with

bond financing. This may be due to lack of familiarity with the marketplace and its players, concerns about possible negative impact on HUD funding and the potential liabilities to PHAs or just ongoing difficulties they face in meeting their mandates with less resources in a changing environment. Pooled financings are one way to ease the way for PHAs to enter the capital markets if they're unlikely or reluctant to do so.

It presents an efficient vehicle by saving costs of issuance. But the benefit is limited because PHA's funding cannot be cross-collateralized. Considering the factors that have strengthened market perception of capital fund securitizations and looking ahead to more expanded use of QHWRA, and perhaps even to the day, when PHAs could have their own credit ratings as corporate entities, we would highlight four key areas for continuing improvement.

First, predictability, stability and fungibility of income sources. Next, clarity, consistency and dependability regarding the HUD regulatory environment, especially as it relates to the leveraging of HUD funding and the potential for financial sanctioning of PHAs, effective in timely communication with the capital markets on the part of the issuers and the Federal Government. From our perspective, this is critically important as we rely upon accurate and adequate information to maintain ratings, and PHA's continuing development of management practices on a par with private market, especially in the areas of asset management and financial expertise with necessary flexibility to achieve best practices.

In closing, I'd like to thank you for inviting us to participate, and I look forward to your questions.

[The prepared statement of Ms. Dolber follows:]

TESTIMONY OF WENDY DOLBER
MANAGING DIRECTOR
STANDARD & POOR'S RATINGS SERVICES
BEFORE THE COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON FEDERALISM AND THE CENSUS

U.S. HOUSE OF REPRESENTATIVES

MAY 23, 2006

Introduction
Mr. Chairman, Members of the Subcommittee. Good morning. I am Wendy Dolber, Managing Director of Standard & Poor's Ratings Services ("S&P"). I manage the tax-exempt housing group within the Public Finance Department of Corporate and Government Ratings, and we rate debt issued in connection with affordable multifamily and single-family housing.

We work with issuers, such as municipalities, state and local housing finance agencies (HFAs), public housing authorities (PHAs), for-profit and not for profit developers and special purpose entities. Our sector includes a broad range of affordable housing financings. In the multifamily sector, we rate issues backed by affordable multifamily properties, individually or in pools, unenhanced or supported by insurance or loan guarantees, and annually appropriated funds. In the single-family area, we rate pools of loans, which may be insured or guaranteed, or uninsured. In addition to rating bond issues supported by explicit collateral (issue ratings), we also provide issuer credit ratings (ICRs) of the issuers themselves. S&P currently has more than 3,350 outstanding issue ratings, as well as 25 HFA issuer credit ratings. For reasons to be discussed later in this testimony, currently, S&P has only assigned issue ratings to PHA debt.

I am here today to provide testimony regarding S&P's view of PHAs in the competitive marketplace. In order to have the most effective and efficient financing programs, PHAs need to have the flexibility and expertise to choose among an array of financing options. PHAs have historically entered the bond market through the use of pledged collateral often supported by Federal subsidies, and/or insurance and loan guarantees. The passage of the Quality Housing and Work Responsibility Act (QHWRA) in 1998 opened the door to leveraging of HUD funding. While this expanded financing opportunities greatly, for the first time it required market understanding and acceptance of Federal appropriation risk and confidence in PHA performance. While S&P has assigned high investment-grade ratings to these transactions, and market acceptance has been positive, only a small percentage of PHAs have issued bonds to date.

In considering how PHAs can take full advantage of available financing options, there are several factors that lead toward a successful outcome:

- Predictability, stability and fungibility of income sources.
- Clarity, consistency and dependability regarding the HUD regulatory environment, especially as it relates to the leveraging of Federal funding.
- Clear direction concerning the potential for and impact of sanctions for poor PHA performance.
- Effective and timely communication with the capital markets -- upfront and ongoing disclosure is critical to PHAs' ability to attain and maintain credit ratings and achieve a competitive advantage.
- PHAs' continuing development of management practices on a par with the private market, especially in the areas of asset management and financial expertise, with the necessary flexibility to achieve best practices.

My comments will address four broad areas:

1. Overview of Standard & Poor's affordable housing bond ratings
2. PHA issue ratings and the impact of performance and appropriation risk
3. PHA capital fund securitizations: Observations on the process
4. Issuer Credit Ratings: Applicability to the PHA industry

1. Overview of affordable housing bond ratings

S&P's ratings address the question, "What is the likelihood of payment according to the terms of an obligation?" Our ratings are divided into several categories, ranging from 'AAA', indicating the strongest credit quality, to 'D', reflecting the lowest. Investment-grade ratings range from 'BBB-' -- indicating adequate protection for bondholders, but susceptibility to adverse economic conditions -- to 'AAA' -- indicating extremely strong capacity to meet financial commitments. In general, the higher rating the lower the interest rate on the debt instrument.

S&P provides a rating only when there is adequate information available to form a credible opinion, and only after applicable quantitative, qualitative and legal analyses are performed. In assigning issue ratings in the affordable housing sector, we analyze the security for the bonds, including mortgage or real estate collateral, investments and reserves, as well as legal structure, cash flows, bankruptcy issues and applicable management practices. It is beyond the scope of this testimony to go into greater detail about our rating criteria, but I invite you to visit our free website, www.standardandpoors.com, which provides a full discussion of our ratings methodology, criteria, and our current ratings.

The issue ratings on affordable housing debt tend to fall into the following broad categories:

- Full credit enhancement at the bond level: Single- or multiple-asset financings with full credit enhancement on the bonds, such as letters of credit, or bond insurance tend to be rated according to the ratings of the credit enhancer. The typical rating is 'AAA'.

- Full credit enhancement at the mortgage level: Single- or multiple-asset financings with credit enhancement on the mortgages such as GNMA, FNMA, and FHLMC guarantees also tend to carry the credit rating of the enhancer. However, reserves and cash flows must also support the rating level. A typical rating is 'AAA'.

- Partial credit enhancement at the mortgage level: Single- or multiple-asset financings with partial credit enhancements, such as FHA insurance will be rated as high as the credit enhancer if shortfalls and reserves are also covered at the same rating level. The typical rating is 'AAA'.

- Unenhanced (no credit enhancement) mortgages: Single- or multiple-asset financings where the debt is supported only by loan or project revenues, with or without Federal subsidies. For multifamily single-asset transactions, ratings are determined based on a full real estate analysis. Quality and management of real estate, as well as debt service coverage, are key rating factors. The typical ratings are 'A' and 'BBB'.

- Packaging pools of loans with sufficient credit support to withstand Standard & Poor's stress scenarios can achieve higher ratings. Typically, issuers use tranched structures and overcollateralization to meet rating standards. The entire rating scale is represented.

- Debt supported by annually appropriated Federal funds: PHA capital fund securitizations are rated based upon the strength and the track record of Federal funding, debt service coverage and legal provisions that guard against HUD sanctions for poor performance. The typical ratings are 'AA'.

- Military housing privatizations also fall into this category. The rating approach is a combination real estate analysis and analysis of the strength of Department of Defense Basic Allowance for Housing payments. The typical ratings range from 'A' to 'AA'.

2. PHA issue ratings and the impact of performance and appropriation risk

Background

PHAs have been active in the bond market for many years, but only recently in their role as operators of traditional public housing. Prior to the passage of QHWRA, debt issued by PHAs (including housing and redevelopment authorities) was supported by single, or in rare cases, multiple, multifamily properties or loans, as well as single-family loans. These are supported by Section 8 project-based subsidies, FHA insurance, or GNMA, FNMA, FHLMC guarantees. S&P rated and continues to rate many of these issues, in the low to medium investment-grade levels. These types of financings are relatively straightforward, do not include PHA performance or appropriation risk, and are widely accepted in the marketplace. A small group of PHAs issued bonds supported by unsubsidized and unenhanced properties. Because of real estate risk, including management capacity of property owners, this type of financing attracted a smaller investor base. S&P rated many of these issues in the 'BBB' and 'A' category. Generally, investors have become more skeptical about unenhanced project based financings as many properties have suffered from market downturns and ever-increasing operating expenses. For this and reasons of efficiency, the market is moving more toward pooled financings of multifamily properties, which can provide insulation from performance risk by reserving against worst case default scenarios.

Capital Fund Securitizations

QHWRA opened the door for PHAs to issue debt backed by capital and operating fund appropriations. HUD focused its attention first on capital fund securitizations. This marked a substantive change in the way PHAs have to interact with the capital markets. Previous financing structures did not require analysis of PHA funding levels or general performance under traditional public housing programs. S&P identified two key risks that need to be addressed to attain and maintain issue credit ratings:

Appropriation Risk

In capital fund securitizations, the payment of bond debt service is directly related to the sufficiency and timeliness of capital fund appropriations. At the time of the first capital fund securitization in 2001, the industry was able to make a strong case for the history of capital fund appropriations and the steps taken to ensure a high level of predictability about each PHA's allocation. In assigning investment grade ratings, S&P looked for excess coverage of capital funds to bond debt service in order to protect bondholders against reductions. However, during the five years since S&P rated the first PHA issue, reductions in capital fund appropriations have been paring excess coverage. To date, no ratings have been affected, but further cuts could compromise a PHA's ability to pay debt service in the future, which could result in lowered ratings. Should that happen, market confidence could be negatively affected.

While it is clear that the Federal government supports public housing, the funding trend is toward increasing tenant vouchers and decreasing capital and operating funds. The aforementioned excess coverage certainly helps to insulate bondholders against these cuts, but more predictability and stability in the level of annual appropriations could

decrease the need for such high levels of excess coverage and stretch the Federal dollar as a leveraging tool for rated bond finance, as well as other financing options. Alternatively, some type of backstop funding mechanism, not subject to Federal appropriations, could greatly enhance confidence in these types of financings.

Performance Risk
Performance risk as it relates to timely payment of debt service is the second key rating factor in capital fund securitizations. There are three questions that need to be addressed:

1. What is the impact of failure to comply with HUD regulations? Failure to comply with certain HUD regulations can potentially negatively affect funding levels, such as failure to obligate and expend capital funds. Clear regulations and accurate ongoing information are critical to addressing this concern.

2. What is the impact of poor overall performance under HUD's assessment system? If a PHA is labeled "troubled" or is being taken into receivership, it must be clear what the impact of such actions would be, and whether they would affect a PHA's ability to make debt service payments.

3. Can the PHA demonstrate an acceptable level of administrative practices and track record to carry out its responsibilities under the bond program?

For capital fund securitizations, performance risk was lessened greatly when HUD agreed to provide written acknowledgement on each transaction that if a PHA were sanctioned for poor performance, the sanction would not reduce the funding level below that needed to make debt service payments to the extent of the law. In addition, HUD allowed PHA capital funds to be paid directly to the bond trustee through the Line of Credit Control System, which effectively insulated bondholders against operating risk. These assurances allowed high investment grade ratings, as long as S&P could analyze a PHA's general readiness to carry out its obligations under the bond program, especially its ability and track record in obligating and expending HUD funds. In the limited universe of capital fund ratings so far, PHAs have demonstrated adequate performance. There have been some instances where poor obligation and expenditure history, failure to complete contracts, high turnover and lack of institutional procedures resulted in low management scores. In these instances, S&P was not able to assign investment-grade ratings.

3. PHA Capital Fund Securitizations: Observations On The Process

S&P has rated more than $2 billion in PHA capital fund securitizations for 63 PHAs, and has provided confidential credit assessments on over 100 transactions. Our observations on the process of working with PHAs, HUD and the marketplace in developing criteria and providing ratings, are as follows:

- While more and more PHAs are testing the waters, PHAs as a group seem very reluctant to move forward with bond financing or other financing options. It is our opinion that lack of familiarity with the marketplace and its players, concern

about possible negative impact on HUD funding, and potential liability to the PHA are the main reasons the majority of PHAs have not participated more fully.

- Pooled financings can increase financing efficiency and could be very beneficial for smaller PHAs that are unlikely to enter the capital markets on their own. However, the benefit of pooled financings is limited because PHA's funding cannot be cross-collateralized.

- It would be beneficial to the PHA's, and to the marketplace in general, if clear regulations regarding leveraging HUD funds were issued. This would increase transparency and greatly enhance the recognition of the financing options available for both the issuer and the market.

- In addition, there is a need for greater understanding between the PHA's as to the best way to approach the marketplace and to keeping it informed. As with any new skill, a training program might prove useful to acquaint PHA management with best practices used in accessing the bond markets and maintaining regular communications with it.

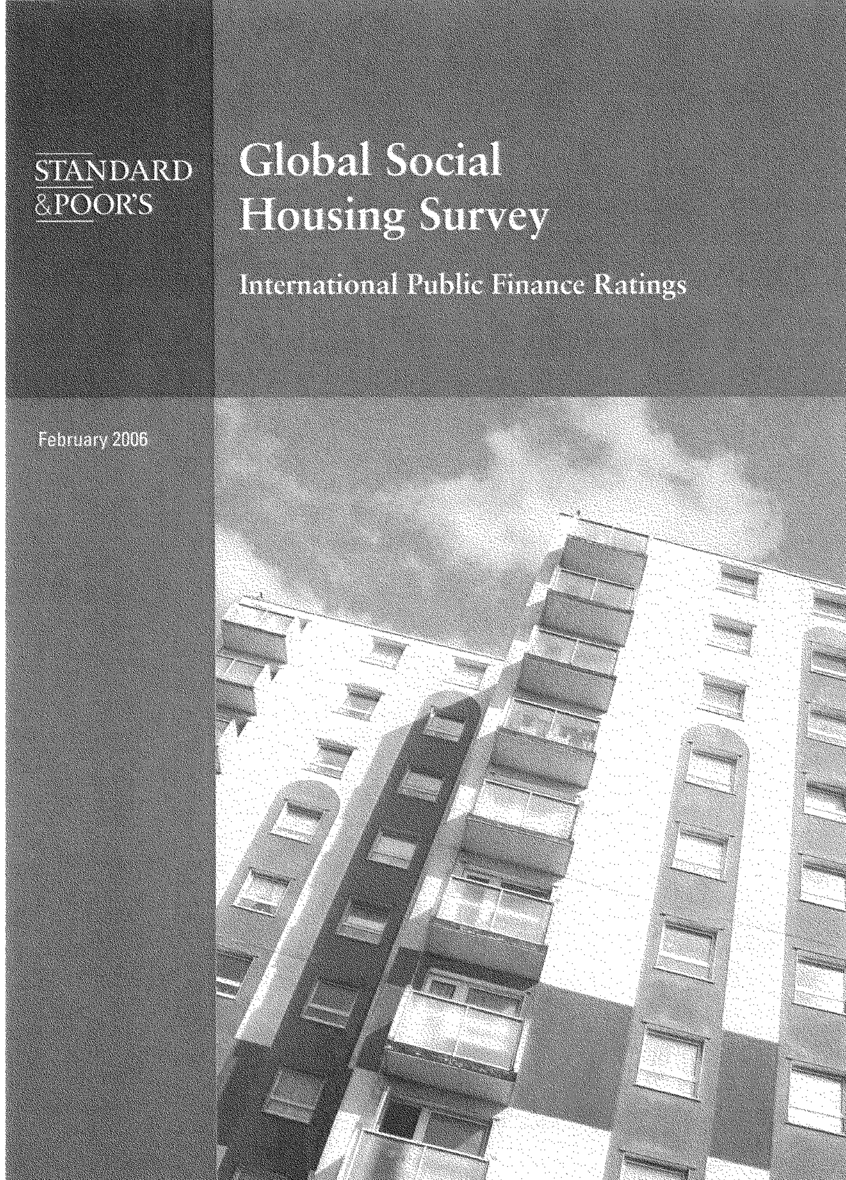
4. Issuer Credit Ratings: Applicability To The PHA industry

Affordable housing providers in the United States and social housing providers in the United Kingdom have taken advantage of ICRs as part of their financing strategies. ICRs, which indicate S&P's opinion of the creditworthiness of an issuer's general obligation to meet its financial commitments, offer a high level of flexibility to an issuer, and are one way of identifying performance strengths and weaknesses.

The key components of an ICR will vary according to the unique characteristics of the entity being rated. For example, HFAs, as real estate lenders, are assessed according to general management processes, single-family and multifamily underwriting standards and asset management; financial strength, including profitability, asset quality, leverage, liquidity and capital adequacy; quality of mortgage loan collateral; state economy and the relationship with state government.

Over the years, market participants, such as HUD, insurers and swap providers, have looked to HFA ICRs to evaluate financial strength, management and asset quality. For example, under the HUD HFA risk-sharing program, HFAs with 'A' rated ICRs were afforded streamlined processing and lower reserve levels. Bond insurers and other credit enhancers routinely look to HFA ICRs in their underwriting. Because of their strong financial track record and excellent management processes, HFAs have achieved ICRs ranging from 'BBB' to 'AAA'. More HFAs are issuing bonds rated based on their ICR, which allows them to benefit from the financial flexibility of backing debt with their general credit rather than the restricted revenues from specific pledged assets.

Since 1997, S&P has issued five ICRs for UK housing associations, all in the medium investment-grade range. (In addition, UK housing associations have issued bonds


STANDARD
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International Public Finance Ratings
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Introduction: Credit Trends In The Global Social Housing Sector

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Affordable housing has in recent years become an increasingly important social and political issue, as the supply of housing has failed to keep pace with demand across both Europe and North America. Standard & Poor's is a global market leader in providing credit ratings for affordable housing in different parts of the world with different systems of regulation and support.

Changing demographics have led to increasing demand for affordable housing, and this demand has not been fully met either by the market or by government spending alone. As a result, mixed-funding solutions are increasingly being sought to meet affordable housing needs. Given the likely scale of future financing needs, Standard & Poor's expects bond finance and credit ratings to play an important role in funding affordable housing development.

The use of bond markets for affordable housing development is well established in the U.S., and bond markets are increasingly being used not only to fund public housing development, but also to expand sorely needed financing for modernization of the rapidly aging public housing stock. In the U.K., private funding for social housing investment is also well established but is largely provided by banks, although it is expected that bond markets will be used more in the future. In the rest of Europe, the use of private finance is more established in certain countries, such as in Sweden, than in others.

The strength of regulation and the level of support in the form of direct capital and operating subsidies from central government vary across countries. Providers of affordable housing which operate in systems with strong regulatory frameworks and good levels of government support are likely to have the strongest creditworthiness. It is important that investors understand the credit implications associated with different national and regional systems of regulation and support. For example, stable systems of regulation can support high ratings, even if the financial performance of individual affordable housing providers is relatively weak on a stand-alone basis. Changes to the regulatory environment are therefore key credit factors in reviewing individual affordable housing providers. ■

Recovery Prospects Will Be Key For Rating U.K. Housing Association Bonds Above Their Issuers

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The ratings that Standard & Poor's Ratings Services assigns to bonds issued by housing associations based in the U.K. can be notched above the underlying issuer, if recovery prospects in the event of default are sufficiently strong.

Standard & Poor's began rating the transactions of housing associations in the United Kingdom (U.K.; AAA/Stable/A-1+) in 1997, and now has issuer credit ratings (ICRs) on five such entities in the country. These ratings reflect the borrower's overall capacity and willingness to meet all its financial obligations as they fall due, but do not relate to specific debt issues.

Although these associations have significant debt obligations, most of the financing needs are provided by a relatively small number of banks, and to date few housing associations have issued bonds directly linked to their issuer credit rating.

Standard & Poor's also rates U.K. housing association structured bonds. These bonds are issued by special purpose entities (SPEs) and are secured on pools of properties that have been overcollateralized to achieve debt ratings higher than that of the borrowing association's own credit rating. The ratings on the bonds also benefit from structural features such as debt service reserves and other liquidity supports. These features would be available, for example, to fund debt service requirements and other expenses in the event of cash flow interruptions during the enforcement period after a borrower default, and to facilitate the replacement of the housing association borrower that operated the assets. As a result, the credit rating of the structured bond is not directly linked to the credit rating of the housing association borrower.

To date, the credit ratings assigned to U.K. housing associations are all in the 'A' category, stemming from strong ability and willingness to meet debt repayment obligations on a full and timely basis. The structured bond ratings are all in the 'AA' or 'AAA' categories, reflecting very strong ability and willingness to meet debt repayment obligations. All these ratings are supported by the stability and predictability of housing association cash flows, which benefit from rents largely paid by local authorities, from high occupancy demand for these properties, and from the supportive conduct of the sector's regulator, the Housing Corporation.

The positive credit factors are partially offset by the ongoing property maintenance requirements and the high debt levels used to fund capital programs and property asset acquisition. Moreover, the not-for-profit nature of these businesses typically results in relatively thin cash flow coverage ratios and tight liquidity, thus creating the potential for technical covenant breaches and possible delays on debt service payments, although Standard & Poor's is not aware of cash defaults in the sector to date.

Diversification Of Funding Sources Needed

Despite the current availability and attractiveness of bank finance, more forward-looking associations are seeking to diversify sources of funding and are considering issuing bonds to help meet funding needs in the future. A diversification strategy makes sense considering the likelihood of increasing concentration of development grants into fewer hands, and the relatively limited pool of banks with experience of lending to the sector. This concentration of development activity is likely to leave individual banks with increasing exposure to individual borrowers, and this may have a consequence on the cost and availability of funding.

As a result, a diversification of funding is expected, which would increase the amount of bond financing in the sector, and hence the need for credit ratings. In particular, an important feature of a Standard & Poor's credit rating is the aspect of timeliness of debt repayment. This emphasis on timeliness differentiates bond investors somewhat from bank lenders, which may be more willing to focus on the strong prospects for ultimate repayment of the loan amount even in the event of a default by a borrowing association. This is due to the control they can exercise over a defaulting association's assets, including the potential sale of assets. Banks have high confidence that they will recover loans from housing associations quickly and in full, reflecting their strong position as senior, secured lenders providing certain rights to control charged assets and cash flows arising from them, along with the sector's experience of sustainable asset values and a special insolvency regime for housing associations which enables lenders to enforce on security quickly.

The Notching Up Of Secured Bond Ratings

Under certain circumstances it may be possible for housing associations to issue bonds that are rated higher than the issuer credit rating of the association but (in contrast to the existing housing

association structured bonds) are still linked to this ICR. This situation can arise if the bonds are underpinned by a strong security package with the expectation that there will be full recovery of the debt in a relatively short timeframe, in the event of a default by the borrowing association. In addition, this expectation is supported by the special insolvency regime that exists for U.K. housing associations. On this basis, an association rated in the 'A' category could issue bonds that could be notched for their strong security package into the 'AA' category. Other key factors considered for achieving a level of notching for secured bond ratings are the seniority of the notes, the quality of the collateral being secured, and the sustainability of the secured assets' value over the life of the notes (also reflecting the degree of conservatism in the valuation methodology undertaken).

The bond ratings notched for security in the cases described above would at all times be linked to the underlying rating on the association. Consequently, a change of the association rating is likely to result in a change of the bond rating.

In practice, the housing association borrowers vary in credit quality, and therefore not all would not be able to achieve 'AA' ratings for secured bond issues. The associations that may be able to achieve 'AA' category secured bond ratings are likely to be those with credit ratings in the 'A' category.

Well-secured 'AA' rated bonds linked to the association ratings are likely to be more competitive when compared with the all-in costs of bank finance including swap costs and fees. Furthermore, bond ratings should enhance the transparency of financing arrangements to the various stakeholders associated with the sector, and widen the funding base available to the sector by opening it out to international investors. ■

REPORT CARD: U.K. SOCIAL HOUSING

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Commentary/Key Credit Issues

Standard & Poor's Ratings Services maintains public credit ratings with regular annual surveillance for five large housing associations (HAs) in the United Kingdom (U.K.; AAA/Stable/A-1+). In addition, the agency also provides annual surveillance for 10 structured bonds issued by housing associations or by special purpose entities (SPEs) set up for the specific purpose to onlend to HAs. So far in 2005 and 2006, rating actions involving publicly rated housing associations comprise the downgrade of Home Group Ltd. in May to A/Stable/-- from A+/Negative/--, a downgrade to Shaftesbury Housing Association in September to BBB+/Stable/-- from A-/Negative/--, and a revision of the outlook on the 'A' long-term ratings on Places for People in October, to positive from stable.

These actions address specific credit issues associated with each individual association, and should not be taken to be an indication of changes in credit quality across the sector as a whole. Indeed, all publicly rated HAs in the U.K. remain well in the investment grade category, reflecting a sector with strong government support, an established regulatory framework, and robust financials. We believe, however, that there will be increasing credit diversity among different associations, as they adapt their business strategies to changing government policies and regulation. In the medium term, issuer credit ratings are likely to be confined to a relatively small number of large diversified associations with significant development ambitions and future debt financing requirements.

Continued government support

The quality and provision of social housing has always been high on the government's agenda and has received increased attention over the past few years. The Office of the Deputy Prime Minister (ODPM), who establishes national priorities and the policy framework, has actively promoted choice-based lettings for all, irrespective of economic background. To cope with the shortfall in social housing provision as identified in the review by Kate Barker commissioned by the government (completed in March 2004) and to improve the efficiency and effectiveness of service provision, the ODPM has initiated changes in the way the sector is regulated and how grants for development are allocated. Increasingly, development grants are being focused in the hands of fewer housing associations with the capacity and expertise to undertake major development and regeneration projects.

More recently, the government's initiatives concerning the creation and protection of sustainable communities, "Homes for all" and "Building for the future" have the common theme of increasing the supply of quality housing and building sustainable communities. In a sense the focus is now much wider than before. Whereas the original emphasis was to provide the less wealthy with a subsidized housing, the focus is now to provide people with the opportunities to move between tenancy types and, where possible, to progress toward home ownership depending on an individual's changing circumstances. In certain low-demand areas, large housing associations are taking the lead in regeneration activity and are increasingly seen as a vehicle for improving community services such as child care, schooling and health care, as well as housing. If this continues to be a successful model, it may result in the development of even larger associations with the capacity to undertake wider regeneration and development activity. This is likely to have important funding implications and will increase the debt needs for individual associations involved.

Recently, the government has been increasing allocations to the sector. The Housing Corporation (HC) has just announced a £3.9 billion national housing development program budget--one of its largest ever allocations from the government. Simultaneously, the ODPM has been advocating "value for money" and "efficiency savings" as part of the funding settlement. HAs are expected to achieve savings of £274 million, £550 million, and £835 million, respectively, over the next three years. Effective procurement methods, providing efficient services, and the increasing use of modern methods of construction are expected to be ways of achieving these savings.

In a bid to provide greater choice for social tenants, the ODPM has announced that housing benefit could be paid directly to tenants. Standard & Poor's is concerned that this proposal may cause higher levels of arrears and bad debts and higher costs of rent collection, and may therefore have negative credit implications. Well-managed associations are focusing on reducing existing levels of arrears ahead of any possible modification to housing benefit, to minimize the impact of this change. Standard & Poor's will continue to monitor any developments in this area closely.

The ODPM has also recently announced the introduction of the new Homebuy initiative in a bid to encourage greater levels of home ownership. Homebuy is very similar to the shared ownership schemes that are currently in operation. The government, through HAs, will fund up to 25% of the purchase price of the property. This will not need to be serviced while the social tenant/owner lives in the property, but up to 25% of the sale price will be repayable when the property is sold. Accordingly, the social tenant will have to fund at least 75% of the purchase through a mixture of a mortgage and personal savings. In the short term, the effect is likely to be minimal, since available government funding for the initiative is currently limited and few social housing tenants will have the financial ability to take advantage of the initiative. If, however, further government initiatives that may expose HAs to the volatility of the private housing market are introduced, this is likely to have negative credit implications.

Robust regulatory framework

Grant allocation and regulation is undertaken by the (HC), while regular inspections are carried out by the Audit Commission (AC). The two organizations work closely together to ensure that public money is used in the most effective and efficient manner. Within the scope of its regulatory powers, the HC assesses and publicly reports on associations' financial viability, governance procedures, management performance, and grant funded new-build development achievements. The Corporation can also use its regulatory powers to intervene and make board-level appointments if it is of the opinion that an association is not managed or governed properly and/or if it receives poor reports from the Audit Commission as to the quality of the service that the particular association delivers to its tenants.

Secured creditors of housing associations are governed by the provisions of Housing Act 1996. The Act sets out the framework for the regulation of HAs, as well as the provisions that govern the enforcement of security over property owned by HAs. In the event of enforcement there is a moratorium that will generally be no longer than 28 days from the date the Housing Corporation is notified of the intention to enforce the security. Furthermore, the proactive role of the regulator in terms of responding to financially distressed associations means that the event of enforcement is likely to be remote in any case.

The role and powers of the HC have been under review and a number of possible options could be considered. At this time, however, Standard & Poor's is not aware of any significant change to regulation that could weaken the level of support provided to the sector.

Emerging Trends Among Associations

Strengthening financial profiles

The financial profile of the sector continues to strengthen, helped in part by a decline in funding costs. We expect to see continued growth in the asset base, both organically and through transfers. Managers are becoming more aware of the need for robust systems of governance, in particular in terms of financial scrutiny, as well as the education and training of staff in the areas of treasury and risk management. There has also been an ongoing shift of talent from the corporate for-profit sectors to the housing association sector and this has introduced "new thinking" in terms of financial management and funding methods.

Furthermore, financial profiles should in general continue to strengthen as the sector focuses on improving efficiency, although we expect creditworthiness to weaken in a few individual cases where housing associations have not managed development properly, or have not effectively addressed demand problems.

Continuing consolidation helps to harness efficiencies

Consolidation within this sector is continuing through the growth of group structures and mergers. Although mergers can encourage business synergies, cultural differences between organizations can impede the delivery of benefits to the business. Developments in the sector are encouraging the emergence of three broad groups of HAs: small associations which mainly engage in local housing management; the large associations (or groups of associations) which bid for grants and are the big developers of new social housing; and the large-scale voluntary transfers (which focus on upgrading transferred council stock).

The emergence of large organizations under umbrella group structures permits cost savings including bulk procurement of materials and the sharing of IT resources, back office facilities, and call centers. Financial profiles have already improved in some cases, as group mergers have delivered savings and achieved critical mass in areas of services provision, although benefits from these trends have tended to be on an incremental basis.

Consolidation in the sector is also expected to

continue and Standard & Poor's has seen increased interest in credit assessments to establish the credit implications of a merger for a group or an individual association.

Diversification helps support core activity
The HC has always encouraged a certain degree of manageable diversification among HAs, as well as the use of surpluses earned on nonregulated activities including market renting, properties built for sale, student accommodation, nursing homes, and other joint ventures, to subsidize further investment in social housing. The overall level of this activity in the sector, however, is still limited. Although certain associations have been able to achieve reasonable surpluses in the provision of these services, others have been less successful and have either had to sell these unprofitable businesses or have seen a general weakening in their overall financial profile.

Stock transfers
The transfer of stock from the local authority sector has contributed to a significant increase in stock in the social housing sector and the construction of new units will continue to stimulate the growth. The latest figures show that the transfer of stock accounted for 55% of the growth in unit numbers in the past year. We expect transfers to continue, but there may be a degree of deceleration if local authorities decide to use their prudential borrowing powers to fund investment in their housing stock, or if the private finance initiative (PFI) develops as an important way of meeting funding needs.

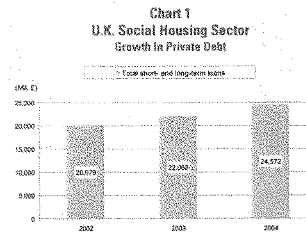
Increasing role of the private sector
Development grant worth £3.9 billion will be distributed to development partners and private housebuilders. This will be the first time that a government grant will be distributed to private housebuilders as well as HAs. It is anticipated that this increased competition will encourage more efficient delivery of new housing development and will expand housing provision. The government is keen to see developers provide a range of housing solutions, including social housing, shared ownership, market-rent, and owner-occupier. Housing associations and private property developers will play a role in meeting this mixed housing solution, with housing associations and private developers being able to provide both social housing and non-social housing.

To date, housing associations have tended to be prudent in their business plan assumptions regarding income from staircasing (incremental sale to tenants) and outright sale. Increasing reliance on this type of income, however, will raise the risk profile of associations, making them more exposed to the volatility of the housing market.

Grants will continue to be given for regeneration of certain areas where there are demand issues. Managing demand in these areas, even with additional government funding, will continue to present specific challenges.

New and more complex methods of funding and treasury management
The sector's two main sources of capital finance are public funded grant and private debt. The debt of the sector rose by 11.3% to £24.6 billion, compared with a 6% increase in Social Housing Grant (SHG) to £28.1 billion (see chart 1). In general, associations have comfortable leverage levels and are well placed from an asset value perspective to support further debt.

Chart 1
U.K. Social Housing Sector
Growth In Private Debt



The emergence of large housing associations with almost £1 billion of debt means that future funding strategies and treasury management approaches have become very important. Banks and building societies provide a significant part of the lending to housing associations, and despite changes in the sector, lending rates have remained very competitive.

Increased Potential For Capital Markets

Grant funding for development is increasingly concentrated in fewer individual housing associations or groups of associations. Demand for private funding from these associations is also high, which in turn increases exposure risks between individual banks and individual associations. Finance is mostly provided by a limited group of U.K. banks and building societies. Due to favorable bank lending terms in recent years, there has been little new bond issuance. Standard & Poor's expects that there will be an increase in bond issuance, particularly among the bigger housing associations with large development plans. This increase will be driven by borrowers seeking to diversify their sources of funds

and to reduce their exposure to a relatively small number of banks and building societies.

New bond funding is likely to be a mix of structured transactions and bond issues directly linked to the credit rating on the association. As well as individual associations seeking to use bond markets, there has also been an increase in banks seeking to securitize their social housing loan portfolios through the capital markets, for example the HBOS Treasury Services PLC Covered Bond Programme social housing series, rated 'AAA'. This securitization activity is also expected to increase. ■

Table 1: U.K. Housing Association Ratings

Entity	Ratings as of Feb. 1, 2006	Analyst	Comments
Affinity Homes Group Ltd. (formerly DownlandAffinity Group Ltd.)	A/Stable/--	Liesl Saldanha, Robert Robinson	Strengths: (i) Strong cash-flow generating ability and and sufficient funds available to reinvest and to service and repay debt; (ii) strong liquidity and access to debt funds; (iii) good geographic location of properties and potential to widen areas of operation; and (iv) strong management team to supervise operations and executive team to provide required direction. ### Weaknesses: (i) Ongoing maintenance-spending pressure, notably for Broomleigh Housing Association, an operating subsidiary of Affinity, and (ii) aggressive development plan that could put pressure on resources. ### Outlook: The stable outlook reflects the continued good progress made by the group in aligning its strategic goals and working together across the group in the achievement of these goals.
Home Group Ltd. (HGL)	A/Stable/--	Liesl Saldanha, Robert Robinson	Strengths: (i) Geographically diverse property portfolio, with strong demand for social housing in most areas of operation; (ii) sound operating performance; (iii) strong management team, with good links to government and an important role in meeting public policy objectives; (iv) higher maintenance, which should improve the group's stock and long-term demand; and (v) strong property sales forecast. ### Weaknesses: (i) Increase in maintenance and management expenditure, which is reducing the operating surplus; (ii) increasing forecast debt levels that could put further pressure on interest coverage ratios; (iii) reduction in grant levels for Supporting People schemes affecting the group's care division, which accounts for one-third of group turnover; and (iv) new divisional structure, which may make it difficult to attract future merger partners and thereby limit the group's development ambitions. To date, however, the divisional structure has not affected HGL's success in attracting Copeland Homes and Nashayman Housing as partners to the group. ### Outlook: The stable outlook takes into account the expectation that care division Stonham will deliver on its efficiency program and that the results of the stock condition survey for HGL--expected in the first quarter of 2006--will not result in a significant increase in maintenance expenditure from forecast levels.
Places for People Group (PfP)	A/Positive/--	Liesl Saldanha, Robert Robinson	Strengths: (i) Strong financial and operating performance; (ii) comfortable and stable coverage ratios; (iii) clear strategy, both operational and financial, for a controlled expansion; and (iv) sufficient financial flexibility and tightly controlled finances. ### Weaknesses: (i) Recent merger with Castle Rock will take time to bed down; (ii) absolute debt levels are high; (iii) reduced levels of government development grants; (iv) risks of significant step-up in development, particularly if, as expected, the Group becomes a development partner of The Housing Corporation; and (v) some market exposure via unregulated subsidiaries Blueroom Properties Ltd. and Emblem Homes Ltd. ### Outlook: The positive outlook reflects our expectation that the rating may be raised in the near term, predicated on the continuation and consistency of PfP's business strategy, with its dominant focus on core social housing activities, and strong financial performance.
Sanctuary Housing Association (SHA)	A/Stable/--	Liesl Saldanha, Carl Nyrerod, Robert Robinson	Strengths: (i) Robust operating and financial performance; (ii) competent and very experienced management team; (iii) good-quality assets, which are favorably located and well-maintained; (iv) strong strategic position to take advantage of changes in the social housing sector; and (v) high levels of fixed-rate debt and very low exposure to interest-rate rises. ### Weaknesses: (i) Speed of growth of the business through mergers and acquisitions, which may possibly lead to management capacity issues; and (ii) increased risk of diversification into areas other than general-needs social housing, notably care-home provision, that may increase business risk and also lead to some short-term stress on the financial profile. ### Outlook: The stable outlook on SHA reflects the strong financial position relative to other similarly rated associations, and the high demand profile for the assets.

Table 1: U.K. Housing Association Ratings (Cont'd)

Entity	Ratings as of Feb. 1, 2006	Analyst	Comments
Shaftesbury Housing Association	BBB+/Stable/--	Hugo Foxwood, Robert Robinson	Strengths: (i) Clear business strategy to divest stock, which should increase business efficiency and improve the financial profile over time; (ii) strong underlying value of assets, mostly located in high-demand areas of Southeast England; and (iii) stable regulatory framework and support. ### Weaknesses: (i) Potential difficulties in divesting stock within the planned timescale; (ii) weak financial performance resulting in deficit for past year, which has technically breached several loan covenants (although lenders have agreed to waive their right to accelerated repayment); and (iii) continuation of Housing Corporation supervision, which restricts the development pipeline. ### The stable outlook on Shaftesbury reflects our expectation that the Group will bring its financial situation under control and move toward a more sustainable operating position in the longer term. Specifically, Shaftesbury is expected to show evidence of delivery on its recovery plan, although the timetable it has set itself is challenging. If Shaftesbury achieves its planned stock-disposal program within its specified timeframe and moves to a more sustainable operating position, then an upgrade could be possible in the short-to-medium term. If, however, the program is substantially delayed, then this could lead to short-term liquidity pressures.

Table 2: U.K. Housing Association Transaction Ratings

Entity	Debt Security Ratings as of Feb. 1, 2006	Analyst	Comments
Guinness Housing Trust £100 mil. 7.5% Bonds due 2037	AA-	Liesl Saldanha, Robert Robinson	The 'AA-' senior secured debt rating on the £100 million ($186 million) 7.5% first mortgage debentures due 2037, issued by the Guinness Trust (formerly referred to as the Guinness Housing Trust), reflects the strong performance of the bonds (net interest coverage of 1.34x) and the good cash-flow-generating characteristics of the charged property portfolios, including high rent collection levels. A certain level of overperformance in the transaction was anticipated in the rating, in order for the payments to comfortably commence principal amortization, which begins in 2008. As the amortization point approaches, however, to the extent that the Trust can demonstrate a sustained level of overperformance, while also maintaining an appropriate level and quality of charged properties in the portfolio, Standard & Poor's will consider reviewing the transaction for a higher rating.
Harbour Funding PLC £255.9 mil. 5.28% Bonds due 2044	AA-	Liesl Saldanha, Robert Robinson	The 'AA-' senior secured debt rating on the £255.9 million ($490.1 million) 5.28% senior secured bonds due 2044 (expected maturity 2034), issued by Harbour Funding PLC, a special-purpose vehicle (SPV) set up for the sole purpose of issuing bond debt and on lending to housing associations (HAs), reflects the expected performance of the bonds, with interest coverage ranging between 1.45x and 1.82x, and the strong cash flow-generating characteristics of the charged property port folios, including the good rent-collection performance of all HAs drawing on the bond.
Haven Funding (32) PLC £100.5 mil. 7% Bonds due 2032	AA-	Liesl Saldanha, Robert Robinson	The 'AA-' senior secured debt rating on the £100.5 million 7.0% senior secured bonds due 2032, issued by Haven funding (32) PLC, a special-purpose vehicle set up for the sole purpose of issuing bond debt, reflects the strong performance of the bonds, including net interest coverage of 1.18x to 1.93x; good cash-flow-generating characteristics of the charged property portfolios, including good rent collection performance of all registered social landlords (RSLs) drawing on the bond; and the strong credit quality of the underlying borrowers.
Haven Funding PLC £329.4 mil. 8.125% Bonds due 2037	AA-	Liesl Saldanha, Robert Robinson	The 'AA-' senior secured debt rating on the £329.4 million ($630.9 million) 8.125% senior secured bonds due 2037, issued by Haven Funding PLC, a special-purpose vehicle (SPV) set up for the sole purpose of issuing bond debt, reflects the expected performance of the bonds, with net interest coverage of 1.16x to 1.45x, and the good cashflow-generating characteristics of the charged property portfolios, including strong rent-collection performance of all registered social landlords (RSLs) drawing on the bond.
Housing Association Funding PLC (HAF) £192.2 mil 8.25% Bonds due 2027	AAA	Stuart Nelson, Liesl Saldanha	The 'AAA' senior secured debt rating on the £192.2 million 8.25% senior secured bonds due 2027, issued by HAF PLC, a special-purpose vehicle (SPV) set up for the sole purpose of issuing bond debt and on lending to housing associations, reflects the expected performance of the bonds and the strong cash flow-generating characteristics of the charged property portfolios, with net rental coverage of 1.22x. In June 2005, a tap of £31.3 million was issued to existing borrowers under the transaction. The rating on the entire transaction was affirmed at the time.
North British Housing Ltd. £100 mil. 6.625% Bonds due 2038	AA	Liesl Saldanha, Robert Robinson	The 'AA' senior secured debt rating on the £100 million ($177 million) 6.625% senior secured bonds due 2038, issued by U.K.-based North British Housing Ltd. (NBH; formerly called North British Housing Association Ltd.), reflects the strong performance of the bonds, with net interest coverage of 1.22x; good cash-flow-generating characteristics of the charged property portfolio, including good rent collection performance; and the strong credit quality of the underlying borrower. NBH is the largest registered social landlord (RSL) in the U.K., and the main subsidiary of Places for People Group (PfP; A/Positive/--).

Table 2: U.K. Housing Association Transaction Ratings (Cont'd)

Entity	Debt Security Ratings as of Feb. 1, 2006	Analyst	Comments
North British Housing Ltd. £200 mil. 5.09% Bonds due 2043	AA-	Liesl Saldanha, Robert Robinson	The 'AA-' senior secured debt rating on the £200 million ($360 million) 5.09% senior secured bonds due 2043 (expected maturity 2024), issued by U.K.-based North British Housing Ltd. (NBH), reflects the performance of the bonds, with a net interest coverage of 1.20x in year one; the good cash-flow-generating characteristics of the charged property portfolio, including good rent collection performance to date; and the strong credit quality of the underlying borrower. NBH, formerly called North British Housing Association Ltd., is the largest registered social landlord (RSL) in the U.K. and the main subsidiary of Places for People Group (PfP; A/Stable/--).
RSL Finance No. 1 £324.95 mil. 6.625% Bonds due March 31, 2038	AA-	Liesl Saldanha, Robert Robinson	The 'AA-' senior secured debt rating on the £342.95 million ($837.13 million) 6.625% senior secured bonds due 2038, issued by U.K.-based RSL Finance (No.1) PLC, a special-purpose vehicle set up for the sole purpose of issuing bond debt, reflects the strong performance of the bonds, which have net interest coverage of 1.29x to 1.62x; good cash-flow-generating characteristics of the charged property portfolios; and the good rent-collection performance of all the registered social landlords (RSLs) drawing on the bond. The bond proceeds are used for acquiring existing loans and onlending the net proceeds to individual U.K. housing associations, under separate secured loan agreements.
Sanctuary Housing Association £110 mil. 8.375% Bonds due 2031	AA	Liesl Saldanha, Robert Robinson	The 'AA-' rating on the £110 million ($201 million) senior secured bonds due 2031 issued by U.K.-based Sanctuary Housing Assn. (SHA; A/Stable/--) reflects the strong performance of the bond and the charged property portfolio, with net interest coverage of 1.20x, good rent collection performance, existence of a dedicated debt service reserve (DSR), and sound credit quality of the underlying borrower. Offsetting factors include the refinancing risk on the partial bullet maturing, exposure to the general property market, and changes in housing policy
Sunderland (SHG) Finance PLC £239.5 mil. 6.38% Bonds Due 2042	AA	Liesl Saldanha, Robert Robinson	The 'AA-' senior secured debt rating on the £239.5 million ($418 million) fixed-rate bonds, due 2042, reflects the robust performance of the bonds and the charged property portfolio, good rent-collection performance, a DSR fund, significant overcollateralization, and continued high demand for properties. The notes continue to perform well above the minimum levels due to significant overcollateralization that in part reflects the risk of a transfer organization. The original business plan was substantially revised in 2003 to reflect increased expenditure on the stock earlier in the program. The revised business plan also supported a reduction in security supporting the bonds. The first release of security took place in May 2005 and the number of charged property units now stands at 21,000, down from 24,472 units. This release was per the original covenant, which specified that two property releases were permissible in the first seven years, subject to certain performance tests. Sunderland has indicated that it intends to apply for a second release within the next 12 months and that the number of charged property units is expected to go down to 17,000. Nevertheless, Standard & Poor's expects that the minimum performance levels will still be met comfortably after the second release of property.
The Housing Finance Corporation (Funding No. 1) £66.3 mil. Bonds due 2037	AA-	Robert Robinson, Adele Archer	The 'AA-' senior secured debt rating to the expected £66.3 million bonds due 2037 was issued by the U.K.-based special-purpose vehicle T.H.F.C. (Funding No. 1) PLC. The bonds are secured on loans to The Housing Finance Corporation Ltd. (THFC; A+/Stable/A-1). The loans are secured on the assets of THFC, which also benefits from a 24-month-interest-payment dedicated liquidity facility provided by ABN AMRO Bank N.V. (AA-/Stable/A-1+), allowing the bonds to be rated one notch above the THFC rating. The rating on the bonds, however, is directly linked to the issuer credit rating on THFC and also to the rating on the liquidity facility provider, ABN AMRO Bank. A change in the rating on THFC, or a change in the short-term rating on the liquidity facility provider, may result in a change in the rating on the bonds.

Report Card: Social Housing In Sweden

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Commentary/Key Credit Issues

Standard & Poor's Ratings Services currently rates five Swedish public-housing companies. The ratings are all in the 'A' rating category with stable outlooks.

Swedish public-housing companies are 100% owned by municipalities and are only allowed to operate within the borders of their respective municipalities. The companies have played a critical role in Sweden's housing market for the past fifty years and today about 340 public-housing companies accommodate 1.5 million people, or about 17% of the population. Almost one-third of all multi-family dwellings are publicly owned. The public-housing sector has a strong influence on the overall rental housing market as the market-leader in setting rental prices.

Compared internationally, the standards of Swedish public-housing apartments are generally high, and there is no equivalent of the low-cost or social housing prevalent in some other European countries. Everyone, regardless of income, has the possibility of renting an apartment, if available, from a public-housing company. In the event of, for example, unemployment, social security benefits are payable to tenants (not to the housing company) to cover a proportion of rental payments.

Public support features

Standard & Poor's analytical approach to government supported entities focuses on the status-quo credit quality of the entity, and the relationship and links between the supporting level of government and the entity. Standard & Poor's uses three broad categories for government-supported entities, assessing the strength and credit implications of government ownership or support (see article Revised Rating Methodology for Government-Supported Entities, June 5, 2001, on RatingsDirect, Standard & Poor's Web-based credit analysis system). Swedish public-housing companies are generally considered to belong to the third category, with less pronounced public support. As a result, the government-supported entity ratings are usually the same or one or two notches above status-quo ratings. A government-supported issuer credit rating in this category would generally be no more than one rating category above its status-quo rating. There are, however, cases where the housing company has closer links to its owner and therefore belongs to the second category. Issuer credit ratings in this category would generally be notched down from the government owner (municipality), but are generally within two categories of the government's rating.

Although most public-housing companies are limited liability companies and have no general guarantee from their owners they still benefit from varying degrees of implicit support from their owners. The support is not formalized, however, and could, for example, be guarantees on part of the loan portfolio, favorable acquisition terms when buying land and properties from the owner, or special lease contracts with the municipality, low yield/dividend requirement, and in some cases capital injections. Temporary national legislation prevents municipalities from divesting their public-housing companies and also regulates and restricts the size of the dividend that can be paid out. During the 1990s there was also a special central government scheme where public-housing companies with financial difficulties could apply for and receive special support from the central government. Standard & Poor's is not aware of any public-housing company in Sweden having defaulted on debt obligations.

Status-quo creditworthiness

Public-housing companies in Sweden were previously sheltered by a number of central government benefits such as special subsidies for new construction and refurbishment for residential dwellings.

The subsidies, however, have now been significantly reduced. In combination with the trend of depopulation in rural areas, this has resulted in greater differences in creditworthiness among companies on a status-quo basis. There are considerable differences in both operating risk (determined, for example, by supply and demand in the local market as well as the property portfolio) and financial risk (for example, gearing, profitability, interest coverage, and self-financing of investments). The difference in ratings, however, is to some extent reduced by more or less pronounced implicit support from the companies' owners.

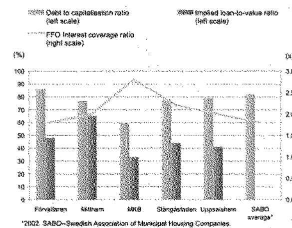
Standard & Poor's finds operating risk to be the most important factor to consider in assessing status-quo credit risk of public-housing companies. Important indicators of operating risk are supply and demand for various kinds of housing, vacancy rates, rental level versus rental or cost level in comparable housing on the local market, tenant

turnover rate, maintenance standard and composition of property portfolio in terms of property type, location, age, and apartment sizes.

Managerial strategy is another important factor in the risk assessment of public-housing companies. Differing strategies can be found among Swedish public-housing companies, such as on how the company operates its capital structure in terms of loan duration and self-financing of investments. Furthermore, there are different strategies on, for example, rental differentiation, relative size of commercial property portfolio and attitude towards engaging in new production. Unlike in the U.K., however, there are no major managerial strategy differences in terms of issues such as cross municipal borders mergers/large scale voluntary transfers or regeneration projects. Another managerial difference compared with the U.K. is that in Sweden the responsible authority is the owner municipality, whereas in the U.K. the Housing Corporation (a state agency) acts as the main regulator for the sector.

Generally, the Swedish public-housing companies operate with a high leverage according to book values, which for some companies is mitigated by surplus values, that is market values exceeding book values. As with the Swedish debt market in general the debt profile is short for most public-housing companies, exposing the sector to interest rate movements as well as refinancing risk. Profitability is stable but modest and interest rate coverage ratios range mostly between 1-2 (x) times (see chart 1). The companies not-profit-maximizing profile, however, reduces the potential upper limit for profit margin and interest cover. Except for the companies with the worst market conditions, however, there is not a very obvious trend that the companies with the best market conditions and highest surplus values should be the most profitable.

Chart 1
Debt To Capitalization And FFO Interest Coverage Of Rated Swedish Public Housing Providers

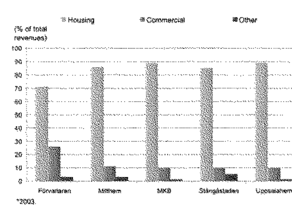


*2002. SABO--Swedish Association of Municipal Housing Companies.

Stable outlook for the sector

Housing rents in Sweden are set according to the utility value system, regardless of whether landlords are public or private entities. This implies that rental levels for every individual public-housing company are determined annually or biannually on a nonprofit basis, based on the prime cost principle, through negotiations with the local tenants' association. The negotiated levels in the public sector are also used as upper limits for the private landlords' rental structure, whereby the rents are set with reference to the rents of equivalent dwellings in the neighborhood that are owned and managed by a municipal housing company. The public-housing sector is therefore the practice or market leader for the rental housing market, which to some extent limits the public-housing companies' operating risk. Going forward, rental negotiations are expected to result in modest increases in housing rents and profitability and coverage ratios are largely expected to remain stable.

Chart 2
Rent Structure Of Rated Swedish Public Housing Providers*



*2003.

Standard & Poor's analyzes new production of housing in detail since it adds uncertainty in terms of future demand and supply, production costs, investment grants, and tenants' propensity to pay rent to cover actual costs in the newly built housing properties.

Standard & Poor's will monitor the possible introduction of IFRS accounting standards among the public-housing companies and its impact on ratings. For more information on impact of IFRS read research article "Transition Without Tears: A Five-Point Plan for IFRS Disclosure," published on RatingsDirect on Dec. 6, 2004. ■

Table 1: Swedish Housing Association Ratings

Entity	Ratings as of Feb. 1, 2006	Analyst	Comments
Fastighets AB Förvaltaren	(A/Stable/A-1; K-1)	Carl Nyreröd	Compared with the Swedish public-housing sector average, Förvaltaren has a large proportion of commercial premises, rental income from which accounts for 29% of total revenues. The vacancy rate in Förvaltaren's portfolio of commercial premises is high at over 10% from October 2004, or about 3% of Förvaltaren's total property portfolio. Although vacancy rates and rental levels appear to have bottomed out and are not expected to have a material negative impact on Förvaltaren's financial performance. Förvaltaren shows adequate financial performance, with funds from operations (FFO) interest coverage at an adequate 1.8x in 2003, which is average for the sector. In line with Swedish public-housing peers, Förvaltaren has significant reliance on short-term funding, making it sensitive to both interest-rate and refinancing risk. Interest rate risk is, however, mitigated by an adequate buffer in interest coverage ratios and ample credit facilities. Förvaltaren has relatively high debt levels compared with international peers, but they are close to the Swedish public-housing sector average, at 86%. Owner: City of Sundbyberg (A+/Stable/-).
MKB Fastighets AB	(A+/Stable/A-1; K-1)	Carl Nyreröd	MKB continues to show strong financial performance. Pretax interest coverage was an adequate 2.0x in 2004 (up from 1.6x in 2003), and is forecast to remain at this level over the next few years. MKB also enjoys strong and stable cash flow, with funds from operations interest coverage at a healthy 3.5x in 2004 (up from 2.6x in 2003). Although MKB has relatively high debt levels compared with international peers, leverage is lower than the Swedish public-housing sector average. At year-end 20043, MKB's total debt to capitalization was 62%. MKB has an above-sector-average reliance on short-term funding, making it sensitive to both interest-rate and refinancing risk. Interest rate risk is, however, mitigated by interest rate caps and a buffer in interest coverage ratios. Refinancing risk is mitigated by ample committed bank lines and liquidity facilities. Owner: City of Malmö (not rated).
Mitthem AB	(A/Stable/--; K-1)	Carl Nyreröd	Over the past eight years, Mitthem has divested its less attractive and more isolated properties, and its vacancy rate has continued to fall to a very low 0.6% at year-end 2004, down from a high 13% in 1996. Funds from operations (FFO) interest coverage improved to an adequate 2.2x in 2004, from 2.0x in 2003. Going forward, profitability and cash flows are expected to remain at adequate levels. Interestr duration of the loan portfolio is rather short and declining at 1.9 years. This is in line with the Swedish public housing average, but it is short in an international comparison and adds to the overall financial risk. Mitthem's low business risk, however, balances the company's somewhat aggressive financial profile. Mitthem has relatively high debt levels, with a debt-to capital ratio of 77% at year-end 2004. Owner: City of Sundsvall (AA-/Stable/A-1+).
Stångåstaden AB City	(A+/Stable/A-1; K-1)	Carl Nyreröd	Stångåstaden shows strong financial performance above the Swedish public housing sector average. EBITDA interest coverage in 2004 improved to 2.8x (2.3x in 2003). The company's cash flow is strong and stable, with funds from operations interest coverage at a healthy 2.6x in 2004. In line with Swedish peers, Stångåstaden relies heavily on short-term funding, making it sensitive to both interest-rate and refinancing risk. Interest-rate risk is, however, mitigated by an adequate buffer in interest coverage ratios. Refinancing risk is mitigated by ample committed bank lines. At year-end 2004, Stångåstaden's total debt to capitalization was 74%, which was an improvement from 78% in 2003 and stronger than the Swedish public housing sector average. Owner: of Linköping (not rated).
Uppsalahem AB	(A/Stable/A-1; K-1)	Carl Nyreröd	During the next five years, Uppsalahem intends to build about 1,500 new apartments. Although the investments are being partially financed with funds from operations, the company needs to take out new loans to help fund the project, and this could have a slightly negative impact on key ratios such as interest coverage and leverage. Uppsalahem operates with a very short debt profile. At year-end 2003, the debt portfolio had an interest-rate duration (including derivatives contracts) of 15 months. The exposure is, however, somewhat mitigated by the company's use of interest rate caps, which protects it, within certain limits, against a dramatic increase in interest rate. Uppsalahem benefits from fairly stable--although decreasing--cash flows from operations. Pretax FFO interest coverage amounted to an adequate 2x in 2003, slightly down from 2.2x in 2002, and is expected to remain above 2x in the medium term. Owner: City of Uppsala (AA/Stable/A-1+).

Table 2: Swedish Housing Association Bond Ratings

Entity	Debt Security Ratings as of Feb. 1, 2006	Analyst	Comments
Framtiden Residential Housing Finance No.3 AB (publ)	AAA	Stuart Nelson	This 2001 transaction effectively employed the same structure as the previous transaction, benefiting similarly from the highly diversified but stable income streams enjoyed by municipal housing companies in Gothenburg, and performance levels have been at the same rate as its predecessor.
Framtiden Multi-Family Housing Finance No.4 AB (publ)	AAA	Stuart Nelson	This transaction closed in 2002, replicating the proven structures of previous deals. Performance levels have also been replicated in terms of both leverage and coverage.
Framtiden Public Housing Finance No. 5 AB (publ)	AAA	Stuart Nelson	This transaction closed in 2004 and demonstrated how Framtiden had established a successful program of securitizations to fund its multi-family housing companies with repeat deal structures to achieve funding at competitive rates. Effectively, this transaction is a financing of a property portfolio that was securitized in Framtiden Bostadsfinansiering 1 AB. Of the properties, 78% by value were included in Framtiden Bostadsfinansiering 1, and we would expect performance of this transaction to mirror that witnessed in earlier issuances.
Akero Multifamily Housing No. 1 Ltd.	AAA, A, BBB	Stuart Nelson	This 2005 transaction was another secured loan CMBS transaction with the issuing vehicle granting loans to two borrowers, Akelius Fastigheter i Haninge AB and Akelius Lägenheter AB (part of the Akelius Fastigheter group) secured against 32 residential properties (comprising 6,484 apartments), located across Sweden with a two-thirds concentration in Stockholm. This transaction is similar in structure to the Framtiden series of transactions. However, in this case, the underlying loans are cross-collateralized through limited guarantees, and three separately rated classes of notes have been issued.

Table 3: Previously Published Related Articles*

Article title	Publication date
Transition Without Tears: A Five-Point Plan for IFRS Disclosure	Dec. 6, 2004
Credit Approach to Rating Social and Public Housing Providers	Nov. 30, 2004
Swedish Public Housing Sector Could Face Threat from New Accounting Recommendations	May 13, 2002
Revised Rating Methodology For Government-Supported Entities	June 5, 2001
Rating Swedish Public Housing Providers--The Role of Revenue Stability and Predictability	Oct. 12, 2000

*Articles are available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com.

PUBLIC FINANCE REPORT CARD: U.S. PUBLIC HOUSING AUTHORITY CAPITAL FUND SECURITIZATION RATINGS

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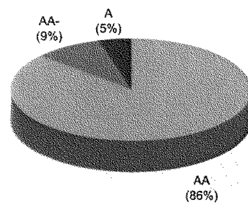
Standard & Poor's Ratings Services' review of its 22 public housing authority capital fund financing program (CFFP) ratings indicates strong overall performance, but the trend of declining Congressional appropriations to the program warrants continued monitoring. Ratings range from 'AAA' (bond insured) to 'A', and all reviews to date have resulted in affirmations. While debt service coverage (DSC) is still strong at an average of 4.62x, many issues show declining coverage due to federal cuts in modernization funds during the past few years.

Chart 1
Public Housing Authority Capital Fund Securitization Ratings Distributions



The primary credit risk of these transactions is failure of Congress, in any given year, to appropriate funds for the public housing modernization program, or a substantial decrease in the amount of funds appropriated for the program. Although the aggregate of the decreases in capital fund appropriations remains within historic thresholds, the modernization program has experienced a five-year continuous decline in overall appropriations for the first time since its inception.

Chart 2
Total HUD Modernization Appropriations

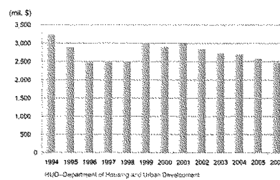
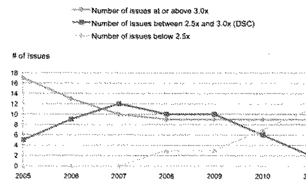


Chart 3
Expected Credit Quality Based On Declining Appropriations

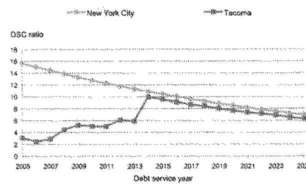


Standard & Poor's tested coverage levels on rated issues, assuming an annual 4% reduction over the term of the bonds. No issue fell below one times coverage. Because these transactions are structured such that annual allocations of capital funds are pledged first and directly to the trust estate, debt service payments would be met during the life of the bonds under this assumption. Nonetheless, the degree of government support associated with future and continued decreases can have certain programmatic and social implications if debt service is paid while other modernization needs are not readily addressed. In addition, annual appropriations can be reduced by more than 4% in any given year, which would have an even more negative impact on debt service. Standard & Poor's carefully monitors these factors that potentially can affect the credit quality program of the CFFP program.

Under this scenario, 45% of issues rated by Standard & Poor's opened at 3.0x coverage at rating, and potentially could be below 2.5x coverage by 2011 (see chart 3). Transactions that are structured with higher DSC will fare better if decreases continue, as they are able to maintain at least 3.0x coverage for a longer period, even if appropriations declines continue. One example is the New York City Housing Authority, which opened at 15.59x DSC and now has a DSC of 15.65x (see chart 4 on the next page). Transactions structured whereby the principal payment is hyper-amortized early in the transaction will also perform better under a trend of decreasing appropriations, primarily because debt service payments decline over the term of the bonds. The Tacoma Housing Authority bond issue opened at 3.0x coverage. However, because principal is paid down quickly over the early

years of the bond term, the actual DSC remains strong at average of 6.63x as debt payments are decreased after year six, even in the event of continued 4% decreases over the bonds term. Transactions structured in this manner are more likely to withstand future cuts in the capital fund appropriation because of the DSC growth (see chart 4). However, because the additional bonds test is at 3.0x coverage, 'AA' is the appropriate rating level in these two examples.

Chart 4
Effects Of Hyper-Amortization And High Coverage At Issuance Versus Declining Appropriations



Standard & Poor's looks closely at the authorities' past modernization performance, particularly because future poor performance circumstances could have a negative impact on the flow of the capital funds pledge directly to the bonds. As part of the upfront and ongoing rating process, Standard & Poor's assesses the management capacity of the authority in order to determine the history of timely obligation and expenditure of modernization funds. Virtually all of the authorities with public Standard & Poor's ratings have timely obligated and expended their modernization funds during the last 10 years.

Standard & Poor's also reviews each authority's capacity to carry out the scope of the work to be financed with the bond proceeds, and annually reviews the progress of these projects. All but one of the authorities reviewed remain on or ahead of schedule with their projects. The authorities have used the bond proceeds for a variety of purposes. The most prevalent use is to expedite overall modernization plans based on long-term capital planning assessments, however some authorities use funds to complete new construction projects, to acquire land or as gap financing for multi-layered financings, transactions financed by HOPE VI, tax credit proceeds, HOME, and Community Development Block Grant funds.

Pooled transactions continue to be the vehicle for smaller authorities to take advantage of the CFFP program. In the case of pooled financings, the addition of more housing authorities can serve to increase the volatility of the transaction. This is due to each authority's obligation to pay debt service on the bonds being a several, not a joint, obligation and therefore limited to the authority's proportionate share of the bond series. Credit risk posed by volatility is somewhat offset by strong oversight in pooled financings. Oversight ensures that pool participants continue to meet their obligations to Department of Housing and Urban Development (HUD) and under the trust estate, to mitigate the potential of any performance issues that can interfere with the allocation of modernization funds. With the exception of the Affordable Housing Agency Certificates of Participation (which included only two very well-managed authorities), all five pooled financings rated by Standard & Poor's have an oversight entity monitoring compliance with the terms of the bond documents, timely project completion and general HUD compliance.

To date, more than 63 housing authorities have benefited from bond proceeds supported by a pledge of annually appropriated modernization funds. Authorized in the Quality Housing and Work Responsibility Act of 1998 (QHWRA), the capital fund program is the latest to administer the federal government's modernization of the nation's public housing stock. The amount of funds received by each authority is determined by the capital funding formula, which is calculated and distributed by the HUD. Despite the recent trend of appropriation decreases, Standard & Poor's believes that the credit quality of these transactions remain strong due to the demonstrated long-term support for public housing in general, and modernization in particular. ■

Table 1: Public Housing Authority CFS Ratings

Oversight agent	Published name	Rating as of Feb.1, 2006*	Analyst	Comments
Public Housing Finance Corp., Ala.	Alabama Public Housing Finance Corporation Capital Fund Program Revenue Bonds, Series 2003A & 2003B	AAA, AA (SPUR)	Valerie White	Issued by the Alabama Housing Authorities, this is a pooled financing. Series A bonds have a term of 10 years and were jointly issued by four public housing authorities (PHAs), while series B bonds have a term of 20 years and were issued by 33 PHAs. An additional bonds test (ABT) allows participating authorities to issue debt that maintains at least 3x coverage. Each PHA's obligation to pay debt service is a several, not joint obligation and is limited to its share of the series. Bond proceeds are used to fund modernization programs being undertaken by each PHA. The extent of each PHA's efforts differ, but typically involve rehabilitation rather than a demolition and redevelopment. As of 2005, all projects were on schedule. Note that this transaction is bond insured by Financial Security Assurance(FSA). Oversight will be performed by the Jefferson County Housing Corp.
Affordable Housing Agency, Calif. (Oxnard-Santa Clara Projects) Series 2004	Affordable Housing Agency Certificates of Participation	AA	Lawrence Witte	Bonds were issued by Affordable Housing Agency (AHA) on behalf of a pool of two housing authorities, the Oxnard Housing Authority and the Housing Authority for Santa Clara County, in the amounts of $5.8 million and $4.5 million, respectively. An ABT allows AHA to take additional bonds into the grantor trust that have a DSC of at least 3x. The bonds are held in a grantor trust administered by the trustee, Wells Fargo Bank, N.A. Bond proceeds were used to expedite rehabilitation and improvement initiatives of existing units for each PHA. Because this pool consists of only two well-managed authorities, Standard & Poor's determined that an oversight entity was not needed for this transaction.
Augusta Housing Authority, Ga.	Augusta Housing Authority Georgia Capital Program Revenue Bonds Series 2004	AA	Valerie White	Bonds were issued by AHA with a term of 20 years. An ABT allows AHA to issue debt that maintains at least 3x coverage Bond proceeds will be used to modernize units in a number of housing developments for the elderly that are managed by the authority. Modernization will include interior upgrades, improvements to common areas, elevator replacements, and security and emergency upgrades. The improvements are designed to improve the comfort and safety of the housing developments' elderly residents. As of January 2006, the AHA's modernization and redevelopment plan was on schedule. The project is expected to be completed by the end of 2007.
Chicago Housing Authority, Ill. Bonds, Series 2001	Chicago Housing Authority Capital Program Revenue	AA	Jeffrey Previdi	Bonds were issued by Chicago Housing Authority (CHA), the third-largest U.S. housing authority, and mature in 2019. Although DSC is very strong, recent appropriations cuts have raised the prospect for coverage below 3x starting in 2006. These bonds were issued in conjunction with CHA's ambitious overhaul of public housing stock in Chicago. The redevelopment plan is on track, with roughly 45% of the units redeveloped at the end of fiscal 2003. Note that through 2009 funding is covered by CHA's "moving to work" agreement with HUD and after 2009 the funds will be determined by the capital funding formula.
Fort Wayne Housing Authority, Ind.	Fort Wayne Housing Authority Capital Funds Housing Revenue Bonds, Series 2003	AA	Valerie White	Bonds were issued by Fort Wayne Housing Authority (FWHA) with a term of 20 years. An ABT allows FWHA to issue debt that maintains at least 3x coverage. Bond proceeds were used to address immediate upgrade and rehabilitation needs throughout the authority's portfolio. The authority anticipated that the total time to complete this work would be reduced to 36 months from 7-8 years by virtue of this bond issue. As of November 2005, the project was proceeding according to schedule and has an anticipated completion date of January 2007.
Kentucky League of Cities, Ky.	Kentucky League of Cities Funding Trust Capital Grant Program Revenue Notes, Certificates of Participation, Series 2004 A (Covington, Ky.)	AA	Karen Flores	This is the first of several COP issuances by the Kentucky League of Cities (KLC) Funding Trust, and was issued on behalf of Covington Housing Authority (HAC). Additional series may be issued on behalf of other housing authorities under the master indenture. Each series will be deemed a separate trust estate and will not be on parity with each other. The series 2004 COPs has a term to maturity of 20 years. An ABT allows HAC to issue debt that maintains at least 3x coverage. COP proceeds fund the renovation of a senior and disabled housing project with 155 apartments upon completion. KLC serves as the program administrator and oversight entity. As of December 2005, the project was 90% complete and is expected to be completed by 2007.

Table 1: Public Housing Authority CFS Ratings (Cont'd)

Oversight agent	Published name	Rating as of Feb.1, 2006*	Analyst	Comments
Kentucky League of Cities, Ky.	Kentucky League of Cities Funding Trust Capital Grant Program Revenue Notes, Certificates of Participation, Series 2004 A (Paducah, Ky.)	AA	Valerie White	This is the second of several COP issuances by the KLC Funding Trust, and was issued on behalf of Paducah Housing Authority (HAP). Additional series may be issued on behalf of other housing authorities under the master indenture. Each series will be deemed a separate trust estate and will not be on parity with each other. The series 2004 COPs has a term to maturity of 20 years. An ABT allows HAP to issue debt that maintains at least 3x coverage. KLC will serves as the pro gram administrator and oversight entity. As of November 2005, the project was on schedule.
New Orleans Industrial onDevelopment Board, La.	New Orleans Industrial Development Board Capital Fund Program Revenue Bonds	AAA, A(SPUR)	Valerie White	Issued by New Orleans Industrial Development Board (IDB) behalf of the New Orleans Housing Authority (HANO), these bonds have a term of 20 years. The 'A' rating on this transaction reflects the slightly lower ABT of 2.5x. Although HANO has a history of poor performance, which resulted in the agency being put in receivership by HUD, Standard & Poor's determined the recent organization changes and management improvements were sufficient to support the rating. Bond proceeds were loaned by IDB to HANO for the development of mixed-financed development projects. As of 2004, all projects were proceeding according to schedule. Note that this transaction is bond insured by FSA.
New Bedford Housing Authority, Mass.	New Bedford Housing Authority, Capital Fund Program Revenue Bonds, Series 2004	AA	Valerie White	Bonds were issued by New Bedford Housing Authority (NBHA) with a 20-year term. An ABT allows NBHA to issue debt that maintains at least 3x coverage. Bond proceeds will fund the major redevelopment of three of the oldest properties in the authority's portfolio, which contain almost 1,650 units in 13 developments. As of November 2005, the project was on schedule and is expected to be completed by December 2007.
Maryland Department of Housing & Community Development, Md.	Maryland Department of Housing & Community Development Capital Fund Securitization Revenue Bonds, Series 2003	AAA, AA(SPUR)	Valerie White	Issued by the Community Development Administration (CDA) of the Maryland Department of Housing (which also serves as the issue's oversight entity), these bonds have a term of 20 years. This is a pooled financing representing five local PHAs. An ABT permits the issuance future bonds series that will maintain at least 3x. Each PHA's obligation to pay debt service is a several, not joint obligation and limited to its share of the series. Bond proceeds were used to fund individual loans to each authority. The PHAs in turn used the loan proceeds to expedite modernization programs outlined under each authority's HUD five-year plans. As of August 2005, all five authorities were on schedule with their rehabilitation projects, and the latest anticipated completion date is November 2006.
Philadelphia Housing Authority, Pa.	Philadelphia Housing Authority Capital Fund Program Revenue Bonds, Series 2002 A&B, Series 2003 C&D	AAA, AA(SPUR)	Jeffrey Previdi	Bonds were issued by Philadelphia Housing Authority, the fourth-largest public housing authority, with a 20 year term. DSC is strong at more than 6x at issuance and with an ABT of 3x. The 2002B and 2003C and D bonds were issued by the Philadelphia Redevelopment Authority on behalf of the Philadelphia Housing Authority. There is no additional backup support from the Philadelphia Redevelopment Authority. All four series were issued under the same parity resolution. The series 2002A and B bonds were issued to assist in the redevelopment of Tasker Homes, one of the oldest developments in the authority's portfolio. Proceeds were used to demolish and rebuild the property. Series C proceeds were used to finance a loan for the acquisition, construction, and equipping of a 184-unit development at Tasker Homes. Series D proceeds funded for additional projects permitted under the indenture. As of Dec. 20, 2005, the PHA's modernization and redevelopment plan was on schedule. The remaining projects are expected to be completed by mid-2006. Note that this transaction is bond-insured by FSA.
Puerto Rico Housing Finance Authority, P.R. Financing Bonds, Series 2003	Puerto Rico Housing Finance Authority Capital Grant	AA	Valerie White	Bonds were issued by Puerto Rico Housing Finance Authority (PRHFA) on behalf of Puerto Rico Public Housing Administration (PRPHA). Bond maturity has a term of 20 years. An ABT allows PRPHA to issue debt that maintains at least 3x coverage. Bond proceeds were loaned to the PRPHA by the issuer pursuant to a loan agreement. Proceeds were used to partially fund an accelerated modernization of more than 20,000 units in approximately 100 properties. As of Sept. 30, 2005, the project was proceeding according to schedule and is anticipated to be completed by December 2008. PRPHA is the second-largest housing authority in the country and manages 56,000 units in more than 320 properties.

Table 1: Public Housing Authority CFS Ratings (Cont'd)

Oversight agent	Published name	Rating as of Feb.1, 2006*	Analyst	Comments
Woonsocket Housing Authority, R.I. Bonds Series 2003	Woonsocket Housing Authority Capital Fund Program Revenue	AA-	Valerie White	Bonds were issued by Woonsocket Housing Authority (WHA) with a term of 20 years. DSC for the transaction was estimated to be at least 3x though bond maturity and an ABT allows WHA to issue debt that maintains at least 3x coverage. Bond proceeds were used to partially fund construction and reconfiguration of 14 buildings of approximately 130 units to comply with Americans with Disabilities Act standards. As of October 2005, the project was on schedule and is expected to be completed in September 2009.
Knoxville Community Development Corporation, Tenn.	Knoxville Community Development Corporation Capital Program Bonds, Series 2004	AA	Valerie White	Bonds were issued by Knoxville Community Development Corp. (KCDC) with a term of 20 years. An ABT allows KCDC to issue debt that maintains at least 3x coverage. Bond proceeds were used to finance accelerated renovation and repairs to two of KCDC's public housing family developments with more than 600 units in 170 buildings.
Tacoma Housing Authority, Wash.	Tacoma Housing Authority Capital Fund Program Revenue Bonds Series 2005	AA	Valerie White	Bonds were issued by the Tacoma Housing Authority (THA) with a term of 20 years. An ABT allows the THA to issue debt that maintains at least 3x coverage. These bonds could better withstand future cuts in the Capital Fund because debt service is expected to increase during the term of the bonds to an average of 4x coverage. The increase in debt service coverage is a result of hyper-amortization of principal during the first five years of the bond term. Bond proceeds will fund infra structure improvements in connection with the overall plan of the THA to develop a housing development known as the Salishan HOPE VI Project located in Tacoma, Wash.
Housing Authority of Portland, Ore.	Portland Housing Authority (New Columbia Trouton Financing) Capital Fund Program Bonds Series 2005	AA	Lawrence Witte	Bonds were issued by the Housing Authority of Portland with a term of 20 years. These bonds can better withstand future reductions in the Capital Fund allocations because of the extremely high debt service coverage of more than 8x throughout the entire transaction, surpassing 11x during the second half of the transaction. An ABT allows the authority to issue debt that maintains at least 3x coverage. Bond proceeds will fund gap financing for a mixed-income development, New Columbia, on the site of the former public housing development, Columbia Villa.
New York City Housing Development Corp., N.Y.	New York City Housing Development Corporation Capital Fund Program Revenue Bonds, Series 2005	AA	Valerie White	Bonds were issued by NYCHDC on behalf of NYCHA with a 20 year term. DSC for the transaction was estimated to be almost 15x though bond maturity and an additional bonds test allows NYCHA to issue debt that maintains at least 3x coverage. Bond proceeds will fund a loan from NYCHDC to NYCHA. Loan proceeds will fund certain improvements to numerous various public housing projects owned and operated by NYCHA. NYCHA is the oldest and largest public housing authority in the nation and NYCHA manages more than 163,000 units in almost 320 developments throughout the five boroughs of New York City.
District of Columbia Housing Finance Agency, D.C.	District of Columbia Housing Finance Agency Capital Fund Securitization Bonds, Series 2005	AA	Valerie White	Bonds were issued by DCHFA on behalf of DCHA with a 20 year term. DSC for the transaction was estimated to be at least 3x though bond maturity and an additional bonds test allows DCHA to issue debt that maintains at least 3x coverage. The 2005 bonds will fund a loan from DCHFA to DCHA. Loan proceeds will fund certain improvements to numerous various public housing projects owned and operated by DCHA.
Illinois Housing Development Authority, Ill.	Illinois Housing Development Authority Capital Fund Program Revenue Bonds, Series 2005	AA	Jeffrey Previdi	Bonds issued by IHDA on behalf of 5 participating public housing authorities (PHAs). The series 2005A bonds will have a term of 20 years and are supported by the following PHAs: Housing Authority of the County of Cook; Housing Authority of Joliet; Greater Metropolitan Housing Area Authority of Rock Island County; Lee County Housing Authority; Quincy Housing Authority. DSC for the transaction was estimated to be at least 3x though bond maturity for each authority. Bond proceeds will be used to expedite the modernization programs being undertaken by each PHA that are funded via annually appropriated capital funds. The extent of each PHA's modernization efforts differs, but typically will involve rehabilitation and improvement of existing units rather than the demolition and redevelopment of housing units.

Table 1: Public Housing Authority CFS Ratings (Cont'd)

Oversight agent	Published name	Rating as of Feb.1, 2006*	Analyst	Comments
Pennsylvania Housing Finance Agency, Pa.	Pennsylvania Housing Finance Agency's Capital Fund Bond Pool Series 2005A	AAA/Stable, AA(SPUR)/Stable	Valerie White	Bonds were issued by PHFA on behalf of seven participating public housing authorities (PHAs). The series 2005A bonds will have a term of 20 years and are supported by the following PHAs: Housing Authority of the County of Beaver, Housing & Redevelopment Authority of the County of Butler, Housing Authority of the county of Lawrence, Housing Authority of the City of Shamokin, Northumberland County Housing Authority, Housing Authority of the County of Lebanon, and Mercer County Housing Authority. DSC for the transaction was estimated to be at least 3x though bond maturity for each authority. Bond proceeds will be used to expedite the modernization programs being undertaken by each PHA that are funded via annually appropriated capital funds. The extent of each PHA's modernization efforts differs, but typically will involve rehabilitation and improvement of existing units rather than the demolition and redevelopment of housing units.
Meridian Housing Authority, Miss.	Meridian Housing Authority's Capital Fund Revenue Bonds	AA Series 2005 A&B	Valerie White	Bonds were issued by the Meridian Housing Authority (MHA). Initially, bond proceeds will be deposited in a guaranteed investment agreement provided by IXIS Funding Corp. guaranteed by IXIS CIB. Funds will remain on deposit pending HUD's approval of the mixed finance application associated with the project. Approval must be obtained within 120 days or the bonds will be redeemed in full. The series 2005A bonds mature in 2025. The series 2005B bonds mature on Sept. 1, 2007, which is reflected by the note rating. Bond proceeds partially fund a 72-unit new construction mixed-income rental property as part of the authority's mixed-finance HOPE VI redevelopment project.
Seattle Housing Authority, Wash.	Seattle Housing Authority's Capital Fund Program Bonds Series 2005 A&B	AAA, AA(SPUR)	Lawrence Witte	Bonds were issued by theSeattle Housing Authority for term of 20 years. Although the coverage level is a very strong 9.75x on the first series of bonds, the next two series of bonds are expected to decrease debt service coverage to 3.30x, at which point decreases in funding will result in over all debt service coverage closer to 3.0x. Bond proceeds will be used for various modernization projects at 21 developments, ranging in cost from $622,000 to $2.1 million. The total budgeted costs are approximately $34 million. The projects are expected to be completed by 2010 and include replacement of water lines and intercom, exterior masonry repairs, and repair and replacement of ventilation system and emergency call system. Other improvements include new finishes, furnishings, carpeting, lighting and hardware replacement, and the completion of previously funded elevator rehabilitation and boiler replacement. There will be no large-scale demolition or rehabilitation, and residents will not be relocated. The individual projects were determined based on a 30-year physical needs assessment. The projects are those that most need immediate attention or can be remedied with minimal expense. The authority states that the securitization of capital grant funding will enable it to reduce the time required to complete the projects to five years from 11 years. By dedicating a portion of the capital grant funds to cover debt service, the remainder can be used to meet needs at other properties.

* All ratings in this table carry a stable outlook.

Table 2: Previously Published Capital Fund Articles

Article title	Publication date
Public Finance Report Card: Public Housing Authority Capital Fund Securitization Ratings	March 21, 2005
The Evolution of Public Housing Authority Capital: Securitizations	Jan. 21, 2004

*Articles are available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com.

Long-Term Public Finance Credit Ratings

AAA	An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.
AA	An obligation rated 'AA' differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong.
A	An obligation rated 'A' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories, but the obligor's capacity to meet its financial commitment on the obligation is still strong.
BBB	An obligation rated 'BBB' exhibits adequate protection parameters, but adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.
BB	An obligation rated 'BB' is less vulnerable to nonpayment than other speculative issues, but it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions that could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.
B	An obligation rated 'B' is more vulnerable to nonpayment than obligations rated 'BB', but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation.
CCC	An obligation rated 'CCC' is currently vulnerable to nonpayment, and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitment on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation.
CC	An obligation rated 'CC' is currently highly vulnerable to nonpayment.
C	The 'C' rating may be used to cover a situation where a bankruptcy petition has been filed or similar action has been taken but payments on this obligation are being continued. 'C' is also used for a preferred stock that is in arrears (as well as for junior debt of issuers rated 'CCC-' and 'CC').
D	The 'D' rating, unlike other ratings, is not prospective; rather, it is used only where a default has actually occurred-and not where a default is only expected.
+/-	The ratings from 'AA' to 'CCC' may be modified by the addition of a plus or minus sign to show relative standing within the category.

HOW THE RATING PROCESS WORKS

Standard & Poor's follows a basic format in assigning a rating to an organization. From first request to publication, this is how our rating process works.

1. The Rating Request

When an organization first requests a rating, a Standard & Poor's analyst in that sector is assigned to head the rating team, and he or she schedules a meeting with management. Several weeks in advance of the meeting, the organization will be expected to provide the following information:

- Five years of audited annual financial statements;
- The last several interim financial statements;
- Narrative descriptions of operations and products; and
- Any other documentation that analysts deem pertinent to a particular rating determination.

2. The Management Meeting

Typically, a few weeks after Standard & Poor's analytical team has had an opportunity to review the materials and has identified the key analytical issues to be addressed, the team meets with senior management (usually the CFO or Treasurer). They review historical results, of course, but the focus is on the organization's future prospects. A meeting with a new issuer can last anywhere from two hours to as long as two days, depending on the entity's complexity, and addresses such issues as:

- The industry environment and prospects;
- An overview of major business segments, including operating statistics and comparisons with competitors and industry norms;
- Management's financial policies and financial performance goals;
- Distinctive accounting practices;
- Management's projections, including income and cash-flow statements and balance sheets, together with the underlying market and operating assumptions;
- Capital spending plans; and
- Financing alternatives and contingency plans, if any.

Management's financial projections are a valuable tool in the rating process, because they indicate management's plans, assessment of its own challenges, and roadmap for responding to its challenges. Management projections also depict the organization's financial strategy in terms of anticipated reliance on internal cash flow or outside funds, and help to articulate financial objectives and policies. All that being said, it nevertheless should be understood that Standard & Poor's ratings are not based on management's financial projections or management's view of what the future may hold. Rather, ratings are based on Standard & Poor's own assessment of the organization's prospects. Comparing the organization's projections with our analysts' own independent views of the organization's and industry's prospects also helps us to evaluate whether its management style is conservative, realistic, or aggressive. Facility tours for one or more analysts are often helpful, but not critical.

3. Standard & Poor's Review And Analysis

Once Standard & Poor's has held the Management Meeting, the lead analyst reviews and analyzes the information obtained, both quantitatively and qualitatively, in terms of business risks, such as growth and cyclicality; those risks peculiar to the organization's industry and competitive position within that industry; and the quality of the organization's management and accounting. Then the organization's financial risks are considered: its characteristics, policies, profitability, capital structure, cash flow and asset protection, financial flexibility, and liquidity. The committee's initial review process usually takes a few weeks and culminates in the Rating Committee Meeting.

4. The Rating Committee Meeting

A Standard & Poor's rating is never assigned by a single analyst. Instead, ratings are all determined by a committee of experienced analysts. The rating committee generally comprises five to seven members, including the primary analyst. When the meeting is convened, the members make a critical examination of the primary analyst's findings. The candid and complete analysis may take several hours, depending on the complexity of the entity. Only when everyone is satisfied that he or she understands the profile fully does the committee vote and assign a potential rating.

5. The Call To The Organization

One member of the analytical team then calls the organization to announce the committee's conclusion.

6. The Appeal Period

After Standard & Poor's has announced the committee's decision to the organization, the organization has a brief time, generally a day or two, in

which it may appeal the rating--but only if it can offer substantive, material information not previously available to the committee. The committee's final decision is then announced to the organization and to the media.

7. The Press Release

A press release is sent out to the media, announcing the rating, the rationale behind the rating, and the rating Outlook (our view of the organization's long-term prospects).

8. After The Rating Is Assigned: Reports And Ongoing Surveillance

The rating process does not end when the rating and Outlook are assigned; it is ongoing. Through ongoing dialogue with management, Standard & Poor's maintains surveillance on all the organizations it rates. If there is a specific event that Standard & Poor's perceives might have an effect on the rating, we review it immediately, and make an announcement either that the rating is being changed or placed on Creditwatch because of the event, or that we see no reason to change the rating at that time, in spite of the event. Absent material financial events, organizations are reviewed regularly and updated as necessary. In addition to providing a rating, analysts also prepare longer, more detailed research reports, which are available by subscription to the S&P information service RatingsDirect.

9. CreditWatch

When a specific situation arises that might affect an organization in the short term and about which Standard & Poor's lacks sufficient information, the organization's Outlook is withdrawn, and the organization is put on CreditWatch. A CreditWatch listing is an indication that we are waiting to see how the situation develops-such as we might in the case of a pending merger, acquisition, or lawsuit-before we make a decision about changing our rating and Outlook on the organization. CreditWatch may have positive, negative, or developing implications, but an organization stays on CreditWatch only until the precipitating event is resolved, usually less than a few months.

10. The Analytical Policy Board

Our Analytical Policy Board is our quality-control system. Standard & Poor's Analytical Policy Board consists of a thirteen-member board of senior criteria and policy experts: one member from each of our geographical regions (such as the U.S., Latin America, or Asia); one member from each business unit (such as Public Finance, Financial Institutions, or Industrials); a chairperson; an attorney; and a research assistant. The Analytical Policy Board's function is to monitor the rating process, so that we maintain a considered and consistent approach--across disciplines, national borders, and business units--and to oversee rating changes that are significant, either ecause some news or economic event has occurred or because a rating is being lowered or raised by more than one rating category at a time. The Board also initiates new criteria when appropriate, such as in response to newly created credit instruments.

11. Additional Information On The Rating Process And Rating Criteria

Additional, more specific information on Public Finance Ratings Criteria is available on our public Web site: www.standardandpoors.com.

Standard & Poor's Rating Process

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June 26, 2006

Via Electronic Delivery

The Hon. Michael R. Turner
Chairman
Subcommittee on Federalism and the Census
U. S. House of Representatives
U.S. Congress
2157 Rayburn House Office Building
Washington, DC 20515-06143

Dear Congressman Turner:

We are pleased to respond to the additional questions submitted by the Subcommittee, as follows. If you require any additional information, please do not hesitate to contact me.

1. *Can you further explain the "Line of Credit Control System" that you mention in your testimony? How does this insulate a bondholder against operating risk?*

The Line of Credit Control System (LOCCS) is the direct deposit method by which HUD distributes funding subsidies to public housing authorities. Under the Capital Fund Financing Program (CFFP), the PHA pledges its Capital Fund in the amount of annual debt service during the term of the bond financing to the trust estate. The legal structure of these bond transactions is such that HUD, through its LOCCS system, earmarks each year the first dollars of a PHA's Capital Fund allocation in the amount of that year's bond debt service for the trust estate and holds it--distributing the debt service payments typically in semi-annual disbursement directly to the Trustee. This insulates the bondholder because the funds are structured not to be in the possession of the housing authority and, therefore, not to be used for any purpose other than for what they were intended--a pledge to the trust estate.

2. *You also mention that in your ratings of PHA management performance, there have been instances where you have had to give low scores because of poor obligation and expenditure history, failure to complete contracts, high turnover and lack of institutional procedures. It sounds like S&P has the ability to rate performance of PHAs rather accurately.*

   a. *S&P and other rating firms have only applied these ratings when a PHA wishes to issue bonds. In your opinion, can S&P apply its ratings to the PHAs as a whole? In other words, could a credit worthiness rating be adapted or applied to rating the performance of the PHAs as whole?*
   b. *How would you do that and what factors, in general, would you look at?*
   c. *In your experience, what has been the general attitude of the PHAs about making the management, operations, and financial practices more transparent?*

As part of analyzing a CFFP transaction, S&P looks at those elements in the management and organizational capacity of a PHA that could impede its creditworthiness. S&P is concerned about the likelihood that a PHA can be sanctioned and lose some or all of its funding stream that is pledged to pay debt service.

There are a number of factors that lead S&P to determine that the management of the organization can likely sustain the practices necessary to maintain good credit quality. Strong codified and institutionalized management practices and procedures with a history of success generally support an organization's strong and positive credit quality. Successful organizational strategic planning along with completion of the tasks associated with supporting their long-term goals also tend to indicate that the PHA can successfully manage the elements associated with long-term bond financings and its obligations under its debt programs.

Standard & Poor's provides Issuer Credit Ratings (ICRs) for many types of organizations. These ratings provide an indication of an entity's general creditworthiness to fulfill their financial obligations. While we have not yet applied an ICR to any PHA, we believe that they would be a valuable tool for the PHA industry and are actively working on developing specific rating criteria. This criteria may be similar to that developed for United Kingdom housing associations, which have some similarities to PHAs, especially given their potentially expanded capabilities. S&P's U.K. housing analysis looks at business risk, including:

- ✓ Government support and regulatory framework, including ownership structure, legal status, history of government financial support;
- ✓ Business overview, strategy, diversification and development, including number and type of properties, location, geographic dispersion, markets served, development strategy, appraisal process;
- ✓ Governance and management quality; including role of the board and status of relationship with board and regulators, experience and tenure of senior and operational management, consistency and achievement of targeted goals, risk management strategy and funding strategy;
- ✓ Demand and competitive position, including local market conditions, socio-economic profile of clientele, affordability;
- ✓ Asset Quality, including portfolio configuration and potential changes; asset condition and overall quality;
- ✓ Operational performance, including scale of operations, operational efficiency and flexibility.

S&P's ratings of U.K. Housing Associations also take into account key financial risk factors, such as:

- ✓ Operating performance and the ability to generate sufficient operating margin in order to meet financial obligations, attract capital for investment and withstand business adversity, including operating margin, net margin and other financial ratios;
- ✓ Capital Structure, to assess borrowing levels, including loan to value ratios, income as a percentage of debt and debt per unit;
- ✓ Cash flow protection, the ability to service debt through the internal generation of cash, including funds from operations over total debt and other ratios;
- ✓ Financial flexibility, the ability to combat adverse financial conditions, including liquidity analysis.

In order to arrive at an ICR, S&P relies upon documentation from the issuer and conducts on site property inspections and interviews with key personnel. Our experience working with PHAs thus far reveals that responsiveness on the part of PHAs varies. In general, larger, more sophisticated PHAs, which have been in the bond market, for example, are used to providing this type of information and do so with relative ease. Smaller PHAs with limited staff may find this challenging, especially if they do not have institutional practices and processes and access to critical reports and documentation.

3. *You mention that PHAs as a group seem reluctant to move forward with bond financing or other financing options for a variety of reasons (e.g., lack of familiarity with the marketplace, negative impact on funding, and potential liability).*

    a. *Can you expand your thoughts on these reasons?*
    b. *In your opinion, what can be done to alleviate these concerns?*

These remarks were based on our observation of the small number of PHAs which have issued bonds individually or collectively, as well as anecdotal information from discussions with PHA personnel,

Mr. TURNER. Mr. Tracey.

STATEMENT OF BRIAN TRACEY

Mr. TRACEY. Good morning. On behalf of the 200,000 associates working at Bank of America, thank you for the opportunity to share our thoughts today on the use of private capital for public housing. As the national leader in community development, Bank of America works to help build stronger and healthier neighborhoods throughout the country. In support of public housing, Bank of America acts as a lender, an investor and a real estate developer, working with housing authorities in more than 30 States. During the last 10 years, Bank of America's provided more than $500 million in debt and equity for over 40 PHA mixed-finance transactions. Our company has also been a leader in structuring capital fund financing program bonds, which allow PHAs to use lower-cost tax-exempt debt to accelerate improvements to public housing properties, providing about one-third of all private capital supplied to the Nation's housing authorities using this technique. This private capital often leverages more limited public funding, multiplying the benefit of public investment typically four to sixfold.

Clearly, public housing benefits from access to private capital. Here's an example of how we've worked with one local agency to combine Federal housing support with a range of public and private resources to benefit low-income residents. Northwestern Regional Housing Authority serves a seven-county area in western North Carolina. Recently acting as a sole developer, Northwestern completed 40 rental apartments for very low-income seniors in Elk Park. This transaction involved the acquisition and conversion of a historic school building and a total cost of almost $5 million. Northwestern leveraged a mix of public and private funding sources, including project-based Section 8 operating support, low-interest financing from the North Carolina Housing Finance Authority, permanent financing through the Federal Home Loan Bank, AHP program and low-income housing tasked equity construction financing and State and Federal historic tax credit funding all provided by Bank of America as lender and investor.

Northwestern's Elk Park development demonstrates the possibilities of alternative sources of funding not always used by housing authorities, but this success is far from commonplace, and many aspects of the current regulatory and funding environment distinctly limit what lenders and investors, such as Bank of America, can accomplish today.

What are these limitations, and how they can be changed? A few thoughts, a few recommendations. Congress and HUD should provide stable and predictable funding for public housing. Northwestern's success at Elk Park would not have been possible without an expectation of predictable Federal funding on the part of the housing authority's financial partners, and recent proposed and appropriated funding trends for public housing have undermined private sector confidence and the stability of many of these programs. HUD should also implement consistent standards for common types of transactions involving private capital and public housing. Today, HUD approves every public housing capital grant

financing and every public housing transaction involving the low-income housing tax credit on a case-by-case basis largely centered here in Washington. Approvals are often very long and coming even in instances where HUD has approved transactions previously using substantially identical documentation.

HUD, working with the private sector, should craft a series of clear, reasonable so-called safe harbor standards for approving transactions. This safe harbor approach will help create a more entrepreneurial climate for public housing authorities where they can predictably access the full range of financing tools used by private developers. One last recommendation, HOPE VI funding should be restored to the levels prevailing 3 years ago. Bank of America, in its experience, has seen HOPE VI funding improve not only the lives of public housing residents, but also act as a catalyst for economic development resulting in private capital flowing to the stressed areas adjacent to the public housing community. One such example is Capitol Park in the Peace College area of Raleigh, NC. This mixed-income, mixed-use community developed by the Raleigh Housing Authority as sole developer now includes both rental and single-family homes, a community center, daycare facilities, a charter school and a commercial office building where once was an isolated 25-acre complex of poorly designed public housing.

So who benefits from the use of private dollars to fund public housing? Well, first and most importantly, we believe the public housing residents benefit through more money sooner to improve both their homes and their neighborhoods. Second, the broader community. As private capital is attracted to the blocks surrounding public housing developments and finally our government and taxpayers by efficiently leveraging government dollars with private capital to accomplish more with the same amount of public funding.

Thank you, Mr. Chairman and members of the subcommittee, for the opportunity to make these observations today. Thank you.

[The prepared statement of Mr. Tracey follows:]

Testimony of Brian Tracey, Senior Vice President, Bank of America
before the
House Government Reform Subcommittee on Federalism and the Census

"Public Housing in the Competitive Market Place:
Do Affordable and Public Housing Developments Benefit from Private Market and Other Financing Tools?"

May 23, 2006

Good morning. I'm Brian Tracey. On behalf of the 200,000 associates working at Bank of America, thank you for the opportunity to share our thoughts on private capital in support of public housing.

As a national leader in community development, Bank of America works to help build stronger and healthier neighborhoods throughout the country.

Bank of America associates are developing real estate, providing financing and making equity investments, using a variety of financial tools and programs in working with individuals, government agencies, nonprofit organizations and businesses. A significant part of this work involves partnerships with local public housing agencies.

In support of public housing, Bank of America is a lender, an investor, and a real estate developer, working with housing authorities in more than thirty states.

During the last ten years, Bank of America has provided more than $500 million in private debt and equity capital for over forty PHA mixed-finance transactions. Our company has also been a leader in structuring capital fund financing program bonds, which allow PHA's to use lower-cost, tax-exempt debt to accelerate improvements to public housing properties. Bank of America, primarily through its affiliate, Banc of America Securities, has provided about one-third of all private capital supplied to the nation's PHAs using this technique. Working with HUD, we pioneered this structure five years ago with a $33 million loan to the housing authority here in Washington.

The capital we have supplied to public housing has often served as an important leveraging resource for limited public funding – multiplying the benefit of public investment four to six fold. While these leveraged dollars benefit public housing, they also help nearby neighborhoods and the larger community. Clearly, public housing benefits from access to private capital.

Here's an example of how we have worked with one local agency to combine federal assisted housing support with a much wider range of public and private resources to serve low-income rural seniors:

Northwestern Regional Housing Authority is a rural housing authority serving a seven-county area from its head office in Boone, North Carolina. This smaller agency has successfully completed several housing projects, acting as the sole developer, and using a variety of funding sources, including the low-income housing tax credit.

For example, two years ago, Northwestern completed development of 40 rental apartments for very low-income seniors in Elk Park, North Carolina. This transaction involved the acquisition

and conversion of a historic school building at a total cost of almost five million dollars. To carry this out, Northwestern leveraged a mix of public and private funding sources, including:

- Project based Section 8 operating support;
- Low-income housing tax credit equity, provided by Bank of America;
- A construction loan, (also from Bank of America);
- State and federal historic tax credits. Again Bank of America served as investor;
- A subordinate, low-interest loan from the North Carolina Housing Finance Authority;
- Low-interest permanent financing through the Federal Home Loan Bank of Atlanta's AHP program, with Bank of America as the sponsoring lender.

Northwestern's Elk Park development demonstrates that leveraging and an entrepreneurial approach are relevant across the size spectrum of PHAs. The development also shows the importance of looking to sources of funding not always used by housing authorities – including historic tax credits, funding from the Federal Home Loan Bank, and various lending programs offered by state and local governments.

But this success is far from commonplace. Many aspects of the current regulatory and funding environment distinctly limit what lenders and investors, such as Bank of America, can accomplish today.

So, what are these limitations and how can they be addressed? A few recommendations:

- Congress and the administration should support and provide predictable, stable funding for public housing and other programs seeking increased levels of private capital.

  None of Northwestern's considerable accomplishments at Elk Park would have been possible without an expectation of stable federal funding on the part of the housing authority's financial partners.

  Recent proposed and appropriated funding trends for public housing have served to erode private sector confidence in the stability and durability of these programs. This includes the public housing operating fund, and the capital fund. Similar success stories are threatened.

  With such declining confidence, the ability of local communities to leverage limited federal funding will decline.

  By contrast, with stable funding, there is an even more significant role for private capital to play in public housing.

- This Subcommittee and the Congress should encourage HUD to work with experienced stakeholders to implement "safe harbor" standards for common types of transactions involving private capital and public housing.

  Today, HUD approves every public housing capital grant financing and every public housing transaction involving the low income housing tax credit on a case by case basis largely centered here in Washington.

Approvals are too often very long in coming – upwards of a year in some cases – even in cases where HUD has approved transactions using substantially identical documentation.

While some transactions and some PHAs benefit from this type of extraordinary close scrutiny, many do not. There are no exceptions for "high performing" PHAs.

In addition to the obvious costs of delay, the currently prevailing approval environment discourages all but the most patient private sector players from seeking opportunities to engage with public housing.

To correct this problem, HUD, working with experienced stakeholders, should implement a series of clear, reasonable "safe harbor" standards for mixed finance, for capital and operating grant finance transactions.

The "safe harbor" approach suggested here will nurture a more entrepreneurial climate for public housing where they can predictably, and more efficiently, access the full range of financing tools typically used by private affordable housing developers.

HUD also needs to provide adequate staffing to expedite the review and approval process. HUD should consider using staff from other HUD program areas to support this effort. The Congress should support such staffing commitments.

- This Subcommittee should promote widespread simplification of existing public housing regulations.

  Too much of public housing's regulatory environment is complex, excessively proscriptive and expensive to administer.

  The emphasis here should be on core program outcomes (income targeting, affordability, availability) while allowing for considerable local flexibility and innovation on how those outcomes are achieved.

- Congress, working with the administration and other stakeholders, should adopt legislation which would permit property based financing in public housing.

  In our nation, substantially all multi-family residential real property finance is "property based."

  This means that the property receiving the investment is available as collateral security to creditors and that most or all property related debt is paid from property operating income. This system works quite well and attracts considerable private capital for all types of market rate properties and for many types of affordable properties.

  Public housing remains the big exception to this rule.

  The bi-partisan Millennial Housing Commission and the Congressionally mandated Harvard Public Housing Operating Cost Study both suggested that public housing needed to join the affordable housing finance mainstream by gaining the ability to effect property based financings.

Also, the administration has twice proposed legislation for a "Public Housing Reinvestment Initiative" which would permit property based financing for public housing.

A number of coordinated changes to existing statutes and regulations governing public housing will be necessary to bring property based financing to public housing.

While we are not today endorsing any specific proposal in this area, we believe that federally assisted housing for the nation's poorest citizens – those who reside in public housing - would benefit from a shift to a more property-based financing scheme, typically used by the rest of the affordable housing industry and by market-rate multifamily housing generally.

- HUD should encourage housing authorities to act as entrepreneurs, adopting private market financing methods and tools. HOPE VI has in many instances had this effect. Funding for this critical program should be restored to the levels prevailing three years ago.

For more than a decade, HOPE VI has been an important tool to leverage private investment in mixed income housing. Throughout the country, Bank of America has seen HOPE VI funding improve not only the lives of public housing residents, but also act as a catalyst for economic development, resulting in private capital flowing to distressed areas adjacent to the public housing community. This multiplier effect, often overlooked in judging the success of HOPE VI, can be seen in many HOPE VI developments.

One such example, in North Carolina, is Capitol Park, in the Peace College area of Raleigh. This mixed-income, mixed-use community, developed by the Raleigh Housing Authority, now includes both rental and single-family homes, a community center, daycare facilities, a charter school, and a commercial office building, where once was an isolated 25-acre complex of poorly designed public housing.

Adjacent to the site, vacant tracts of land and older, existing houses were purchased by private investors and developed or renovated into single-family homes. Peace College, a private two-year institution, expanded its campus toward the former public housing site, purchasing several undeveloped acres, which had formerly served to divide the community. And Pilot Mill, once a vacant and blighted warehouse before the HOPE VI redevelopment began, now contains residential condominiums, office space and a charter school.

HOPE VI funding serves as the catalyst which makes possible this kind of comprehensive revitalization, transforming not just one block, or a few houses, but an entire neighborhood, an approach to revitalization that magnifies and accelerates improvements in the quality of life in a community, using not just government funding, but a much larger amount of private capital as well.

To conclude, we should ask: "Who benefits from the use of private dollars to fund public housing?"

First, and most importantly, the public housing residents, through more money, sooner, to improve both their homes and their neighborhoods;

Secondly, the broader community, as private capital is attracted to the neighborhoods surrounding public housing developments;

And finally, our government and taxpayers—by efficiently leveraging government dollars with private capital to accomplish more with the same amount of public funding.

Thank you, Mr. Chairman and members of the Subcommittee, for the opportunity to make these observations.

Mr. TURNER. Thank you. Mr. Tracey, I'm going to start with you. In turning to the issue of the low-income housing tax credit, I have a couple of questions that are issues that you've not really raised. My experience has been that for Low-Income Housing Tax Credit Program, the participation by banks as investors or purchasers of low-income housing tax credits themselves has been really essential for this success. If you look industry-wide, the participation by other sectors of businesses who could be investors for the tax credits is very minimal. My understanding of part of the reason for that is not just the great expertise that banks have in being able to wade through the technical requirements but also the Community Reinvestment Act incentive that is there for banks. I would like, if you would, please, talk about that for a moment and the Community Reinvestment Act's incentive for banks to participate. And then second, which is the real crux of my question is, once the Community Reinvestment Act was an incentive for banks to participate in low-income housing tax credits, today are you experiencing enough of a return? Are the projects profitable enough for the bank? Is your participation in it now for just basic business principles independent and sound enough that you would continue that even without the Community Reinvestment Act by impacts?

Mr. TRACEY. That's a very interesting question, and I think clearly historically as the creditors evolved, we've seen more private capital, primarily through banks, however, attracted to the low-income housing tax credit. As a result, on the one hand, it's become a much more efficient credit so prices of the credit are now increased to some cases approaching or exceeding $1 whereas 20, 25 years ago it was much lower than that. So we've seen additional private capital flowing in.

Now, how much of that is a function of Community Reinvestment Act, and how much is it a function of the attraction to that return? I can't really quantify that. I've never seen any type of statistical analysis trying to differentiate between the two. We are clearly driven in our low-income housing tax credit approach by the requirements of the CRA. At the same time, the returns—and we define returns probably a bit differently, more broadly in the use of the credits—are still attractive enough that we're getting positive overall yields from our portfolio. When I say returns, we're looking at the definition of return as also including the other business opportunities to credit drives for us as a financial institution, which is the opportunity to provide construction and permanent financing to those developments that benefit from the tax credit.

One other observation, again, because of the increased private capital flowing into these markets, the returns on low-income housing tax credits are actually quite low, and in some instances, approach the yield for similar type Treasury investments, and the concern we have is clearly there is a difference between the risk in a low-income housing tax credit investment and the risks investing in U.S. Treasuries. We're not quite sure what to make of that in the financial markets. I think some could say, well, that's the effect of the CRA, driving down returns because there's a nonfinancial component of why private capital is attracted to those investments.

Mr. TURNER. Thank you so much for your answer. That was an excellent answer. Very tough topic and very well described. Once the investment is made, the issue has been raised of the exit tax, if you will, of once the purchaser of the tax credits becomes an investor in the project and the period of time in which the tax credits have expired and the abilities of the investor to exit the project, then it incurs a tax consequence. Can you talk about that for a moment, because we're getting our inquiries as to ways that we might be able to modify.

Now that some of these projects are maturing and the investors have their investment there and wish to exit the project, could you speak about those tax consequences and if you have any suggestions as to how that might be addressed?

Mr. TRACEY. Well, I'm not a tax expert, but it is an issue, and we rely very heavily on others in the industry that are studying this issue. I know there's a group that we support, a small collection of developers, attorneys, financial professionals called the Institute for Responsible Housing Preservation. It's based here in the District, that is studying this issue. We've had several meetings with officials at HUD to talk about specifically the exit tax and proposals for exit tax relief. Other industry groups, National Housing Conference, for example, is also focused on this issue. This is becoming more of an obstacle to the preservation of affordable housing as tax credit projects that were done early in the life cycle of the credit now either have expired or are approaching the end of the compliance period. And I'm not prepared today to give any recommendations to that effect, either than just refer you to the same industry professionals we look on for advice.

Mr. TURNER. Thank you. Mr. Clancy, do you have any comments about the issues of the exit tax?

Mr. CLANCY. The exit tax relief, if applied broadly, could be extremely valuable, but it is an expensive item. What we have been able to utilize in our attempt to preserve some affordable housing assets where owners are facing exit tax but want to sell is if, in fact, the value of the property has gone up to some degree as a nonprofit, we've been able to structure transactions where a charitable contribution, a bargain sale can be structured where the investors get a charitable contribution for contributing their interest and that deduction can help offset the exit tax and provide relief.

Now, that requires the property have value that there be enough value in the property, that, in fact, that's a legitimate deduction that, in fact, they are, in turning over the property, giving over value, but I think that mechanisms like that could be further developed in ways that might avoid the large-ticket expense of broad-scale exit tax legislation, which we in the industry have been talking about for about 15 years, but you know, obviously the Congress has not seen fit to enact, given the price tag involved.

Mr. TURNER. Mr. Clancy, you raised a number of issues in your testimony concerning transitioning funding in programs to a competitive basis. As you are aware, there are a number of communities that have varying levels of expertise and varying levels of access to expertise. A city like Chicago is going to have individuals even beyond the public housing sector who are going to have complex financial transaction experience, complex real estate and legal

experience that may not be easily found in communities where we have public housing and where that public housing needs to be remedied.

You have been highly successful and, as you know, I've toured some of the wonderful transformations that you've been a part of that have occurred in Chicago. I'm wondering if you might, for a moment, please describe to us some of the types of expertise that you think are necessary in order to be successful. As we look to what assistance communities are going to need, part of it is funding. I noted the commonality of stability of funding that was in each of your risks. I wondered if you had all compared notes before you got here, but I assumed not. But that level of expertise is also an issue that is necessary even beyond funding. And to just highlight this, as you are aware, part of the problems in continuing HOPE VI funding is the belief by some members that HOPE VI funding has not met the level of expertise and performance that we've seen in other communities. So I'd love your thoughts on that.

Mr. CLANCY. Well, I think that the substantial majority of effective HOPE VI production over the last 10 years has happened in public-private partnerships between housing authorities and development actors with experience in utilization of tax credits, utilization of forms of debt and equity that get combined with public housing capital. Those development actors—because HOPE VI itself is a complex program and is layered on top of tax credits—you're absolutely right that the actors with the sophistication to carry out that kind of a complex financing there tend to be many more of them in large cities than in smaller cities.

I think that this is less true today than it was 10 or 15 years ago, and the industry has reached a certain level where many of the lawyers, many of the accountants, many of the smaller developers who were involved in doing affordable housing have had some degree of experience with public housing capital sources and could—particularly if some of the recommendations on looking at ways to streamline and simplify some progress could be made—could be brought into utilizing those resources.

I think one of the key requirements, Mr. Chairman, that is often a complicated one, is the way in which housing authorities reach out to the private sector and the complex procurement regulations of the department, and oftentimes again, why I recommended reinstituting planning grants, often times housing authorities don't quite know what's possible with a given site and so how do they reach out for a private partner when they don't know what they're reaching out for?

So there needs to be an understanding and there needs to be support from HUD, which I think in the early years of the HOPE VI program, there was for housing authorities to be able to understand how they can procure a partner, how they can acquire the expertise to enable them, even if they're a smaller authority to utilize the same kind of techniques that larger cities are able to use. I think that's very possible to do.

Mr. TURNER. Ms. Dolber, in looking at your written testimony and your comments, both my staff and myself are curious about the issue that you have raised for pooling of resources and in looking at how that is accomplished. You're talking about PHAs, having

used HUD's capital fund financing program and the pooling have been accomplished ranging from two PHAs to 35 PHAs. Could you just describe this process? Obviously, the lack of a clear relationship between the public housing authorities and, as you have raised in your comments, the issue of funding sources just raised several questions about that whole process. If you could elaborate, I'd appreciate it.

Ms. DOLBER. The pool financings—the way they work is that a group of PHAs will issue bonds collectively. So instead of each one going out with, let's say Norfolk Housing Authority will go out and do a $2 million bond transaction on its own, pay over costs of issuance, and all the other—the costs associated with doing that, they would team up with a number of other housing authorities in the State, and they would do it together.

So therefore, the cost of issuance is spread out among all the different housing authorities, and typically these are put together by an FA an investment banker or a State housing finance agency, as Pennsylvania Housing did, who will corral all the PHAs together and bring them into the financing. And the way that it works is that they will pledge their capital funds, you know, together, but their capital—Norfolk is only going to be used to pay for Norfolk's obligation, and if it had excesses available, it's not going to help any other housing authority. So they—there will be a debt service reserve fund that anybody, you know, could use to pay debt service, or the trustee will use to pay debt service, but there's no fungibility among the PHA funds, and that's fine, but it's a very rateable transaction. It sells well on the marketplace, but what it—what it doesn't allow is for a public housing authority that doesn't have as much capital funds to bring to the table. They might be—not be able to participate in the financing.

Mr. TURNER. So it lowers their cost, but not their risk?

Ms. DOLBER. That's right.

Mr. TURNER. At this point, I'll turn to Mr. Clay for his questions.

Mr. CLAY. Thank you, Mr. Chairman. I'll start with Mr. Clancy. Welcome. Although our public housing authorities have longer waiting lists than ever, there's no longer one for one matching requirement concerning the demolition and reconstruction of low-income housing units. Doesn't this pose a threat to those already on a waiting list for public housing? And what long-term solutions would you offer to the shortage of units available?

Mr. CLANCY. I think obviously there are huge funding challenges that, as somebody committed to supporting good housing and good supports for low-income families, particularly in urban areas, I'd feel the lack of resources is an outrage. To talk more particularly about what happens in the demolition of public housing and its replacement, our experience has been—has been mixed. One of the interesting things that happens—if you focus on the families that are in the public housing itself, often times when we get involved, the housing authority's already planned for demolition of the public housing, has already relocated a lot of families, and they'll be in other places and then they're offered, oftentimes, a chance to come back, oftentimes with requirements like work requirements, for example, in the city of Chicago.

What's interesting is that a lot of the families that actually have moved have been relocated out of a public housing site don't want to come back, even when you build a really attractive, you know, first-rate mixed-income environment. It's not always the case, but what happens many times is again, a lot of these developments have been very distressed. There've been environments that people who have stayed in those environments are people who don't have a choice, and even though people who have been relocated may have been given a voucher or something else that is not necessarily a stable, long-term fixed asset in terms of affordable housing, and so it gives us all concern. Yet for that family, that relocation that they went through, 9 times out of 10 has been a positive experience, compared to where they were living.

Now, you created a whole new environment, and so it's a whole new day, but many times the history of having lived in that environment when it was a bad environment and the fact that a family may be stably settled in another neighborhood, they don't want to come back. What's more important, I think, is to really focus on the families that are there, the families that want to make a transition to the new community, and there's a real timing challenge there, because supporting a family that has been on public assistance for perhaps two generations to meet a jobs requirement, I mean, you're talking about needing to work with a family over an extended period of time, needing to deal with a lot of very intractable social challenges that family faces to enable that family to really become a strong part of that future community.

And I think one of the disconnects is that we don't always sustain the attention to that effort in these redevelopments, and while we create a mixed-income community, I think it's critically important that, you know, over 3 years, over 5 years, over 10 years, the kind of public education that happens in a neighborhood, the kind of support for families to get jobs and to get better jobs need to be sustained and maintained to really be of service to those—to the low-income families that really are the core of the mission of the transformation effort itself.

Mr. CLAY. You mention relocation with voucher and Section 8. Do you have any examples of some creative relocations, such as a first-time homeownership?

Mr. CLANCY. I'm aware of limited amounts of that. There has been some, certainly, for example, in Chicago where we're working, we are in the first phase of home ownership that's happening right now. There are, I believe, a handful of public housing tenants that are going into ownership units in the new mixed-income community. That's a very small number in a large community, but at least it's a start. Again, I think that what we expect, actually, in Chicago where it's a 3,000-unit total build-out, mixture of rental and sales is that we hope that a number of our public housing families that come in as rental families over time will graduate to ownership units within the same community, and we're trying to basically end up with a community that has that kind of escalating opportunity for those families.

Mr. CLAY. Thank you for that response, Mr. Clancy. Ms. Dolber, how can your agency factor in the reliability of Federal support of public capital financing programs when Congress and the adminis-

tration are constantly at odds over its value? And are tax credits over a 5 or 10-year budget window more reliable for establishing the creditworthiness of a PHA? Two questions.

Ms. DOLBER. I can answer the first question. I didn't really understand the second question about tax credits.

Mr. CLAY. Let's try the first one.

Ms. DOLBER. OK. I think what you're talking about is the risk of appropriations and the declining of appropriations every year and how we view that, is that right?

Mr. CLAY. Yeah.

Ms. DOLBER. All right. That's a great question. When we first did our rating in 2001, the industry was able to supply us with a lot of very good information about the history of the appropriations. And so we were able to look at it and feel that we knew what the track record was, and that in order to make sure that service could be paid, we look for excess coverage.

So we got comfortable with a lot of the mechanisms that have been put into place at that time, like negotiated rulemaking and, you know, things that would allow us to predict what level each individual PHA might get that we would look at in a financing. Now we knew that in years to come, it could be possible that appropriations could be cut, and that's why we look for excess coverage. Without the excess coverage, there's no way that the bond issues that we raised would have been investment grade.

Now, in the last 6 years or 5 years, every single year appropriations have been cut. That definitely got our attention. We watch it very closely, and we really did ask ourselves a question, do we have to downgrade the bonds? It's very difficult for us to put our finger on, what is the level of the Federal Government's support for public housing finance? It's clear the support for public housing, but what about public housing finance? Because there's really no one from the Federal Government that's going to say to us, don't worry about it, everything's going to be OK.

So we have to look at what's actually happening out there. So what we did, we created a stress test, and in order to affirm our ratings, we had to anticipate that the funding cuts would continue every single year as long as the bond issue went on. And we made sure that debt service would be paid irregardless. So what I'm saying is that if we could—because the excess coverage was there, we could factor it into our rating. However, the track record that we've been looking at is changing. We looked at a pretty stable track record and a pretty strong track record, and now we have a more questionable track record. So the question is, what's going to happen in the future if cuts continue, are we still going to feel that there's a strong track record?

Mr. CLAY. Let me reword the second question there. It's a follow-up to what you said. Would the S&P view tax credits like, the low-income tax credit as more reliable than appropriations for PHA ratings?

Ms. DOLBER. Well, it's a different mechanism that we usually see coming into a transaction at the beginning, and putting money on the table, if you will. And we look to see how those funds—from the sale of the tax credits are going to be used in the financing, you know, sometimes they're used in development costs. So this is

where they reduce the amount of bonds that have to be issued. So that type of mechanism where money comes in up front and it's on the table, but there are things that can affect whether it's going to continue, whether the tax benefits of the tax credit are going to continue don't really affect our ratings.

In a sense, because the money is already there, it affects the tax credit investor because they could lose their tax credits. So if we're rating an issue that's based on the performance, for example, of the tax credit investor, which we sometimes do, we have to be concerned about what's going to happen if it loses value for them and they're not going to be there the way we expected them to be there, and usually we expect them to be there and—I mean, a lot of tax credit investors have actually put money into properties, and that's something—because there's a question about what could happen, we give what I would say soft credit to that.

Mr. CLAY. Thank you for that response. And my last question is for Mr. Tracey. Welcome. Are State housing authorities providing adequate lending options to local authorities who may not have the technical or economic base to access markets along—and please explain how utilizing property and financing can expand the options available to public housing authorities.

Mr. TRACEY. When you mention State housing authorities, housing finance authorities, the issuance of bonds?

Mr. CLAY. Yes, yes.

Mr. TRACEY. Thank you. Thank you. I would say generally, yes. Our experience has been favorable across the country, working with State housing finance agencies. Again, we're looking for much the same as we had referenced consistency, predictability, not so much of the funding but of the processes themselves because that makes us more comfortable devoting resources, people resources, financial resources to certain markets. If we have a framework for working with various State agencies in the issuance of bonds where we—I won't mention any particular jurisdictions, but where we've had difficulties is where the rules change, and the rules change frequently.

And that creates a hindrance for us in order to provide our capital. What we're always looking for is additional places to use our resources and support community development, whether that be by providing construction financing, use of taxes and bonds or permanent financing by buying those bonds, creating secondary markets attracting other capital to purchase those bonds. So anything that adds or anything that, rather, reduces the friction in those markets, eases costs of transactions, makes us more comfortable, more likely to put private capital into those particular jurisdictions.

Mr. CLAY. Thank you for that response. I yield back, Mr. Chairman.

Mr. TURNER. We acknowledge that we've been joined by Charlie Dent from Pennsylvania, and Ms. Foxx from North Carolina.

And Mr. Clancy, I'm going to ask you a question that is somewhat off topic, but I'm going to explain, ask you the question so that you will understand why I'm asking it to you. Whenever we look at the issue of community development in addition to process and expertise and financing, there's also public policy theory that gets overlaid on everything that we do; and in that discussion of

topics of public policy theory, from that, programs are designed, and rules are established that can restrict or that can permit the various types of development.

One of those public policy theories that has been bantered about is the issue of public housing land and whether once public housing has been established on a piece of land, whether or not that piece of land shall therefore forever be public housing land.

I happen to be of the opinion that with communities in shifting both in the location of populations, the shifting of even employment centers, the shifting and transportation routes, school populations, construction of schools and response to populations, but as a theory, that it is overly limiting for us to say that once public housing has been established on a piece of land, that it shall forever be public housing land. Our goal of providing affordable housing should not be tied to a historical decision that was made at another point in time when a community had other development factors.

I was wondering if you might have an opinion on that, knowing the creative things that are occurring in your community and the shifts that have occurred in populations, if you believe that affordable housing needs can be addressed without overly restricting once public housing land.

Mr. CLANCY. Affordable housing needs, I think, can only be addressed effectively if, in fact, one is continually attentive to market forces and market dynamics, and that is, as you describe, Mr. Chairman, a shifting dynamic, value-shift in neighborhoods and property needs to be looked at in a very dynamic market-oriented way. I think that often people who espouse the theory that you are alluding to are really concerned about the extent to which there's long-term commitment to serving the poor, and whether there's some place, you know, some way to nail that down so that the commitment doesn't get extinguished inappropriately.

And I support that 1,000 percent, philosophically, ideologically, morally, and on a million other levels. But as a real estate professional, I think it's a huge mistake to take that to one-for-one replacement or to take that to tying land, let's say, to a particular use. The whole point is, you've got to be able to capture market values. You've got to be able to utilize those values to support a diverse population, and that's, you know, very much the centerpiece, I think, of our approach.

If I could come back to an earlier question that you asked, because I had a further thought afterwards, smaller localities getting the sophistication to utilize a program like HOPE VI, you know, what are the things that HUD has done very successfully over time when the HOME Program first got passed, CPD, the Community Planning and Development section of HUD put out a series of technical assistance contracts to organizations that then could work nationally with different localities in apprizing them of how to utilize the HOME Program to make them more able to be effective in how they designed local use of HOME. The same thing could be done to assure that localities—smaller localities, particularly, can acquire the expertise to utilize HOPE VI, and HUD could allocate some dollars for technical assistance out of public and Indian housing that could support smaller authorities in that effort in the same way.

Mr. TURNER. Mr. Tracey, similarly, I'm going to ask you a question that is more subjective. You had talked about the issue of the cumbersomeness of the process. And a great recommendation when looking at a safe harbor process where people could be not on a case-by-case basis waiting for approval, but know specifically the area of something that is a cookie cutter-type development that has occurred before a certainty of approval and a timeline for approval.

So many times when we look at government bureaucracy, it can fall into two different categories of impact. One is cost, and another is just straight out barrier to entry, meaning that the cumbersomeness is so great that the expertise required is a barrier for those who might otherwise enter it.

Cost increase is something that the government can just continue to subsidize undesirably, but nevertheless we can. Barrier to entry, though, is something that rises to the level of completely thwarting our ultimate goal and objective. Knowing that the banks with the CRA have not only the cumbersomeness but incentive to go through the process, I wonder whether or not you believed that, in many instances, the types of cumbersomeness, the processes that you're seeing, rise greater to the level of just cost, but actually thwart our ability to bring people into the process.

Mr. TRACEY. Well, actually, I do think that some of the issues that have been raised by all of the panelists today do result in barriers in entry, and not so much entry into community development as a whole, but rather pushing resources into a more certain and predictable area of community development.

That's likely one of the reasons why yields are so low and declining in low-income housing tax credits because that is a more certain or predictable program. It has a history. Many players have been involved in that market for quite a number of years. Our experience, I think, on working with capital grant financing could also help illustrate the point. Our company was involved in structuring the very first cap grant financing which was a taxable loan to the D.C. Housing Authority here in Washington.

And QHWRA had been around since 1998. We closed our transaction, I think, in 2000. So it took 2 years for the first transaction to be closed after the legislation had been enacted that enabled that type of financing. Two years is a long time in the finance industry.

One of the issues was that there was no standard, no safe harbor for what the transaction would look like. We were making that up as we structured the financing with HUD and the D.C. Housing Authority. The one point that was still unsettled very close to closing was the degree of leverage permitted, which is a critical point. How much of the cap grant payment stream would HUD permit the D.C. Housing Authority to borrow against?

As those types of issues became resolved, then we've seen the market evolve; and private capital flows in; and instead of more expensive taxable financing, which was what we were able to put together 5 years ago, now we're in the tax exempt arena with lower transaction costs on a pooled basis and so forth. All of that should have been compressed, though, into a much shorter timeframe rather than taking the 5 to 6 years that it did for that market to evolve.

And with consistent standards up front, more parties would have been attracted to that type of structure; and again, the lack of consistent standard of framework for that particular financing structure, you know, it wouldn't have acted as a barrier to entry.

In 2000, Bank of America, D.C. Housing Authority, we were pretty much it, even though the legislation had been on the books for 2 years.

Mr. TURNER. Thank you for that. I want to recognize Mr. Dent.

Mr. DENT. Thank you, Mr. Chairman. Thank you for holding this hearing. Thanks, too, to our panelists.

Mr. Clancy, over the past 20 years, one of the better Federal incentives for private investment in affordable housing has been the Federal low-income housing tax credit. Many hundreds of units of affordable housing have been constructed and developed in my district because of this Federal initiative. However, over the past few years, that production has dropped off to near zero. What kinds of changes to the tax credit program would you recommend to strengthen that program?

I'd like to start with you, Mr. Clancy. If any others have an opinion. I would be pleased to hear that.

Mr. CLANCY. It's a multifaceted answer. And let me try to—the reason why production would have tailored off to zero in your district, I suspect, has more to do with some of the other resources that are necessary to make a tax credit project feasible. The tax credit program itself has continued and, as Mr. Tracey has said, has actually gotten somewhat more efficient over the last few years; but most tax credit developments have either significant—for example, in Pennsylvania, the State HOME Program of PHFA or local Community Development Block Grant or other resources going into the housing.

So I don't know the particular situation and why the decline is taking place. I do think generally the credit is a very specific and not very flexible vehicle and that one area that would make it more broadly useable would be if, in fact, instead of everybody having to be under 60 percent a median, let's say, to get the credit, you might have a band of people who are at 30 percent a median and a band that are at 50 percent of the median and a band that might be at 70 or 80 percent the median; and as long as it averaged out to 60, you could get credit on all the units, some of those kind of simplifying changes that would make it more flexible. But again, it's been a very effective piece of legislation.

The tax committees have made only minor changes to it; and it is, as you say, still the biggest resource that's supporting affordable housing today.

Mr. DENT. Anybody else want anything to that?

Mr. TRACEY. No. I would just make two comments. I would concur with what Mr. Clancy said about the need to create more income, diversification in low-income housing tax credit projects. If there has been a push to define affordable housing not just to supporting the very low income or low income but new definition, work force housing, those that 80 percent to 100 percent, 120 percent of median income are also struggling in finding adequate and affordable housing as well.

And the second comment, too, would be to focus on both scarcity of land in many markets, and also the high cost of that land, which does prevent much affordable housing from being constructed, notwithstanding any tax credit programs. It's just very high cost to entry in the affordable housing market because of the scarcity and the cost of the land in many of our markets.

Mr. DENT. Thank you. Mr. Clancy, back to you. I know the Community Builders often acts as the tax syndicator in tax credit deals. Is that correct?

Mr. CLANCY. Yes. We are a principal in the work that we do, but we also directly structure and design the tax credit investment and work directly with—Bank of America is one investor that we often work with. We work with many of the major financial institutions and directly structure investments with them.

Mr. DENT. Can you describe the role that syndicator in those transactions and essentially in how they benefit?

Mr. CLANCY. Basically for us, it's been really a critical tool of affordable housing, and I won't bore you with the whole history; but going back to 1970 when we did the first nonprofit-sponsored tax shelter syndication for affordable housing in the South End of Boston, the tax incentives available under the code—and obviously, since 1986, the low-income housing credit are such a central part that we end up, for example, in a typical transaction. Whether it's HOPE VI or whether it's just a tax credit transaction, we will end up with perhaps as much as 60 percent of our total development cost coming out of the tax credit value and as little as maybe 15 percent coming out of a first mortgage financing. And let's say the other 25 percent coming out of perhaps public housing capital or HOME or CDBG or other kind of grant resources.

So in the mix, the largest private investment piece is the low-income housing tax credit. So being able to structure that effectively, being able to bring investors in on a basis that maximizes the return to the project from their investment, and also one of the things that has been important for us in that industry for the last 35 years, is to be able to bring investors in on the basis that is completely compatible with long-term affordability of that housing, is one of the structures that we've insisted on, as I say, going back 35 years.

Mr. DENT. Thank you. And I guess, finally, I will just maybe touch on HOPE VI, and maybe prior to my arriving here, you may have touched on that issue. But in my district, we have a substantial HOPE VI project underway, and it's been helping us attract a considerable amount of private investment; and, of course, HOPE VI funding has been diminishing in recent years, and with it, a number of communities in which obviously housing projects can benefit. So that is a problem.

Do you have any experience with HOPE VI? Any of you that you would like to speak to; and if so, what is it about that program that attracts so much private investment?

Mr. CLANCY. Well, I think, as I did stress in my testimony, I think one of the things that has enabled HOPE VI to do that has been that since 1995 in the competitive allocation rounds, it has actually encouraged housing authorities to leverage the grant that they receive with private debt and equity; and so to be competitive

for funding, it really has created an active marketplace of housing authorities who, to get the money, have almost got to leverage the money with private debt and equity.

So one of my recommendations is to look at the total funding for housing authorities, total capital funding and make more of it competitive so that, in fact, you get that same—and have the competitions be—provide a preference for leveraging and for taking a more comprehensive approach so that, in fact, you could expand the extent to which public housing capital was leveraged with private debt and equity, was combined with things like the low-income housing tax credit.

Because I think even though the HOPE VI work has been very high visibility and has been fairly dramatic in a number of places, we've still only really scratched the surface of the overall capital needs for public housing. And the more leverage that can be brought to meeting those needs, the quicker we'll be able to meet more of them.

Mr. DENT. Thank you. Anybody else wish to add anything on HOPE VI?

Mr. TRACEY. I would. Yes, thank you.

Bank of America has been involved as a lender investor and actually real estate developer in more than two dozen HOPE VI projects across the country, and our experience has generally been very positive. In particular, we view the multiplier effect as very common in the successful HOPE VI developments; and effect often gets overlooked in judging the success of the projects, we believe.

One example is right up 95 on the west side of Baltimore, two different HOPE VI projects, Lexington Terrace and what's now known as Heritage Crossing. Initially, homes were selling there for $65,000. So on the face of it, the criticism was, why should our government be selling homes at $65,000 when they cost $165,000? But upwards of 5, 7, 8 years later, private capital has now been attracted into that area. There are homeowners from Washington now buying $400,000 homes in that same community, in the surrounding neighborhoods.

The University of Maryland has now crossed over Martin Luther King Boulevard, which was a dividing line for the community, and has built a biotech center in that same community. So when taking the long view and stepping back and doing the overall returns to the community, we think the HOPE VI program has actually been very effective and very efficient.

Mr. DENT. Thank you. I think it's been a good program too. I just wanted to get your feedback on this. Thank you, Mr. Chairman. I have no further questions.

Mr. TURNER. Thank you. We've been notified that in the next 10 minutes, we'll have a series of votes. So what I'd like to do is in closing, allow each of you, if there are other thoughts that you have or other issues that we have not raised that you would like to place on the record or a question that you've heard someone else answer that you would like to comment on, get any closing additional thoughts that you might have that you would like to leave with us on the record.

Before I do that, I would like to ask Ms. Dolber, our staff have prepared a number of questions that are highly technical in re-

sponse to your statements; and rather than go through those in this format, I was wondering if you might be kind enough if we submitted those questions to you in writing, if you would respond back to us in writing that we would make it part of this record.

Ms. DOLBER. Sure. I would be happy to.

Mr. TURNER. I would greatly appreciate that. And with that, I would like to turn for opportunities for closing statements. So I'll start with Mr. Clancy.

Mr. CLANCY. Thank you, Mr. Chairman. And thank you for the opportunity to be here today. There's just one item that I would point to that we haven't expressly dealt with; and I did cover briefly in my written testimony; and that is that this same challenge of re-engineering and repositioning and dealing dynamically with distressed affordable housing assets exists in the privately owned Section 8 assisted housing portfolio that we've talked a lot about in the public housing arena. And the same kind of approaches are, I think, critically important in that arena. There is a section that was passed, Section 318 of the HUD Appropriations Act of 2006—2005, gave a 2-year window for moving project-based Section 8 contracts from obsolete developments to new developments or to other developments.

That's the first real avenue for, in effect, applying a HOPE VI-type approach to distressed Section 8 properties; and I think housing authorities should be encouraged; and I think HUD should be encouraged to look creatively at ways to use Section 318 to accomplish some of the same things that the committee has viewed positively that have been accomplished in public housing revitalization. Thank you very much.

Mr. TURNER. Thank you. Ms. Dolber.

Ms. DOLBER. Thank you. I'd also like to thank you again for inviting us to be here. The communications with the capital markets about federally funded types of transactions is very important, and we really appreciate the opportunity to be able to provide our thoughts.

I've mentioned the importance of communication. It really helps to help us make decisions about where things are going, and it helps investors as well.

I wanted to make a comment about what Mr. Clancy said about competitive grants, if there was an aspect of competitiveness to it. While that might not work for a structured financing like the capital funds securitizations that have been done because you have to know how much each PHA is going to get, the thing that would be beneficial for something like that would be that it does instill the competitive spirit and a drive for excellence, which is really needed in the industry.

And if PHAs are going to get their own credit ratings as opposed to just getting ratings on issues that they might do, you know, a finite issue like the capital fund securitization, if they had their own ratings, that competitive ability to compete would help them a lot, I think, to move forward to that kind of thing. But in a strictly structured financing, it doesn't work as well.

Mr. TURNER. Thank you. One of the questions that we have for you is your thoughts about transitioning to a rating for the agencies themselves and your recommendations on those processes. So

it's good that you raise that in your closing because that's one of the questions that we'll be coming to. Mr. Tracey.

Mr. TRACEY. Just one final observation and really a summary. We talked quite a bit about the need for predictability, stability and funding sources for public housing from the providers of private capital. Also, however, there is a need for a legal structure for these transactions that provide secure collateral. Again, that comes due to the certainty involved in the transactions that we are lender or investor. Within the final point too, which we didn't address is, which ties back to the reference to CRA, is the need from the private markets for adequate and consistent returns because if we build a market that's dependent only on the negative incentives of CRA, we haven't built a market that's sustainable over time, because as banks move in and out of compliance with CRA, as the regulation changed, it's been weakened in recent years unfortunately. In our view, that will not provide the consistent source of capital, I think, we all want from our public housing authorities.

So from our perspective, I think there's often a misconception that our capital is limited by the CRA, and that's really not a true statement. There is ample private capital that will flow into public housing markets, provided we have a stable, predictable source of funding, safe and secure collateral and adequate returns.

Mr. TURNER. Mr. Tracey, I appreciate your comments in that regard; and I do think that alone is an issue that this committee needs to pursue further, although the crux of our success may be the relationships that are currently there, through CRA and the banks and their expertise, our ability to encourage an expansion of these types of investment opportunities and greater—other industry sector participation is going to be based on our ability to transition, make it more interactive, make it more stable and less of a negative consequence, more of a positive. I'm certain we'll be having further discussions with you on your ideas and thoughts as how we can accomplish that.

I want to thank all of you for your participation. I know that in addition to the time you've taken today, you've put in considerable preparation for your testimony today, but I also want to thank you for your dedication to your careers and your expertise to this important area because I know each of you, as you look into the communities that you've impacted, can see real changes have occurred as a result of your choice to dedicate yourselves to what you're doing and real changes for the lives of the people who have benefited for the programs and the projects which you've applied your expertise. So thank you for that.

And with that, we'll be adjourned.

[Whereupon, at 11:19 a.m., the subcommittee was adjourned.]