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Affordable Housing Alert

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HUD updates Section 18 'Demo/Dispo' guidance

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HUD clarifies Section 18 eligibility for Mixed-Finance public housing and adds a new functional obsolescence pathway.

What's the impact?

- The guidance makes it easier for Mixed-Finance properties to qualify for Section 18, including new, specific requirements separate from the onerous "physical obsolescence" requirements and alternative qualifications for the 90%–10% RAD/Section blend.
- The new qualification category — functional obsolescence — provides an alternative to physical obsolescence for properties constructed before 1950.
- The guidance also increases the number of public housing units eligible for streamlined processing by expanding the definition of scattered sites from four to six contiguous units, and increasing the limit of public housing units for "very small PHAs" from 50 to 75.

On August 28, 2026, the United States Department of Housing and Urban Development (HUD)'s Office of Public and Indian Housing issued Notice PIH 2026-23 (the Notice), updating guidance about public housing demolition and disposition pursuant to Section 18 of the U.S. Housing Act of 1937, known as "Section 18" or "Demo/Dispo."

The Notice expands Demo/Dispo flexibilities and, notably, expands opportunities for Mixed-Finance developments. Here is a summary of the key changes.

Greater opportunities for Mixed-Finance developments

There has been confusion in recent years about whether Mixed-Finance developments qualify for Section 18 and if so, what requirements apply. Mixed-Finance developments differ from traditional public housing in that there may be a project owner, such as a Low-Income Housing Tax Credit (LIHTC) entity, separate from the Public Housing Agency (PHA), and public housing units *may* comprise only a portion of the units in the development. Many of these projects were developed more than 20 years ago and are struggling. This guidance clarifies that Mixed-Finance developments can qualify for Section 18 if the long-term viability of the public housing units are at risk, based on two conditions:

- Expiration of the applicable LIHTC compliance period or passage of 15 years since the last major recapitalization event
- Documentation of capital needs and financial modeling indicating inadequate financial resources to address underlying operational and capital needs

The application must provide a plan to ensure the property's long-term financial and physical stability. The guidance recommends (but does not require) that the new owner entity have a PHA or PHA affiliate or hold an interest in a general partner or managing member.

When requesting disposition of a Mixed-Finance development, the PHA applies on behalf of, and with the consent of, the Mixed-Finance owner entity. In a nod to the controversies regarding eligibility, HUD states that procedures for requesting a waiver of federal regulations will be published in subsequent guidance.

Mixed-Finance developments may now also receive favorable treatment in Rental Assistance Demonstration (RAD)/Section 18 Construction Blends. RAD/Section 18 Construction Blends allow RAD transactions to take advantage of Section 18's ability to generate Tenant Protection Vouchers (TPVs), which can be project-based in a transaction to boost rents. Mixed-Finance developments that meet the criteria above now automatically qualify for the highest RAD/Section 18 Construction Blend: 90% Section 18 and at least 10% RAD.

The Mixed-Finance changes are significant and respond to a gap practitioners have flagged for years. Many older LIHTC-financed Mixed-Finance projects face a recapitalization cliff. This new guidance expands opportunities for repositioning these assets.

‘Functional obsolescence’ now explicitly available as a disposition justification

Before this guidance, many projects had to prove physical obsolescence to obtain Section 18 approval and qualify for TPVs. The physical obsolescence test applies specific, often clunky, parameters that can be difficult to meet. This updated guidance creates a new path called “functional obsolescence.” The functional obsolescence justification may be used if:

- The project was originally completed no later than 1950;
- The cost to address obsolete building features exceeds 57.14% of Total Development Cost (TDC) for non-elevator buildings or 62.5% of TDC for elevator buildings; and
- Future plans do not result in a net loss of housing for families at 80% or less of AMI (considering both the replacement units and TPVs).

However, relocation needs may complicate the use of the functional obsolescence criteria because the guidance prohibits a PHA from placing Project-Based Vouchers (PBVs) at an existing structure that has been approved under Section 18 pursuant to the functional obsolescence justification.

Increased scattered site unit maximum: 4 units → 6 units

Scattered-site projects qualify for streamlined Section 18 processing. HUD previously defined scattered-site units as projects with four or fewer total units on one side of a block. This notice raises the threshold to six or fewer total units on one side of a block. The underlying justification — that the distance between units and lack of uniformity of building systems makes it challenging to continue operating and maintaining the units as public housing — remains unchanged. Five- and six-unit clusters fell just outside the prior definition, forcing PHAs to demonstrate eligibility for more burdensome categories, such as physical obsolescence, even when the core issue was operational inefficiency. This change aligns justification better with the on-the-ground reality. PHAs with portfolios of small scattered-site buildings should re-evaluate properties with five or six units that were previously ineligible for this streamlined pathway.

Expanded ‘very small PHA’ threshold: 50 units → 75 units

Very small PHAs qualify for streamlined Section 18 processing. The Notice raises the definition of a “very small PHA” from 50 or fewer ACC units to 75 or fewer ACC units. Very small PHAs may seek disposition by demonstrating that closing out the Section 9 Public Housing program is in the best interest of the PHA and residents, following HUD Notice PIH 2019-13 closeout procedures.

In addition, units voluntarily transferred from a very small PHA to a larger PHA retain eligibility for repositioning under the very small PHA justification. This change removes a potential disincentive to consolidation of very small PHAs with larger agencies.

PHAs with between 51 and 75 units — often agencies with limited administrative capacity that are struggling under compliance burdens — now have access to the streamlined closeout pathway.

New 30-day discontinuance policy for deficient applications

PIH 2026-23 adds guidance for discontinuance of Special Applications Center (SAC) applications. Substantially incomplete applications or those deficient in material items will not be processed beyond the initial review. If the SAC determines that the PHA cannot provide the required submission items within 30 days, the SAC will discontinue review of the application.

The 30-day window imposes real discipline. PHAs must ensure that applications are substantially complete before submission and not rely on post-submission supplementation to cure material gaps. It will be critical for PHAs to engage counsel and consultants early in the application process to avoid discontinuance.

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