5

Drawing on the Private Sector Experience:
Asset Management of Public Housing

by

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Bachelor of Architecture, Rensselaer Polytechnic Institute, 1987

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Abstract

Public housing authorities (PHAs) are becoming increasingly concerned with operating more efficiently, accessing alternate sources of capital, and implementing alternative asset plans. This is due to deregulation and reduction of federal subsidies as well as the need for modernization, major rehabilitation, or redevelopment of public housing developments. A significant response is to look to the private sector as a model. Asset management is a private sector process within which an agent of the property owner supervises the operation and monitors the performance of assets as well as creates and implements asset plans. Whereas preserving and adding to the value of real estate assets with respect to the owner's financial objectives is the goal of private asset management, a PHA's mission is to provide safe, decent, and sanitary housing units at affordable cost to low income families.

Reviewing the literature yielded the following five principles for the implementation of an asset management system: define objectives, respond to the external operating environment, separate roles to ensure accountability, analyze alternative asset strategies, and formalize reporting. PHAs cannot simply view properties as assets from which value can be added. There are additional indicators of performance that need to be assessed that the private sector does not. And, a different set of asset alternative plans need consideration given the PHA's social mission, organization, and legislative requirements.

Using organizational profiles of both New York City and Boston PHAs, this thesis explores which and to what extent the five principles of asset management are applicable to PHAs. This thesis finds that all five principles are being implemented to some extent. Differences result from each PHA's particular circumstances. Both PHAs are able to define clear objectives that respond to their unique external operating environments. They have analyzed alternative asset strategies and created strategies consistent with the objectives. However, difficulty arises in separating roles to ensure accountability and formalize reporting. There are three major impediments. First, HUD funding structure disperses asset management functions into multiple departments, Second, PHAs have social as well as financial objectives. And third, current legislation does not contain incentives for PHAs to improve performance.

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Table of Contents.

Chapter 1. Introduction

Given federal spending cuts, deteriorating stock, and declining incomes of tenants, PHAs are searching for improved efficiency from operations and alternative or cheaper sources of capital as well as the ability to implement alternative asset plans. For some of the large PHAs this has instilled an interest in the private sector model of real estate asset management.

The private market has historically been unable to supply affordable housing units to low income families without notable trade-offs resulting in either substandard quality units or high rents. To balance low rental revenue from units occupied by poor families, private owners have frequently taken one of two steps. They have either maximized cash flow by cutting back operating expenses, resulting in poor living conditions--or, during inflationary periods, held the property vacant for capital gains from future appreciation. These strategies have led respectively to substandard housing units and losses to the stock of affordable housing. It was believed that the public sector could build affordable housing better than the private sector.[1]

Public Housing Background

A public housing program to alleviate unemployment caused by the Great Depression and create higher quality housing for the working poor was initiated by the Housing Act of 1937.[2] The original purpose of public housing was to provide temporary shelter for households whose situation would improve through their own means, whether by saving or earning more. The original tenants were what Rachel Bratt, a prominent scholar in the field, called the "deserving, temporarily poor" or the "submerged middle class."[3]

PHAs, empowered through state enabling legislation, provided housing within their mission to provide safe, decent, sanitary housing affordable to low income families. They owned and operated public housing units, and administered the subsidies needed to make those housing units affordable within federal regulations. There were two methods for delivering the physical structure. First, PHAs issued bonds to fund the construction of public housing units, and then operated them at break-even with operating costs offset by rental revenue. Principal and interest payment obligations on the bonds would be passed-through to the federal government. Second, in the later "Turnkey" program, a private developer purchased the land, developed it, and sold it to the federal government who then handed it over to PHAs to operate.

Public housing has undergone three crucial transformations during its sixty-year history. First, the demographics of public housing tenants have changed from the working poor to large concentrations of the poorest-of-the-poor. Second, it has changed from debt-free real estate able to operate self-sufficiently, to a service program requiring operating, modernization, drug elimination, and severely distressed project rehabilitation or HOPE VI Urban Revitalization Demonstration.[4] Third, the stock has deteriorated through age and inadequate funding for capital improvement and maintenance.

Over time, public housing became increasingly aimed at those who could not afford private housing units of decent quality. Today, by mandate, public housing accommodates primarily the poorest-of-the-poor.

Public housing "projects" became spatially isolated and physically distinct from market rate housing. Islands of poverty were formed in highly media-genic[5] "towers in the park" that have become a part of national consciousness through sensationalized demolitions such as Pruitt-Igoe in St. Louis. Early attempts to separate public housing from private housing included an "equivalent demolition" clause requiring every private unit replaced by a public housing unit to be demolished.[6] During the post World War II building era, the design of public housing became distinct from private housing. Social workers, architects, and building unions attempted to emulate the European model of open space and courtyards to replace the "mean streets of small houses and tenements that characterized the city's slums."[7] Municipal governments influenced location decisions and placed public housing in isolated locations. Columbia Point (now Harbor Point) in Boston, for example, was located on the site of a former garbage fill. This separation was sustained through not-in-my-back-yard (NIMBY) sentiments among the working class, which leads to concentration of poverty through exclusion.

In the post World War II period, government intervention also affected spatial location of households. City residents were encouraged to move to the suburbs where the cost of owning a house could be lower than the cost of renting an apartment in the city.[8] Those who were unable to attain full middle class status and move to the suburbs remained in public housing.[9]

There were two prime causes for this movement: construction of the interstate highway system and federally insured mortgages promoting home ownership.[10] The interstate highway system was developed following World War II partly to provide efficient transport of arms from multiple contractors, i.e. "second sourcing." Clusters of land in areas surrounding the city became accessible for residential development. This network of highways allowed workers to move to the suburbs and commute to the central business district (CBD), as well as, move to southern cities that received a large share of the military contracts.[11] Federally insured mortgages made debt available to families by protecting issuing banks from default risk.

Previous residents of public housing moved on to middle class status through FHA and VA mortgage insurance and guarantees. Remaining tenants had lower incomes resulting in a higher rent burden, i.e. percentage of rent to income. As operating expenses grew in response to inflation in the sixties, rents rose. But incomes did not.[12] The new demographics were institutionalized by the Housing Act of 1949, which restricted public housing to very low-income households and authorized the eviction of higher income households.

The Brooke Amendments, 1969-1971, restricted rents to 25 percent of income. (This was later updated to 30 percent in the Omnibus Budget Reconciliation Act (OBRA) of 1981.) Rent restriction addressed the issue of affordability. But it did not address the issue of growing operating expenses. Indeed, rent restriction aggravated it. Under the Nixon administration in 1974 several new programs were introduced. First, operating subsidies were granted for PHAs. Under the Performance Funding System (PFS), the amount of subsidy would be determined by subtracting rents, interest earnings, and utility costs from allowable operating expense levels of a "well run" PHA. Second was a housing moratorium on all new development. And third, was the introduction of a new tenant based subsidy, Section 8.

The Current Status of Public Housing

Four issues that evolved during the past two decades concerning the operation of PHAs today are (1) potentially increased decision-making power over assets and organizational structure, (2) decrease in tenant income, (3) reduced subsidies from the Federal government, and (4) deteriorated state of the stock of public housing.

Today, PHAs face a volatile legislative environment. New legislation in both the Senate and House has been proposed that could dramatically change the landscape of public housing (see Exhibit 1). Currently, funding streams, i.e. operating, modernization, etc., are non-fungible; funds must be used for the purpose they were appropriated. Greater decision-making authority might be granted. With proposed changes, PHAs might have incentives to cut costs and raise revenue. They could market units to higher income families, begin new development and acquire discretion over use of their resources. Specifically, they may be granted more power over tenant selection and application of funding.

The average income of PHA tenants has decreased from 33% of local median income in 1981 to 17% in 1995.[13] Welfare reform further reduces rental income in public housing. The emphasis of the new welfare program no longer is maintaining an income floor but assisting families to find work. Approximately fifty percent of public housing residents receive public assistance income.

Congress has consistently provided less operating subsidy than PHAs requested based on PFS calculation. For several years prior to 1996, Congress appropriated 95% of PFS. In fiscal year (FY) 1996, Congress appropriated only 89% of the amount required for PHAs to close the gap between operating expenses and rental income.[14] To close the operating gap, PHAs can either reduce operating expenses or draw down on reserves.

As a result of past underfunding of subsidies and the number of units built over 50 years ago, a large part of the public housing stock needs rehabilitation, or redevelopment.

> ...a recent estimate suggested that about 15 percent of all units have renovation needs of $20,000 or more. In many cases, maintenance estimated $12.2 billion (1990 dollars) would be required to put all public housing in an acceptable physical condition with all existing building systems operational. In many of the large metropolitan areas, those public housing units constitute 10 percent or more of the total rental stock.
>
> ...HUD further estimates that renovation is not cost-effective for about 10 percent of public housing units; in those cases, renovation expenses exceed the costs of new construction.[15]

Action is necessary for the preservation of the existing stock of public housing. Modernization subsidy through the Capital Grant Program (CGP) is insufficient to address modernization needs. Years of deferred maintenance have created outdated utilities and unit plans. Plants and equipment at many PHAs date back to the 1930s and 1940s.[16]

The combination of shrinking resources and deterioration of existing stock is forcing PHAs to make difficult choices. They may need to divest themselves of units, make capital investments, reduce costs, and search for ways to raise revenue, or simply improve management.

Driven primarily by arguments that PHAs are inefficient, Congress has considered the option of "vouchering out." Under this scenario, current supply side or project-based subsidies for the operation of public housing developments are replaced with demand-side Section 8 vouchers and certificates, to tenants. Under the Section 8 program, tenants awarded vouchers or certificates, (usually by a PHA) search for a landlord who will accept them. A landlord who accepts the voucher or certificate enters into a lease agreement with the tenant and a contract with the issuer of the Section 8 voucher or certificate. The landlord must agree to maintain the unit at stated minimal levels of quality. In return, the landlord receives a subsidy that covers the difference between what the tenant can pay in rent – 30 percent of income - and the fair market rent for that unit. If the landlord fails to meet those minimal standards during an annual inspection from an officer of the issuer, the subsidy he receives from the Section 8 voucher or certificate holder can be revoked. A Section 8 voucher or certificate is not connected to the project but to the tenant, who "chooses" a landlord in the private housing market.[17] PHAs are thus forced to compete for tenants as would any other private real estate company or landlord. The mere threat of "vouchering out" is an impetus for PHAs to consider operating differently than in the past.

Economists view a tenant-based or demand-side subsidy as being efficient since it does not distort the price of housing and thus misallocate resources. As opposed to demand vs. supply, this issue can also be framed as people vs. place. Place, or project-based subsidy, can be construed as limiting tenant location decisions or "choice." Proponents of demand side subsidies accuse project-based subsidies of forcing poor families to locate in isolated, distressed neighborhoods.

PHAs in both Portland, Oregon and Baltimore, Maryland either commissioned or were involved in studies that projected how they would fare under "vouchering out." Both studies anticipated the devolution of power from the federal government to localities, causing PHA decisions to be more affected by local housing market conditions than by federal regulations. PHAs would have to exercise their own discretion to carry out their mission.[18]

These studies indicate that strategic responses are required. In the event of "vouchering out," for example, the Housing Authority of Baltimore City (HABC) was projected to lose tenants, thereby raising vacancy and reducing revenue. The effect on individual developments would differ greatly. Elderly housing developments would be able to break-even but many of the family developments would lose tenants. Also, one-third of current tenants would not be able to find housing in the local sub-market. HABC's units are below market level and would require substantial modernization expense to become market level. However, that expense would not be offset by the additional income generated from increased marketability.

A framework was needed to understand the relation between modernization investment, revenues, and social effects. The HABC report was able to project alternative scenarios by utilizing asset management. Each development was analyzed for its unique effect on the HABC. Each development's condition was assessed by private real estate consultants and graded. Then, the effects of various modernization strategies were projected. By building a strategy development by development, it was possible understand the implications of alternative scenarios as well as derive policy and agency changes. These changes would prepare HABC for increased self-determination, reduced subsidies and stock with substantial modernization needs.

Private Asset Management Background

Asset management is a private sector process within which an agent of the owner (1) supervises the operation and monitors the performance of assets as well as (2) creates and implements asset plans. The first, more tactical function, enhances the performance of individual properties by generating more and better information on a timely basis, and managing the daily operational aspects of the properties efficiently. The second, more strategic function, involves analyzing each individual asset as well as producing and implementing asset plans.

Ownership of private real estate over the past thirty years has shifted from individual owners directly operating their real estate assets to institutions holding a portfolio of assets. Most large institutional owners cannot or do not choose to directly plan and monitor operations of individual properties. Instead, they require an intermediary professional to oversee all property management activities and perform periodic buy/hold/sell/reposition analysis. This is the role of the asset manager.[19] The asset manager is a fiduciary that is responsible for managing the property. S/he oversees the operation of the asset and also creates a plan to optimize the value of the asset.

Managing portfolios of real estate emerged as a profession during the 1960s, as large pools of capital became available through the issuance of new securities by several vehicles. These included limited partnerships, real estate investment trusts (REITs), Federal National Mortgage Association (Fannie Mae), and Federal Home Loan Mortgage Association (Freddie Mac). During the 1970s, the flood of capital continued amid an atmosphere of minimal government intervention, as well as political and economic stability. Unlike active investors of the past holding single real estate assets, these new investors were passive and could own diminutive parts of the real estate. They were either too far removed physically, had no experience in managing real estate, were unable to elect a single representative to manage, or were not available to make decisions.[20] In order to control the ensuing owner / agent conflict, it was necessary to formalize management and control decision-making authority to align the interests of management and owner.

After the real estate crash of the 1980s, many U.S. real estate companies abandoned development and started searching for earnings through more effective management and lowering costs of capital. Today, investors see real estate investment as an asset class within the broader capital markets. As such, they have demanded disclosure of management practices and performance assessment as they would any other investment.

Public Asset Management

Bratt et al have described asset management as a continuum in which to understand nonprofit or public housing stock, anticipate problems, and prepare suitable strategies.[21] In their empirical study, Bratt et al found that low operating reserves in non-profit affordable housing are "ticking financial time bomb." Observing day-to-day operations alone would not have revealed the problem. For a myriad of reasons, public housing faces financial and physical problems of its own that need to be uncovered and managed.

PHAs can improve their financial condition by thinking of real estate as a strategic asset from which they can produce earnings by exploring market opportunities.[22] Indeed, this may be necessary if they are to survive.[23] However, asset management is controversial since some strategies appear to contradict the mission of public housing.

There are substantial incentives for PHAs to understand more about the position of their assets. The current environment dictates that PHAs operate more efficiently. With a reduction in federal subsidies, PHAs must know where to apply them. Which specific developments should be invested in? Which ones should be divested in or repositioned? Deregulation assists PHAs in pursuing individual asset strategies by granting them more discretion over use of resources. The threat of "vouchering out" makes survival an issue for PHAs.

Figure 1-1. Incentives for Public Asset Management

Reduction in federal subsidies. Existing assets must be operated more efficiently. Repositioning and reinvestment must be considered for underperforming assets.

Deregulation. This requires increased discretion over use of subsidies. PHAs must know more about their local markets.

Ability to respond to political vicissitudes. Section 8 vouchers and certificates may replace project based subsidies altogether. Under this scenario, PHAs would compete directly with private owners.

Required capital. Existing developments are old and require capital investment or major rehabilitation.

However, there are legislative impediments that must be overcome. Currently, there are powerful disincentives for PHAs to increase revenue from assets. They cannot benefit from additional revenue they might generate by raising rents or generating other income. For example, the Boston Housing Authority (BHA) suggested renting space atop its tall buildings to cellular phone company transmitters. Under the Performance Funding System (PFS), PHAs' subsidies are reduced dollar-for-dollar when revenues are raised. And similarly, an increase in subsidy is granted for losses in revenue.

Some provisions of the PFS have been lifted temporarily. Current changes have been legislated in two-year authorization language due to expire at the end of 1997. Without permanent legislation, PHAs cannot commit to long term strategies as would a private asset management company.[24] For example, if certain restrictions under PFS are lifted for two years, and PHAs cut costs and raise revenues by mixing incomes, they may be penalized for these innovations a year later; this would occur when the PFS formula is reapplied and their operating subsidies are reduced. Entrepreneurial action is punished rather than condoned.

Public vs. Private Asset Management

PHAs can be expected to have a more difficult time adapting strategic than operational asset management. Tactical asset management is adaptable for PHAs since it is relatively uncontroversial and requires only modifications to existing property management. But the second, or strategic function, creating and implementing asset plans, introduces a level of decision-making that may be more difficult for PHAs to adopt. Changes are required in the system of federal funding, legislative constraints, objectives, and culture of PHAs. The PHAs would thus need to begin searching for value in their real estate portfolios by performing hold/reposition analyses. At the strategic level, this means that there are essential differences in the asset alternatives that PHAs face as compared to the private sector.

Methodology

This thesis draws on private sector asset management as a model for PHAs to address current issues. These issues are examined in the literature and two organizational profiles. How do PHAs define asset management and what strategic elements will they employ? How do they view strategic as opposed to operational considerations? Can value be created through strategic planning of assets? Indeed, is public asset management possible?

Chapter One has introduced the challenges facing PHAs and the particular relevancy of asset management as a framework to address these challenges. Potential changes in the operating environment require more than ad hoc solutions.

Chapter Two delineates five principles of asset management. It compares and contrasts these dimensions using the available literature. It is clear that there is an analogy for each of the private strategic dimensions but not necessarily direct applicability.

In Chapter Three, organizational profiles will illustrate how two very different PHAs plan to perform asset management and what steps they have taken so far. The two PHAs were chosen because they were each actively taking innovative steps towards asset management. Initial interviews with personnel from several large PHAs indicated that asset management was being considered in only a few locations. The New York City Housing Authority (NYCHA) proposes a portfolio strategy that actively pursues changes in federal regulation and new development opportunities. The Boston Housing Authority (BHA), in contrast, proposes a series of pilot projects designed to raise revenue by seeking opportunities in the local real estate market.

The case method is utilized because of the exploratory nature and complexity of this topic. PHAs are only now considering formal asset management functions. They are not currently asset managers and many may never be. Thus, personal interviews were the best way to acquire information beyond the brochures or packages offered by each PHA. Contact was maintained throughout the research as the framework used in this thesis was developed. Application of a private sector process into the public sector is hypothetical and potentially complex. There are unknown impacts and tertiary issues.

Finally, Chapter Four analyzes the organizational data in relation to the private asset management principles. Some conclusions are drawn regarding the applicability of private asset management to the public sector.

Notes:

[1] Husock, Howard. "Back to Private Housing," *The Wall Street Journal*, July 31, 1997.
[2] Bratt, Rachel. "The Public Housing Program," *Rebuilding Low Income Housing Policy*. Philadelphia: Temple University Press, 1989, p 55.
[3] Bratt, "The Public Housing Program," *Rebuilding Low Income Housing Policy*. Philadelphia: Temple University Press, 1989, p 57.
[4] These are the four major categories. Other subsidies for public housing include: Comprehensive Improvement Assistance (CIAP), Choice in Management, Tenant Opportunity Program (TOP), 5(h) Housing Act of 1937 flexible design and homeownership, Public and Assisted Housing Drug Elimination Program, Section 22 Housing Act of 1937 grants for access to educational and job opportunities, Public and Indian Housing Youth Sports, Section 14(p) Housing Act of 1937 Vacancy Reduction in Public Housing, Section 18 Housing Act of 1937 Demolition and Disposition of Public and Indian Housing, and Section 202 fiscal year (FY) 1996 appropriations Act.
[5] The author coined this term. It refers to something that is particularly attractive for the media to sensationalize and otherwise cause to be distorted.
[6] Bratt, Rachel. "The Public Housing Program," *Rebuilding Low Income Housing Policy*. Philadelphia: Temple University Press, 1989, p 56.
[7] Warner, Sam Bass, Jr. "Federal Programs," *Housing: Symbol, Structure, Site*. Taylor, Lisa ed., New York: Rizzoli, 1982, p. 35.
[8] Jackson, Kenneth L., *Crabgrass Frontiers: The Suburbanization of the United States*. New York: Oxford University Press, 1985, p 205.

[9] Bratt, Rachel. "The Public Housing Program," *Rebuilding Low Income Housing Policy*. Philadelphia: Temple University Press, 1989, p 58.
[10] Byrne, Greg A., Levis, Robert L., and Lambert, Paul. Public Housing Asset Management: A Handbook for Local Governments. Newport, Rhode Island; Community Development Training Institute, 1996, p 2.
[11] Intersections in the interstate highway network also formed satellite cities that developed their own CBDs. Today, the notion of suburbia is quite different than it once was. Due to the movement of both jobs and residences out of the CBD, commuting to the CBD no longer defines suburbia.
[12] The new permanent status was reinforced by the Housing Act of 1949, which restricted public housing to very low-income households and authorized the eviction of higher income households. Federal regulations mandate a certain proportion be set aside and occupied by families receiving less than 30% of area median income.
[13] *Public Housing Authorities: Facing Challenges With New Financing Strategies*. New York: Moody's Investors Services, 1997, p. 6.
[14] Interview with staff member, Boston Housing Authority (BHA).
[15] Gabriel, Stuart A., "Urban Housing Policy in the 1990's" *Housing Policy Debate*, 1996.
[16] *Public Housing Authorities: Facing Challenges With New Financing Strategies*. New York: Moody's Investors Services, 1997, p. 7.
[17] There are sub-markets for Section 8 vouchers and certificates since not all landlords will accept them.
[18] Public Housing in a Competitive Market: An Example of How It Would Fare. HUD Office of Policy Development and Research, April 1996.
[19] Norwell, William. "The Real Estate Decision Process." *Journal of Property Management*. March/April 1991, p 60.
[20] Soens, Margaret A., and Brown, Robert Kevin. *Real Estate Asset Management: Executive Strategies for Profit Making*. New York: John Wiley & Sons, 1994.
[21] Bratt, Rachel, and Keyes, Langley, and Schwartz, Alex, and Vidal, Avis. Confronting the Management Challenge: Affordable Housing in the Nonprofit Sector. New York: Community Development Research Center, Graduate School of Management and Urban Policy, New School for Social Research, 1995, p 88.
[22] Pederson, Rick, "Establishing a Real Estate Asset Management System," *American City & Country*, April 1990, p 60.
[23] Byrne, Introduction.
[24] Interview with Paul Graziano, GM, New York City Housing Authority (NYCHA).

Chapter 2. Principles of an Asset Management Organization

There are three primary factors making asset management relevant to PHA operation. First, as a result of pressure to balance the federal budget by 2002, fewer dollars are being earmarked for public housing. Second, and partly as a response to the first, the Federal government is also relaxing the regulatory constraints placed on public housing authorities.[25] Third, the existing stock requires modernization, major rehabilitation, or redevelopment. Gordon Cavanaugh, General Counsel for the Council of Large Public Housing Authorities (CLPHA), recently stated, "Change has to come if the public housing program is to survive." In this new environment, some PHAs and the United States Department of Housing and Urban Development (HUD) have looked to the private real estate company as a model for operating proactively in a competitive market in which PHAs must search for value in their existing portfolios.

There are five dominant principles to be considered by the asset manager. The asset manager must (1) define the objectives, (2) respond to the external operating environment, (3) formalize reporting systems, (4) separate roles to ensure accountability, and (5) analyze alternative asset plans. These principles are derived from the literature on private asset management and on developments in institutional asset management. The following section describes these principles and then discusses issues in transferring them to the public sector.

1. Define Objectives

Private asset management is driven by the owner's objectives with respect to profit. The owner may be interested in the asset(s) for cash flow, tax advantages, portfolio diversification, or capital gains from appreciation.[26] If, for example, the asset(s) are purchased for providing current income, then the asset manager would be concerned with maximizing cash flow rather than making capital expenditures that would reduce cash flow but add value at disposition. These objectives can be met by empowering an asset manager to balance the loan/equity ratio, employ and coordinate professionals with expertise in specific areas, minimize liability exposure, gather and apply market information, and minimize the impact of external factors.[27]

Distinct differences in these objectives arise in the public sector. First, public housing generates negative cash flow, an operating "gap" that needs to be closed by federal and state subsidies. Certain developments, such as elderly housing, sometimes create positive cash flow. Second, PHAs usually make a payment in lieu of property taxes to the municipal government. But there are no real tax advantages from operations. Third, very little portfolio diversification is possible. Neither geographical nor asset type diversification is offered since PHAs are locally-based and manage predominantly multifamily residential. Finally, while there is potential for appreciation, gains cannot be realized. To do so would mean selling public housing developments without deed restrictions to a private owner. This conflicts with the mission of preserving affordable units.

Another crucial parameter is the intended holding period of the owner. If the owner wants to hold for a short period of time, the asset manager might not make capital investments that pay back over a long period of time. However, public housing is held as a public asset that is socially valuable because it is permanent.[28] There is no intended disposition. The closest analogy to a holding period is a defined time horizon in which specific objectives are to be met.[29]

PHAs provide housing primarily as a service, not as an investment. Profit is not the goal. There are social objectives. Providers of affordable housing often support housing with programs in economic development, creation of resident networks, recreation, security, and education. Public housing is often located in distressed neighborhoods that a private real estate firm might not enter. These neighborhoods may often be incapable of supporting market rents. In some cases, median rents in a distressed neighborhood may fall below rent levels that qualify families for affordable housing programs.

Tenants occupying public housing would at the same rent be able to bid only for substandard quality units in the private housing market. As such, PHAs serve a population facing few decent housing choices. They must face the issue of who the tenant is. Given that resources are limited, PHAs must decide if the same dollars should best go to providing housing for as many very low-income families as possible, or providing higher quality units for fewer higher-income families, or some combination of the two.

Objectives may be difficult to distill from the social mission. Greg Byrne, former Director of the Housing Authority of Dade County, Florida, and author *of Public Housing Asset Management: A Handbook for Local Governments*, lays out the obstacles for creating a mission-based asset management objective. The extent of the social mission is open to interpretation.

> At times the program was viewed as a stimulus for the economy. Other times it was viewed as a social service or economic development program. Still other times it was seen as a catalyst for the building and rebuilding of cities. And, even for those who have regarded public housing as primarily shelter, there is no common agreement on who public housing should serve.[30]

PHAs provide decent housing to low income families at affordable cost. Decent quality units drive costs up. Affordable rent (burdens) drives revenues down. This is not the formula for profit. Bratt et al refer to this essential conflict as the existence of a "double bottom line." There is a financial bottom line and a social bottom line. Maximizing revenue directly contradicts supplying housing to low income families.

Attitudes towards the poor have changed over time. Current efforts to consolidate the welfare program will reduce rental income and modify the mission of PHAs. What was previously an entitlement has been turned into a block grant delivered to states. Entitlements are offered to anyone who qualifies. The federal government funds the program through annual estimates of outlays. Grants are a specified amount. Welfare reform is (1) a part of the trend towards local government and competition among localities, (2) a shift in focus from public assistance to incentives for work, and (3) a euphemism for less overall spending on transfer payments to the poor. A shift is occurring in which PHAs no longer provide housing as a service, but support for poor families and individuals to work.

2. Respond to the external operating environment

The asset manager must understand and proactively respond to external changes such as new tax laws, inflows of capital, or changes in the performance of individual assets. This person also needs to understand the peculiar traits of assets in the portfolio.

Consider the case of an investor interested in tax losses. In recent history, dramatic tax law changes had to be closely monitored. The Economic Recovery Tax Act (ERTA) of 1981 provided tremendous tax benefits to real estate investors through accelerated depreciation schedules and tax shelters. Combined with deregulation of the financial markets, an unprecedented amount of capital flowed into real estate. But the expansion was halted by the Tax Reform Act (TRA) of 1986. Passive investors could no longer take tax losses against active income and the accelerated depreciation schedules ended. Owners who invested in real estate for the tax losses needed their asset managers to anticipate and respond to these changes in the tax laws.

PHAs are not directly affected by taxes. But availability of capital depends on the federal and state government, which must control tax policy to raise revenue. As businesses require stable environments in order to implement strategic plans so do PHAs. Whereas for a private company these external changes are primarily tax laws and economic factors, PHAs face legislative and political pressures. The creation of a deregulated and competitive environment conducive to asset management is far from certain as new legislation is proposed and debated every day in Congress. Every action of a PHA is subject to the scrutiny of the voting public. And every request for funding must be approved by HUD.

Because cities retain some power over PHAs, they are often forced to carry out the cities' agendas and not their own. Gordon Cavanaugh has urged public housing personnel to oppose proposed "home rule" legislation that would cede even more power to cities by transferring PHA subsidies through local government rather than through the State.

In addition to public capital, PHAs are becoming interested in asset management partially for the potential of accessing private capital. By shifting resources to certain developments and planning an appropriate strategy, it may be possible to place debt on the development or attract foundations, corporations, and REITs to become partners.[31]

The performance of public housing is uniquely affected by crime and drugs. A study performed on the Housing Authority of Baltimore (HABC) indicated that an optimum size of development for operating costs per unit was between 100 and 200 units. Above that, increased marginal costs accrued from additional security and maintenance. Below that, economies of scale were lost.

In a significant number of public housing developments the drug situation is worse than in the private sector because of:

- "The special responsibility of public housing to shelter the poorest of the poor;
- The resulting aggregation in multi-family developments of particularly vulnerable households, i.e., young single women with young children;
- The historic difficulty of getting evictions from public housing for "cause," i.e., disruptive behavior including drug-related activity because judges are reluctant to evict when they perceive no other place than the street for such families to go, and because of competent legal service lawyers who have historically not distinguished among public housing tenants whom they will defend against eviction;
- The breakdown of management capabilities in such developments and the corresponding inability to enforce patterns of tenant behavior that would challenge drug traffic;
- The absence of sense of community in many public housing projects and the alienation of residents from issues of control and mutual responsibility;
- The resulting "disorganized" multi-family developments that then present opportunities for "outsiders" to utilize the developments a base of operations".[32]

In the face of such intense problems, management of public housing requires the deployment of significant resources simply to meet its fundamental mission. As a result PHAs are never involved in purely housing management. They must also be involved in human services.

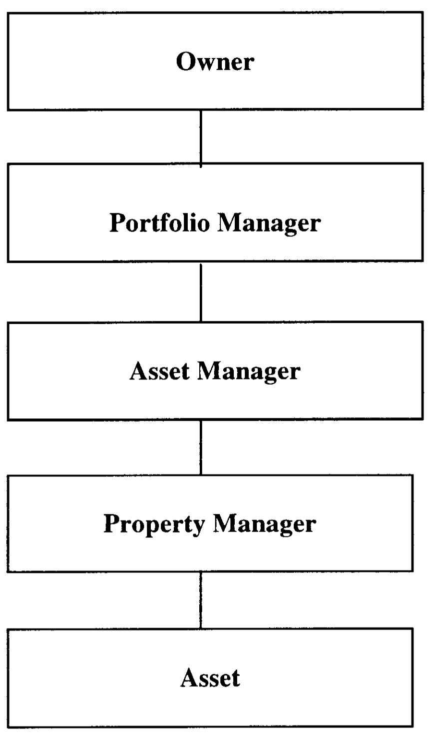
3. Separate Roles to Ensure Accountability

In commercial real estate, the consolidation of real estate holdings by large institutional investors has created a "real estate management triad" that maintains accountability and divides positions and roles to match the expertise required.[33] Maintaining this division has become more important as portfolios have grown in size and must be systematically reviewed to provide overall portfolio balance. An effective structure will reduce redundancy of tasks and lead to improved decision-making. Individuals in all three roles are relied on for their information processing skills and ability to judge bounds maintained by the checks and balances of the asset management system.

The "Management Triad"

The private sector real estate industry is moving towards firms specializing in one of three roles.[34] Property management, being closest to the asset, is concerned with operation. Asset management, distanced from operation and close to the owner, is concerned with performance. Portfolio management is concerned with how all the assets behave in conjunction with each other.

Figure 1. Organization Chart for Asset Management



This system has been devised to eliminate redundancy by delegating tasks and responsibility, and using resources, i.e. people, information, and assets, effectively. In theory, tasks are delegated to the professionals who with their specialized knowledge are best suited to perform the tasks and manage the risks. The asset manager must decide which activities should be outsourced. For PHAs, outsourcing raises privatization issues about whether accountability to voters can be maintained.[35]

The asset management system itself needs to be assessed. How well have tasks been defined and dispersed? The owner needs an indication of how well the asset manager is performing the following:

- Supervision of property management.
- Supervision of leasing activity.
- Managing cash flow and bank accounts.
- Reporting correctly and on time.
- Preparing tax returns.
- Monitoring physical condition/capital improvements.
- Hiring/replacing professionals.
- Managing sales/purchase/refinancing.
- Monitoring contract compliance.[36]

In public housing there is no formal separation between ownership and management. However, although PHAs are technically owners, they must answer to public officials.

A primary issue is quality. Tenants are customers for whom asset managers provide a service. Asset managers focus on attracting and selecting good tenants, and retaining them by responding quickly and courteously to tenant problems and maintaining and operating building systems. They need to plan and rethink the tenant mix, collect rent on a timely basis, lease vacant space, and when necessary, evict. Marketing needs to become a core competency at the property level once individual property performance is known and each property is competing against every other.

Portfolio Manager

The "management triad" is instituted from the top down (Pederson, Soens and Brown). The portfolio manager attempts to enhance returns by managing the synergy among a diverse group of assets in order to reduce unique risks of each asset. Investors diversify their large investment pools by avoiding large single assets in a portfolio, investing in several assets, investing in assets in different geographic locations, and/or investing in different asset types.

A portfolio manager is responsible to create a strategic plan or a "road map" guiding decisions over the holding period. This plan is derived from the goals of the owner and can be used to review the performance of the portfolio manager. With the existence of a portfolio manager, the asset manager must guide the performance of single assets in accordance with a plan that takes into account the performance of other assets in the portfolio.

PHAs have limited capacity to perform portfolio management in the private sector sense. To do so requires free exchange of assets within capital markets. But, as mentioned earlier, PHAs have a fixed geographic area and one asset type. They are local entities with limited power over the physical form and location of public housing. Location decisions for new projects require approval from the local government which are inclined to only provide the most isolated and undesirable locations to public housing projects.[37] Any synergies created are within an existing or expanding local portfolio of one asset type.

Asset Manager

The asset manager focuses on asset based plans and strategies. Specifically, the asset manager must (1) ensure compliance with the broader policies of the management company, (2) monitor non-routine decisions and transactions, and (3) serve as liaison between the property manager and owner.[38] In the first capacity, the asset manager administers the contract with property management. Among those at the property management level are the real estate analyst, tax return preparer, property manager, leasing agent, legal advisor, and sales broker/appraiser. Depending on the language of the contract, the asset manager may be more or less involved in the leasing process. In the second capacity, the asset manager is a "conduit for information." And in the third capacity, this person manages relationships.

Frequently recurring words in asset management are entrepreneurial and innovative.

> Today's highly competitive, complex and unpredictable real estate market, however, is requiring this discipline to rely on more than just property management expertise and a standard business plan. Critical now to the success of any real estate asset is an entrepreneurial and innovative asset management program that is specifically designed to anticipate market trends, isolate problems and integrate the various facets of a full-service real estate company in order to maintain and enhance a portfolio's value.[39]

Asset managers require a diverse skill set. These skills include financial analysis, marketing, and management, as well as knowledge of the assets themselves. Problems need to be anticipated rather than responded to as they occur.

Finally, the asset manager has fiduciary duty. S/he is entrusted by the owner to administer the asset in his/her place and know the limits of his/her own decision-making authority. The owner must be notified of certain decisions or events. The precise terms are drawn out in an asset management agreement.

Currently, PHAs do not have asset managers per se. All decision-making authority is centralized. Policies are supervised and defined by the PHA executives. Non-routine decisions and all major transactions are managed at the executive level. In principle, since there is no separation between ownership and management, there is no need for a liaison. In reality, however, elements of all are present in PHAs as will be observed in the organizational profiles.

Property Manager

The distinction to be drawn between the private asset and property manager is that the asset manager thinks globally and is empowered to respond strategically. The property manager is concerned with operating efficiently by reducing costs and vacancy, responding quickly to existing or potential tenants' requests, maintaining the physical asset, operating within a budget and raising revenues. With the closest level of contact with tenants, the property manager generates the information necessary for strategic planning, though this person is not typically empowered to make a strategic decision. For example, if a major tenant is late with rent, the property manager may send notices or negotiate an alternate payment schedule. But an asset manager may revise the long-term outlook for the asset and decide whether to renew the lease or search for another tenant if the market is strong. If the asset manager believes the market is weak and that the long-term outlook for rents looks bleak, he may decide to dispose the asset altogether. The private property manager has sufficient responsibility to operate the asset independently of other decision-makers.

The property manager's role in public housing is dramatically different. Property managers do not lease public housing units. Tenants come from centralized waiting lists rather than site-based waiting lists. Tenants are screened at the central office and assigned to a development on a first come, first served basis as units become available. Because tenants do not choose the development, a property manager's incentive to make the development attractive through maintenance and advertising are curtailed. Moreover, the PFS gives no incentive to reduce costs.

It may even encourage some PHAs to inflate costs and access larger amounts of subsidy. Relative to private companies, PHAs perform many of their property functions off site at the central office.[40] Property managers in PHAs do not lease or make capital plans.[41] They may be consulted in the budgeting process but they do not create budgets and make requests for funds to the central office.

Variations on the "Management Triad"

In reality, divisions in the private sector between the three positions are not distinct. Property managers are often called on to make asset management decisions. Also, the asset manager can sometimes double as the portfolio manager. This is most likely to happen when there is only one asset type or one geographic location for all assets in the portfolio.

The property manager may not be one individual. Each of the property management functions may be dispersed among different entities each of whom the asset manager enters into a separate contract with. Often the building management and leasing functions will be handled by separate firms. In this case, the asset manager often has additional operations responsibility. Whatever form the asset management organization takes, there will be a strategic level of decision-making that will be handled at various times and to various capacities by the portfolio manager, asset manager, and sometimes, the property manager. It is through this process that value is created and the owner's objectives are met.

4. Analyze alternative asset plans.

If property management is effective, then all properties should be performing optimally. In such an event, all major decisions will be strategic and not tactical. The private asset manager must perform continual analysis of the buy/sell/hold/reposition decision. Blake Eagle, Chairman of the MIT Center for Real Estate, states that there are two questions that need to be answered every day: "Would I buy this asset today?" And closely related to the first question, "Has this asset already achieved its peak value?"

Opportunities to maximize value are lost without proactive analysis of investment alternatives. It is important to analyze real estate as a cash flowing asset whose performance can be optimized with respect to the owner's objectives. It is the asset manager's role to produce an action plan for guiding asset decisions.

Non-routine decisions may involve buy/sell/hold/reposition analyses. This may mean investing capital that can be recovered with future cash flow and appreciation, or demolishing the property and selling the land if the property is not providing the highest and best use of land. Going back to the capital markets and refinancing may lower costs of capital. It may be time to dispose of the asset if it has reached its peak value or if it is dragging down the overall performance of the portfolio. It may be better to reduce operating expenses and hold for future appreciation. Another possibility is to redevelop and change or mix uses.

Whereas private real estate asset manager analyzes each asset and then disposes assets that are driving down the performance of the portfolio,[42] PHAs have traditionally operated under one strategy: hold. Rachel Bratt summarized the argument against disposition or any strategy that might reduce the number of assisted units:

> The existing stock of public housing represents a scarce and invaluable resource that must be protected and supported. Efforts to privatize, demolish, or convert the existing stock should generally be opposed.

Bratt et al stated that for non-profits, affordable housing is "forever." This philosophy has etched itself into current regulations that force PHAs to continue operating all of their assets, even in the face of poorer and poorer performance due to Federal cut backs.

There are still several legislative hurdles to clear before PHAs can consider some asset strategies. An April 8, 1994 memorandum from Nelson Diaz, then General Counsel for HUD pointed out that PHAs can dispose of assets to private entities. He noted that the Housing Act of 1937 did not require that PHAs own all units receiving Federal subsidies. In addition, the same act did not prohibit PHAs from commingling their public capital with private capital sources. However, PHAs must still await relief from one-for-one replacement requirements.

Buy/sell/hold/reposition analysis, which forms the basis of private real estate asset strategy, is difficult to absorb when there are conflicting criteria and conflicting objectives. PHAs own and operate housing built and financed by the Federal government. They own it free and clear, but they can't place debt on it. They cannot evict tenants easily and cannot raise rents, for legal and mission-related issues. Due to one-for-one replacement requirements, they typically cannot dispose of assets.

Though a private real estate company sifts through the portfolio to find the assets that are creating a drag on earnings and eliminate them, a PHA finds underperforming assets and seeks to preserve and, when possible, reposition them. Those assets, therefore, require additional resources. There are numerous alternative strategies to do so. They tend to cluster around efforts to reduce costs or raise revenues.

1. Cut back operating expenses. With subsidies constantly being cut back, PHAs must either (1) cut back operating expenses on some properties while allowing others to continue as they have been or (2) cut back pro rata on all developments. Ironically, when a development falls into disrepair, the public's perception that public housing is inefficient and creates islands of poverty is affirmed.[43] Pro rata cut backs are viewed as equally distributing the burden and, therefore, maybe acceptable with tenant advocacy groups. However, asset management implies analyzing and re-allocating resources.

Some experts view the abandonment of units with high operating costs as a more socially and politically neutral method for cutting costs.[44] However, other point out that high cost does not mean poor management. It may mean that the PHA is simply allocating more resources to that project and as a result it is in better condition. Again, this is predicated on the lifting of the one-for-one replacement rule.

2. <u>Raise revenue.</u>

Modernize. Modernization involves making capital investments. A major cost is utilities, therefore, any modernization should consider energy-related improvements. Also, modernization creates the potential to sell marketable units or convert occupancy. A modernization project that results in a net loss may still be undertaken through cross subsidization. Cash flow from one development in the portfolio can be used to cover shortfalls in another.

Sell marketable units. Some detailed market analysis will need to be done. In both the Baltimore and Portland studies, researchers attempted to find the maximum value that could be created by selling the most marketable units. In some cases, this may require modernizing and then selling unitsif the increase in sales price more than offsets the modernization cost. Developments could also be sold and preserved as affordable housing if deed restrictions are attached.

Increase the number of high-rent households. This alternative is more commonly called mixing incomes. As with selling marketable units, this strategy is not without controversy. It attempts to raise rent revenue to match operating costs.

This option is a way to preserve at least some of the existing units vis a vis budget cutbacks. Mixed-income housing developments could become self-sustainable, i.e. not dependent on subsidies. In theory, a cash flowing project could then have debt placed on it or have its rental income stream securitized in order to raise capital for other modernization or redevelopment projects. PHAs would be able to finance through the private capital markets.

Another hurdle is that existing public housing units tend to be below market standards, making it difficult to attract higher income tenants. Substantial modernization might in some cases be needed to sufficiently upgrade units to be marketable. Also, tenants apply to centralized waiting lists and are provided housing on a first-come first-served basis. Higher income families demand a choice in housing units and will not enter the public housing system through a centralized waiting list.

Convert occupancy. Public housing serves a variety of tenant groups including elderly individuals, families, the previously homeless, victims of domestic violence, etc. Elderly housing can often function as financially self-supporting assets due to low operating costs.

If mixing incomes is itself the policy objective, then there are other alternatives. Some alternatives have been explored, but they are beyond the scope of this work.

5. Formalize an Asset Management Plan

Asset managers do not operate the asset. They are not involved in the decisions required for day-to-day property management. They create a plan and then monitor performance and make broad-based decisions. To fulfill this role they must acquire the right information, in the right form, on a timely basis. The asset manager needs to be aware of the financial, physical, and operational characteristics of the assets. This person must also assess the management organization itself and the quality of services produced.

Several performance indicators must be reviewed. The financial condition of the property can be determined by monitoring the amount of operating reserves and reviewing cash flow history. The site should be visited to assess its physical characteristics. Otherwise a true comparison cannot be made between one property and another. There is a potential trade-off relationship between the two. A project might be in excellent financial condition but poor physical condition. In that case, underinvestment in operating may be the cause for the excellent financial condition.

Experts in the field identify two types of required information: standard and dynamic.[45] Standard information includes the location, size and purchase price of the asset. It identifies the property management company and fee structure. It also includes relevant information regarding the owner, long-term tenant leases, structural aspects, loan information, and a site plan.[46] The asset plan should indicate vital aspects of this standard information such as prepayment penalties or lockout dates. Public housing requires the same standard information with the exception of loan terms, since PHAs do not currently place debt on their developments since default/foreclosure risk would then be affixed to a public resource.

In contrast to standard information, dynamic information consists of factors or events that impact the value of the asset, impact the cash flow, or alter the management strategy or holding period. Specifically, the asset manager must be attuned to market (leasing/sales/refinancing) information, tenant status, building structure/physical condition, business/industry environment, third-party performance/decisions, regulatory changes, and operational costs.[47]

> ...The asset manager must oversee detailed plans to meet broad goals, summarize detailed reports into succinct analysis, and communicate the means by which returns can be optimized.[48]

Effective decision-making is closely related to having the correct communication mechanisms in place. It starts with the investor who initiates the process by communicating the objectives to the portfolio manager. Then the asset manager is in the next tier acting as the "intermediary professional" who communicates with the property manager who is in turn directly in contact with tenants, vendors, and contractors. This process needs to move quickly. Moving quickly and proactively is required to overcome the status quo.[49]

PHAs are also interested in much of the same dynamic information. However, they are more attuned to the political/legislative environment since all activity is bounded by HUD rules and regulations. Moreover, PHAs are bureaucratic political entities that are subject to public approval. Their ability to respond to available information is therefore impeded.

PHAs currently collect most of the performance information as a result of their own internal accounting systems. Information is available regarding physical conditions, financial performance, and tenancy. But, budgeting is not project-based. It is a highly centralized activity. Revenues are easily obtained, but costs for individual developments are somewhat difficult to determine since some operational costs are incurred at the central office and not at the property level.[50] Without accurate project-based-budgeting, asset managers cannot know precisely how an asset is performing.

A commercial real estate management company might use the Russell-NCREIF index as a benchmark for its performance. But what can a PHA use? The closest analog is the Public Housing Management Assessment Program (PHMAP). However, it is widely agreed that PHMAP is flawed for measuring management performance.[51] It doesn't measure project-by-project performance as a private sector income and expense report would but agency-wide performance. It includes redundant performance measures. Also, no actual site inspection is performed to determine the physical condition of the project.[52] Nonetheless, Greg Byrne posits the view that PHMAP can be modified to create an accurate performance measure.

An additional assessment that needs to be done in the public sector is the state of the neighborhood. PHAs exist to help poor people. They are concerned about the potential that poor families have to improve their situation in life and, more fundamentally, their quality of life. Certain physical attributes of a neighborhood can be observed such as the number of vacant lots, boarded-up storefronts, and vandalism.

Another necessary public assessment also includes the demographics of the units in order to understand who the tenants are and then assess whether the mission is being met. A property may be low cost, but it might not be serving the families to whom the public housing program was intended.

Summary

From the literature and from preliminary field research, one can expect PHAs to have many difficulties becoming asset managers in the private sector sense. Objectives cannot be reduced purely to financial terms. Current federal funding structure provides few incentives to add value and affords little coordination of decision-making. PHAs cannot simply view properties as assets from which value can be added. There are additional indicators of performance that need to be assessed that the private sector does not. And, a different set of asset alternative plans need consideration given the PHAs social mission, organization, and legislative requirements.

Notes:

[25] Byrne.
[26] Soens and Brown.
[27] Soens and Brown.
[28] Other housing programs, Section 8 and the low income housing tax credit are authorized for finite periods of time.
[29] Byrnre, p
[30] Byrne, p 57.
[31] This idea is under investigation at the Boston Housing Authority.
[32] Keyes, Langley C. Strategies and Saints: Fighting Drugs in Subsidized Housing. Washington, D.C.: The Urban Institute Press, 1992, p.10.
[33] Black, J. Thomas, "Restructuring Pension Fund Investment in Real Estate," Urban Land, Feb., 1997. Historically, this consolidation dates back to the Stock Market Crash of 1929 when banks foreclosed on defaulted properties and inadvertently became the owners of large portfolios of real estate.
[34] Black.
[35] The theory here generally states that activities that have easily specifiable tasks such as construction can be outsourced and maintain the accountability of the public official. Also, the theory based on empirical evidence generally says that the best price can be obtained when private contractors are forced to bid against public ones. In cases of purely private bids, the process tends to suffer from collusion,

driving up prices. The alternative is having public departments essentially sole-sourcing the contract and not obtaining competitive bids at all.

[36] Soens and Brown.

[37] Bratt, Rachel, "The Public Housing Program," *Rebuilding Low Income Housing Policy*, 1989, p 70.

[38] Soens and Brown

[39] Iezman, Stanley L., Asset Management: A Proactive Approach, *Development Magazine*, Jan/Feb, 1991, p 32.

[40] Byrne, p 30.

[41] Leasing at the property management level is unnecessary because of centralized waiting lists.

[42] Interview with Blake Eagle.

[43] The public might then decide to allocate even less money to the public housing program, by claiming that "good money is being thrown after bad."

[44] Byrne, p.

[45] Soens and Brown.

[46] Soens and Brown.

[47] Soens and Brown.

[48] Norwell, p 60.

[49] Pederson, p 62.

[50] Byrne, p 28.

[51] Byrne, p 53.

[52] Byrne, p.

Chapter 3. Organizational Profiles

The following case studies present information that gives an indication of the major challenges facing NYCHA and the BHA. Also described are the history, portfolio, organizational structure, current operation, and major initiatives currently being undertaken. The cases present material that is relevant to the principles identified in Chapter 2.

The New York City Housing Authority

The New York City Housing Authority (NYCHA) was created on February 20, 1934 by Mayor Fiorello LaGuardia, popular and well remembered for his characterizations as he read the Sunday "funnies" on the radio during the Great Depression. LaGuardia appointed a Chairman and board, all of whom were unpaid, to run the public corporation. At the time NYCHA was formed in the Municipal Housing Authority Act, government-subsidized housing was considered highly experimental. But the experiment succeeded in the New Deal era when funding was plentiful. And 1934 is significant to all New Yorkers as the first year that Robert Moses, the "power broker," was appointed Commissioner of Parks.

In the early years, NYCHA produced high quality low-rises. Many of the early projects like Harlem River Houses continued to be among the best designed developments in NYCHA's portfolio.[53] In the time since the Housing Act of 1937, it had been discovered that taller buildings were cheaper to build than lower ones. As a result, low rises had lost favor to the new "tower in the park." From 1937 to 1957, 33,335 units were built through federal programs. In addition, 29,601 were built through state programs and 24,787 through city programs.[54] Nearly 50 percent of NYCHA's stock in 1997 dated back to that early period.

By the 1960s, the stock had aged and required some rehabilitation.[55] Also, the new development program, Mitchell-Lama, was funded through philanthropic sources and placed a premium on quality. NYCHA felt the influence of Lewis Mumford and Jane Jacobs who urged a retreat from the towers and geometries that were neutral to surrounding street patterns. The new planners preferred a connection with urban life. In the 1970s, President Nixon imposed a moratorium on housing construction and shifted the focus of affordable housing development to the private sector. Notwithstanding this shift, development dwindled to a fraction of what it was just ten years earlier.

The 1980s brought little development and a widening of the gap between high and low income households. Consider that in 1969, 14.9 percent of New York City could be considered poor. By 1983, it was 23.4 percent.[56] This trend continued. Even during the economic recovery after 1990, the income gap grew. Real incomes fell for households earning in the lowest 20 percent from $25,993 in 1990 to $23,000 in 1992. In the 1990s there was little new development. In fiscal year (FY) 1994, 299 units were newly completed. In FY 1995, 209 were completed.[57]

Current Situation

In 1997, NYCHA was unique among PHAs. It was much larger and operated in an especially strong rental housing market. It owned and managed 181,331 units of assisted housing in 341 public housing developments, making it by far the largest public housing authority (PHA) in the United States. Puerto Rico with 60,000 units was second.[58] There were 1.4 million units of public housing in the United States.

NYCHA had a large presence in its housing market. One of every twelve New Yorkers lived in public housing.[59] It officially managed units for 560,000 residents. There were 100,000 additional residents that "doubled up" with the official residents making the actual total 660,000.[60] These residents live illegally in units without paying rent to the housing authority. NYCHA rented approximately 11,000 units each year.

Rental income in NYCHA was relatively high for public housing. Average rents were $302 per month and corresponding family income was $13,000 per year. Nationally the averages were $186 and $8,800 respectively.[61]

Public housing was not the only program administered by NYCHA. In addition to public housing, 71,749 families were housed in private apartments through Section 8 vouchers and certificates, a portable tenant based federal subsidy administered by NYCHA. Including combined public housing units and Section 8, NYCHA was the largest PHA in the United States.[62]

Of 3400 PHAs in the United States, NYCHA was widely held to be one of the best managed.[63] In HUD's system for ranking the performance of PHAs, the Public Housing Management Assessment Program (PHMAP), NYCHA consistently scored in the top ten. NYCHA's developments were in very good physical condition and in many cases were attractive to higher income working families.[64]

The unique scale and environment of New York provided natural advantages for public housing. There were seven million people living in the five boroughs and 16 million in the metropolitan area. Many of the large developments go relatively unnoticed here due to high overall density. Many New Yorkers will say they have been walking by public housing all their lives and never noticed.[65] Also, the ratio of renters to owners is above the national average resulting in high demand for multifamily rental real estate.

New York City has been experiencing a housing emergency for over a decade. There is a strong statistical relationship between vacancy and rent. As rents decreased, vacancy also decreased. In 1993, vacancies for units renting below $300 per month were exceptionally low at .58 percent.[66] Vacancy in NYCHA housing was .5 percent in 1997. According to NYC legislation, a housing emergency can be declared when net rental vacancy for all classes of rental housing falls below 5 percent.[67]

Though by all accounts, NYCHA's stock was in very good condition, it had been estimated that $7 billion would be required to make all necessary capital improvements. That figure was based on an internal assessment in which project superintendents listed their needs to capital planning. All capital improvement needs were scored on a scale of one to five. Five was urgent. One was least urgent. But with limited capital funding through the Comprehensive Grant Program (CGP), the federal subsidy for modernization, the most urgent needs were addressed and less urgent needs often neglected. In FY 1997, $347 million had been allocated for CGP. In 1994, another $435 million had been allocated.

The Homeless Initiative

Another force driving down rents was the priority that New York City has placed on housing its homeless. In each of the fiscal years (FY) 1994 through 1996, approximately 1,000 units were rented to homeless households referred by the Department of Homeless Services (DHS), the Department of Housing Preservation and Development (HPD), and the Human Resources Administration (HRA). Between FY 1994 and 1996, NYCHA also provided housing to an average of 150 additional homeless families per year that were not referred.

As further evidence of the citywide priority on homelessness, Section 8 assistance was provided to 2,708 homeless families through the Emergency Assistance Rehousing Program in FY 1996. In addition, Section 8 assistance was provided to 1,083 homeless families through the regular application.

Organization

NYCHAs organizational structure has been described as the "classical pyramid."[68] A Board of Directors included a Chairman and two members, all appointed by the Mayor. The Chairman then appointed a General Manager to oversee the operations. Also, there are five Deputy General Managers and two Assistant General Managers who are responsible for day-to-day operations.

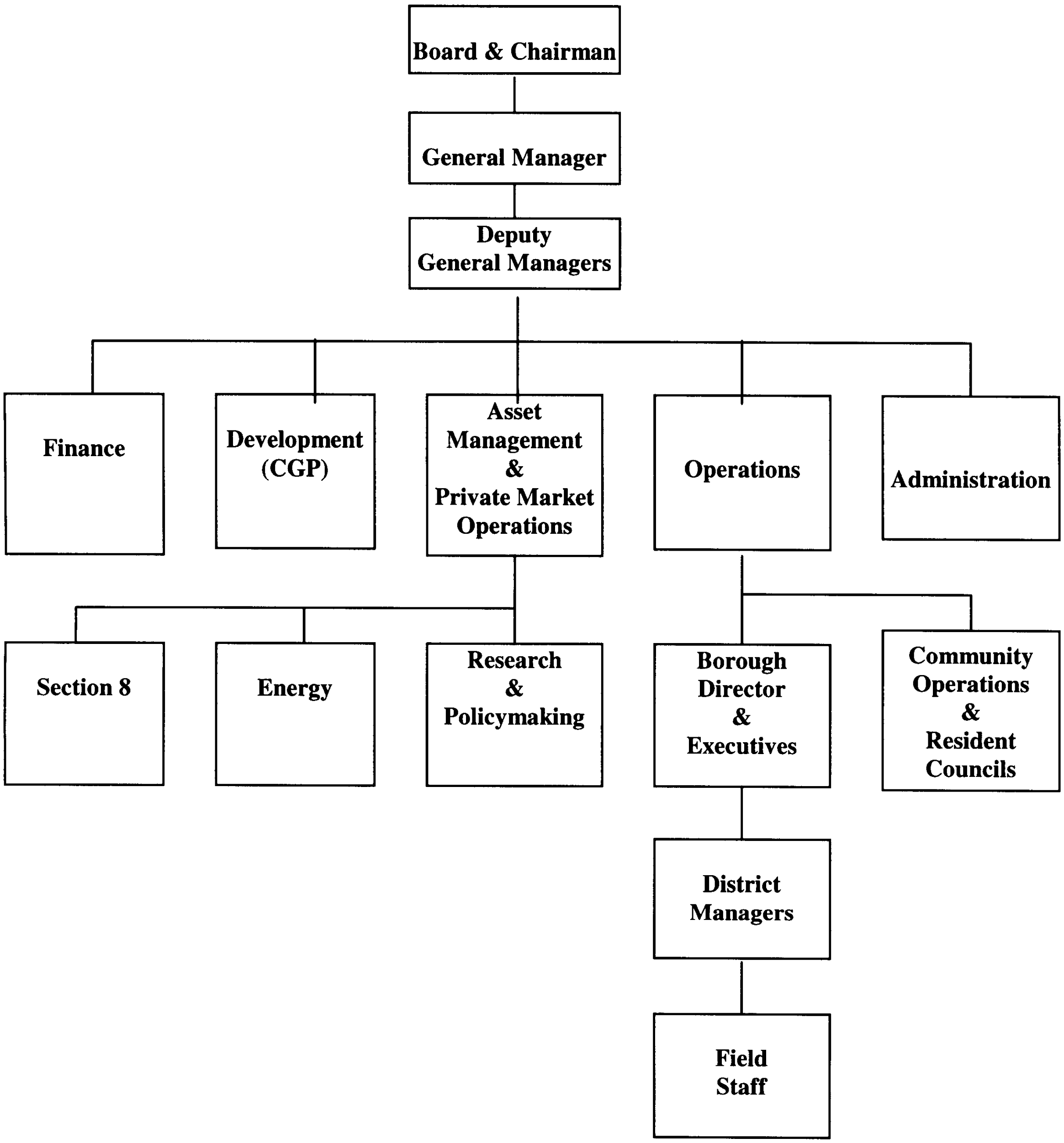
A decentralization initiative occurred in 1995 that restructured Management, Technical Services and Community Operations into five borough-based departments. The intention was to "facilitate communication between residents and borough management, increase accountability of managers in the field, and encourage residents to take a more active role in the development of their communities." Resources were moved out of the central office and into the field closer to local development managers. Several supervisory layers and central office managerial positions were eliminated.

In 1996, NYCHAs Housing Applications Department was decentralized into borough offices that provided information and interviewed tenants. Interactive computer kiosks were installed in borough offices as a marketing tool. They provided touch screen access to floor plans and pictures of public housing and Section 8 units.

There were 15,000 employees at NYCHA making it the largest real estate manager in the United States.[69] The staff was involved in managing housing as well as providing housing support services. NYCHA provides social services including guidance with family problems, recreational programs, youth education programs, employment opportunities, employment counseling, and community programs. These programs support NYCHAs intention to actively support the upward mobility of tenants and improve the quality of life.

Figure 3-1. 1997 Organization Chart of the New York City Housing Authority.

Note: This chart indicates only the divisions most relevant to asset mangement.



Recent reorganization at NYCHA has introduced new responsibilities and managed others in new ways. In 1995, the 2,500 police officers in the Housing Authority Police Department

(HAPD) merged with the New York Police Department (NYPD). Since 1995, some property management has been contracted out to private management companies. During 1996, a total of 1,899 units were contracted out. Continued modernization of aging units and some new development have occurred. Also, a recycling campaign was initiated.

Challenges and Objectives

Financially, the gap between allowable expenses and revenues grew during the 1980s due to federal preferences for homeless / displaced households and households paying exceedingly high rent burdens i.e. rent as a proportion of adjusted gross income. In FY 1996, Congress appropriated only 89% of the operating subsidy needed under the Performance Funding System (PFS) formula. The difference could be compensated for by drawing on reserves. It was estimated by NYCHA that if rent is received from a tenancy that averages 60 percent of area median income, public housing in New York City can become financially self-sustainable.[70]

In June 1997, the primary challenges identified by the General Manager were financial and social. There are four major objectives:

1. Maintain stock. NYCHA will commit to maintain 181,000 subsidized units.[71]

2. Improve Quality of Life. Resident councils can directly inform NYCHA about how management is performing.[72]

3. Make NYCHA self-sufficient. NYCHA planned to meet its mission to provide safe, sanitary, and decent affordable housing regardless of whether Republicans or Democrats control Congress and regardless of who's in the White House.[73] A level of economic self-sufficiency is implied where the portfolio is managed as a self-sustaining group of assets (as per the original intent of PHAs).

4. Create additional housing opportunities - Mixing incomes and creating development capital through tax-exempt bonds will maintain the 181,000 subsidized units and create higher income units. However, the subsidized units will not all be in publicly owned buildings. Some will be master leased in privately owned mixed income developments. Units would be "transferred" but not lost.[74] Private capital will be leveraged to build more mixed income developments that add to the total number. This strategy is termed "expanding the pie."[75]

Strategy

NYCHA plans to raise rental revenues through mixed income developments. First, a ceiling rent (or maximum rent) will be imposed. That ceiling rent would make some public housing units attractive to higher income working families who want to pay less than 30% of their income for rent. As units become vacant through attrition, those units would then be made available to working families. A second waiting list would be required to attract working families who could choose to live in other private housing units. Rental revenue would rise, and extra income would be generated from those developments.[76] In addition NYCHA planned to lobby for repeal of the Brooke Amendments to create incentive for poor families to raise incomes.

There were four arguments for mixing incomes. The first reason was primarily financial, two were social, and the last was political. First, PFS permitting, the additional income could be invested in capital improvement, reserves, or new development. Second, NYCHA believed that higher income families would serve as role models for other families. Third, mixed income developments provided a tenancy that is more representative of the surrounding neighborhood in New York City. And fourth, mixed income developments were representative of a broader range of income groups in the overall population. Therefore, mixed income developments would broaden the political support base for the public housing program. Building political support was particularly important in an era in which the public had grown distrustful of public agencies.

Improving the financial condition of individual developments by gradually raising rental income was hoped to produce two outcomes. First, individual developments would move towards financial self-sufficiency. Self-sufficiency would reduce NYCHA's dependence on HUD and therefore provide some insulation against political shocks. Second, NYCHA might also be able to use the additional revenue to enter into public private joint ventures. They could then build new mixed income developments. The new developments would be self-sufficient and could therefore be financed by tax-exempt bonds. NYCHA could then reduce the cost of debt, access more debt, or otherwise cause the development to be feasible by master leasing the affordable units.

Income mixing was particularly viable in New York because, by all accounts, the units are well maintained and capable of being marketed to working families who could choose to live elsewhere. NYCHA was pursuing higher income tenants through an outreach program.

To further raise the marketability of existing units, NYCHA planned to improve its day-to-day operations. NYCHA's strategic plan included reducing turnover, improving tenant screening practices and collecting rent diligently. Today, HUD requires that tenants be consulted on some modernization plans through CGP. Also, PHAs have limited power to evict, particularly in New York where the housing laws extended the length and cost of evictions.

Implementation

NYCHA had recently undertaken a major initiative to cut utility costs which comprise a substantial part of operating expense. As part of an energy conservation initiative, NYCHA entered into a contract with the New York Power Authority (NYPA). NYPA would freeze energy charges until December 31, 2001 and spend $38 million over the next five years on energy conservation. New environmentally safe refrigerators will be installed in every NYCHA unit. The resulting energy cost savings to NYCHA will be between $31 million and $50 million. In a further effort to reduce energy costs, which constitute a large part of operating costs, twelve developments were converted from oil to gas heating in each of fiscal years 1995 and 1996.[77]

By June 1997, NYCHA had completed a major initiative to assess its portfolio and understand the factors that contributed to the attributes of the assets. The Asset Management and Private Market Operations Department visited the buildings and neighborhoods of all 341 developments. Each development has been assessed according to a number of objective and subjective criteria. Scores were added and then each development was ranked from one to 341 to find the best and worst performers. The objective criteria included percent on welfare, percent minors, percent single parent households, percent elderly, vacancy, and crime rate. Subjective criteria generally concerned the surrounding neighborhood and included assessment of economic development need, cleanliness of streets, number of vacant lots, conditions of storefronts, and presence of graffiti.

NYCHA intended to use its stock assessment to find developments that were especially suitable for various funding programs. The final decision on what strategies to pursue would come from the Board. While Asset Management and Private Market Operations planned broad based changes and prepared a business plan for NYCHA, Operations, Section 8, and the other departments continued on with their own work.

The Boston Housing Authority

In 1935, the Boston Housing Authority (BHA) was established through enabling legislation of the Commonwealth of Massachusetts. It was governed by a five-member board; one member was appointed by the Mayor, and four by the Governor. The board set policy and hired an Administrator who ran the day-to-day operations of property management.

The BHA weathered a particularly difficult period during the 1970s when it was hit with a class action suit. Tenants took the BHA to court over poor routine maintenance. Though the BHA continued to operate under a consent decree, the situation deteriorated and culminated with court appointed receivership on July 25, 1979.[79]

During that period, the BHA, with 17,000 units, was the fourth largest PHA in the country but had a 28% vacancy rate. The stock was in a state of "shocking physical decay" according to the court appointed receiver, Harry Spence. Labor had become entrenched through the unions and impeded operations. According to Harry Spence, patronage was rampant at the BHA. Management didn't respond to tenant requests. Tenant screening was poor. Criminal activity and poverty had grown in the developments. Information and control systems were ineffective. And the BHA was operating at a deficit.[80]

Current Situation

In 1997, the BHA was no longer a troubled housing authority. Its Public Housing Management Assessment Program (PHMAP) score had improved each of the previous five years.[81] Vacancy rates, which contributed disproportionately to a PHMAP scores, had declined.

At least one prominent affordable housing advocate noted in May 1997 that the BHA was in a transitional period in which it was "turning things around."

The BHA was the largest landlord in Boston.[82] It owned and managed 12,777 units of assisted housing in 70 developments that were 79 percent occupied.[83] Most were funded by the United States Department of Housing and Urban Development (HUD). The rest were funded by the Commonwealth of Massachusetts Department of Housing and Community Development (DHCD). Ranked by the total number of units owned and managed, the BHA was the eighth largest public housing authority (PHA) in the United States. Including Section 8 vouchers and certificates, a portable tenant-based subsidy, the BHA administered another 6,280 units or 19,505 units total. Combined, BHA units housed approximately 10 percent of the city's population. Ranked by total housing units administered, public housing and Section 8 vouchers and certificates combined, the BHA was the 11th largest PHA in the United States.[84]

There was no shortage of demand for BHA units. The Section 8 waiting list had 6,175 families. Each family anticipated at least a five-year wait before they were assigned to a unit. There were approximately 30,000 families on the centralized waiting list for BHA public housing. In the overall Boston housing market, residential vacancies had dipped below 2 percent thus triggering new development activity.

Many developments were old and in need of capital improvement. In 1994, a study concluded that $1 billion of capital needs existed in the BHA portfolio.[85] Only $28 million was committed to BHA capital improvement under Comprehensive Grant Program (CGP) for FY 96. Two years prior, that number was $32 million. In addition, other funding sources were applied, as they become available. A sixty-year-old development in South Boston, Mary Ellen McCormack, contained over 1000 units. It was built in 1936 and was still operating with the same steam heating system. But through ESCO (Energy Savings Contract), this system would be modernized using financing created by bonding future operating cost savings with a new heating system.

However, the bulk of capital improvements were funded by CGP. These funds were allocated first to the most pressing problems. In order of priority, CGP was distributed first to health / safety, then preserving the physical structure, unit modernization, and then management improvement.

The highest priority for CGP at the BHA was health / safety. In particular, vacant units would be tested for lead-based paint and abated as required. The extensive abatement problem was due to the age of the units. During the early years of the public housing program, units were required to use lead-based paint. Mary Ellen McCormack was in the midst of an ongoing abatement program. As such it was experiencing abnormally high vacancy. Other health / safety items included fire safety, ventilation, and security.

The second priority was preserving the physical structure. Preservation included roofing, plumbing, building envelope, common areas, and electrical. In some cases, a failure in a roofing system or building envelope caused some units to go vacant.

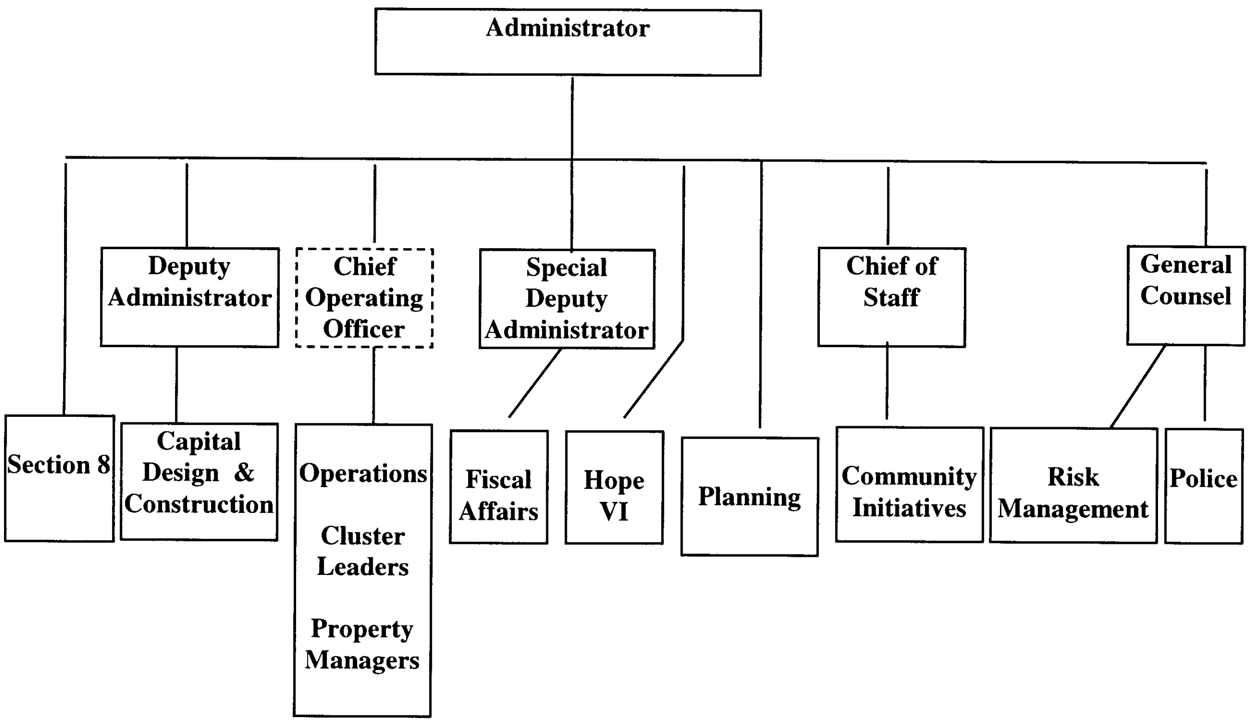
Third, many family developments were built to outdated standards and required modernization. Modernization constituted the largest line item under CGP. These units were designated *comprehensive modernization projects* and underwent upgrades. New equipment and space planning were often required to attain modern standards of living. Fully, a third of the $28 million requested for CGP in fiscal year 1997 was dedicated for modernization.

Fourth, 8 percent of CGP funding was used to improve management.[86] Management improvement consisted of four goals. First, tenant organizations were an integral part of the capital planning process and needed to be funded. Second, the self-sufficiency of residents was to be enhanced through social service and outreach programs to elderly and youth. Third, resident security would be enhanced with public safety investigators and a grievance panel coordinator. Fourth, improving operational efficiency would be addressed through turning around vacant units more quickly, improving rent collection by funding new positions in the central office, and improving the management of Worker's Compensation and General Liability claims. In 1995, field offices were equipped with PCs, touch-tone telephones and fax machines for the first time by using CGP funds.

Organization

In 1997, the BHA operated as a centralized small company. "There aren't many layers here," said one of the officers.

Figure 3-2. 1997 Organization Chart of the Boston Housing Authority



There were 950 employees at the BHA; 250 worked at the central office in downtown Boston.[87] The remainder consisted of field personnel who performed day-to-day property management. The BHA was a bureaucratic organization performing multiple functions. The major divisions were formed to administer specific federal funding programs: Section 8, CGP, operating subsidies, drug elimination grant, and HOPE VI Urban Revitalization Demonstration Program for severely distressed developments. Unlike some other PHAs, the BHA had its own Police force providing quick response to tenant problems.

In 1997, the Administrator was appointed directly by the Mayor. The absence of a Board of Directors, a remnant of the receivership period, was unique among PHAs. The Administrator incorporated the responsibilities of day-to-day operations, policy making, and served as liaison to the Mayor. "It's up to the Administrator to identify a direction," said a staff member. "My role is to put it together. The policy makers must decide."

Capital planning, day-to-day operations, fiscal controls, and policy making, aspects of property management that are particularly relevant to understanding the potential for asset management were dispersed throughout the BHA. The following section focuses on these.

Property management responsibility was divided between Operations, Fiscal Affairs, and Capital Design and Construction (CDC). Purchasing, budgeting, tenant selection and assignment, and capital planning was handled through the central office which incurred overhead costs of about 15 percent of operating expenses.

Financial Controls were administered by the Fiscal Affairs Department at the central office. Budget analysts monitored the operations, prepared future budgets, and took part in quarterly site assessments. Fiscal Affairs cut across organizational lines to monitor the various programs. Fiscal Affairs created the strategic management plan (SMP) for the assets. Analysts in the central office consulted with development managers to produce detailed annual plans for each development.

Operations was divided into two main categories: Family and Elderly / Disabled. There were six Cluster Leaders in Family and a General Manager for Elderly / Disabled. Cluster Leaders were responsible for several developments. In 1996, they had moved out of the central office in downtown Boston and into field offices. But they retained responsibility for communicating with the central office, which they visited once a week. With the position of Chief Operating Officer currently unoccupied, Cluster Leaders reported directly to the Administrator.

At each development, a property manager and a small staff were responsible for collecting rent, maintaining the stock, responding to tenant needs, and executing work orders. This group reported directly to the central office and to the Cluster Leader. They were required by HUD to respond to emergency work orders within 24 hours and other work orders in a reasonable amount of time. Working within the operating budget, property managers were sometimes forced to draw down on the operating budget to fund an emergency capital improvement.

CDC was responsible for capital planning. They prepared capital plans with the assistance of tenant groups. Project Architects in CDC are also responsible for bidding, awarding, and supervising construction contracts.

Some capital and maintenance planning occured in the field. The Elderly / Disabled Division has its own engineer in charge of capital planning. Each development has its own maintenance staff. And the Elderly / Disabled Division has its own centralized maintenance staff. Within the Family Division, there has been a recent effort to gradually decentralize maintenance staff and move them to developments.

Challenges and Objectives

In 1997, the BHA Administrator was focused on positioning the organization. It was important to instill the notion that the BHA was a competitor in the real estate industry. As such, the most important goal was to improve service. It was believed that service had never been provided as well as it could have. BHA property management was not considered to be up to the private sector standard. Through funding from the administrative budget, some personnel in Operations had undergone training to learn from property management in the private sector.[88]

Aside from property management, the BHA was involved in some non-housing services. In 1997, the primary activity of the Community Initiatives Division (CID) was the administration of the drug elimination program. The CID was planning expansion of BHA services to include day-care and job training.

Reduction in federal subsidies also drove the need to operate better. It was important to anticipate the effect of current policy trends such as Welfare reform that would contribute to funding cut backs. Preparing for such inevitabilities represented a shift from the organization's strategy of "crisis management." [89]

Strategy

A Planning Unit was formed in June 1997. It had the charge of developing a "long range plan" for the BHA that would guide the timing and criteria for future redevelopment / rehab efforts. This unit recognized that there were opportunities for new development in the strong Boston housing market. Recently, rents had risen and vacancy was decreasing. Financing might be available through public private development with foundations, corporations, real estate investment trusts (REITs), and community development corporations. Through public private development, the BHA could partner with a private company. The BHA would provide land, and expertise in the approval process. If necessary, they could also provide subsidies and/or structure. The private partner would provide development expertise and/or capital.

The Planning Unit had performed evaluations of its assets in order to understand its developments as real estate assets. Two interns had looked at each of the large family developments. They gathered site maps, area maps, zoning studies, demographics, incomes, and financial histories. A third intern explored the potential for alternative private and public capital.

The BHA planned to find ways to engage the private sector. Through pilot projects, the BHA would test the marketability of its units and explore new potential sources of financing. The BHA will maintain ownership of the land through 20-year land leases.[90] After 20 years, the property reverts back to BHA control at which time, the BHA retains the right to redevelop or pursue any other appropriate action.

In June 1997, the BHA issued a Request for Proposal (RFP). Feasibility studies were solicited as the first part of a plan to continue the rehabilitation at West Broadway; a project in South Boston first occupied in 1949 and redeveloped in 1986 during the receivership period. However, insufficient funding was appropriated to complete the redevelopment. Altogether there were 27 buildings with 726 units at West Broadway. Twenty buildings were occupied but seven buildings remained vacant. Preliminary studies by the BHA indicated that these seven buildings were attractive for redevelopment. They had access to off-street parking, were in Boston's "Enhanced Enterprise Zone" and "Main Streets" program areas, and were close to the subway. The RFP sought feasibility studies for West Broadway's potential for residential, commercial or mixed-use redevelopment.[91]

The underlying concern behind West Broadway was operating subsidy reduction.[92] Land lease income could be used on the other 20 buildings at West Broadway or at other developments in the BHA portfolio. It attempted to create a level of financial self-sufficiency. The planning unit was busy searching through the portfolio for other pilot projects. And the BHA continued under the new mantra of being "the best landlord it could be" as it attempted to upgrade service to a private sector standard.[93]

Notes:

[53] Plunz, Richard. *A History of Housing in New York City.* New York: Columbia University Press, 1990, p. 216.
[54] Plunz, p. 234.
[55] Internet source. NYCHA Homepage.
[56] Plunz, p. 322.
[57] Internet source. NYCHA Homepage.
[58] Internet source. HUD User.
[59] Internet source. NYCHA Homepage.
[60] Internet source. NYCHA Homepage.
[61] Internet source. HUD User.
[62] Internet source. HUD User.
[63] Interview with George Latimer, CEO National Equity Fund, and former Mayor of St. Paul, Minnesota.
[64] Interview with staff member.
[65] Anecdotal evidence.
[66] Blackburn, Anthony J., *Housing New York City.* NYC: Department of Housing Preservation and Development, June 1995, p. 168.
[67] Internet source. HUD User. This number may not reflect units held deliberately vacant. Actual vacancy maybe below 1%.
[68] Guilderbloom and Appelbaum. *Rethinking Rental Housing.* Philadelphia: Temple University Press 1989. The authors empirically found that equilibrium pricing was not attained in housing markets with less than 7-9 percent vacancy.
[69] Interview with staff member.
[70] Internet source. NYCHA Homepage.
[71] Interview with John Martinez, Deputy General Manager for Asset Management and Private Market Operations, NYCHA.
[72] Interview with John Martinez.
[73] Interview with John Martinez.
[74] Interview with John Martinez.
[75] Interview with Paul Graziano.
[76] Interview with Paul Graziano.
[77] Interview with Paul Graziano.
[78] Internet source. NYCHA Homepage.
[79] Scott, Esther, "Managing the Boston Housing Authority: The Receivership Begins," Kennedy School of Government Case Program. Harvard College, 1985, p. 1.
[80] Scott, pp. 5-9.
[81] BHA – FY97 Comprehensive Grant Program.
[82] Interview with staff member.
[83] Internet source, HUDUser. Note that the 12,777 does not inlcude DHCD funded units. The actual total is approximately 15,000 units. Also, 79 percent understates occupancy because it includes units that are deliberately held vacant. Such units are designated "F" units and include the units which are being abandoned for redevelopment. Mission Main and Orchard Park are currently undergoing HOPE VI redevelopment and falsely lower the HUD reported occupancy. Unofficially, actual vacancies at the BHA may be around 5 percent.
[84] Internet source, HUDUser.
[85] Interview with Sandra Henriquez, Administrator.

[86] BHA – FY 1997 Comprehensive Grant Program.
[87] Interview with Sandra Henriquez, Administrator BHA.
[88] Interview with Sandra Henriquez.
[89] Interview with Sandra Henriquez.
[90] Interview with staff member.
[91] *BHA RFP for Real Estate Advisory Services at West Broadway Development*, June 1997.
[92] Interview with staff member.
[93] Interview with Sandra Henriquez.

Chapter 4. Analysis and Conclusions

This thesis proposed that changes in the external operating environment were leading PHAs to consider asset management. Each PHA is responding to its mission, changes in the funding of public housing, and the condition of its stock. Both PHAs included in this study are implementing the principles of asset management to some extent. They are also planning broader applications. Both are able to define clear objectives that respond to their unique external operating environments. They have analyzed alternative asset strategies and created strategies consistent with the objectives. However, difficulty arises in separating roles to ensure accountability and formalize reporting. Their bureaucracies disperse responsibility for capital planning, financial planning, and operating. In a private asset management system, these responsibilities would be consolidated into one entity or individual. Centralized decision-making and budgeting processes can conflict with the delegation of authority to agents responsible for one or several assets. Figure 4-1 summarizes how the principles of asset management are being implemented.

NYCHA

With its entrepreneurial history, recognized strength in management, and exceptionally strong rental housing market, NYCHA has the capacity and latitude to be proactive in its approach to asset management. NYCHA plans to institute portfolio asset management, with wide ranging implications for organizational structure and policy in response to changes in federal regulations. Asset management is viewed as a means to distance NYCHA from expected volatility in the legislative operating environment that might have adverse effects on its ability to execute the mission.

1. Define Objectives. NYCHA has taken an entrepreneurial approach that anticipates change in the external operating environment. It has multiple objectives that reflect the various parts of its mission. The quality of life objective is clearly mission-driven. Achieving self-sufficiency is related to the intention of preserving public housing stock and connotes financial self-sufficiency. Self-sufficiency is intended to allow NYCHA to carry out its mission regardless of which party is in power in Congress or the White House. Indeed, positioning the organization to be resilient from changes in the political landscape was the charge given to the Asset Management and Private Market Operations Department. By attempting to create an organization capable of perpetual life, NYCHA recognizes that its service mission is "forever." This contrasts Rachel Bratt's statement that the housing itself is "forever." NYCHA adds the idea that the managing agent can be perpetual, but units can be "transferred."

NYCHA clearly perceives that development and financing opportunities exist. However, this growth is predicated on a shift in policy. Creating additional housing opportunities implies growth. As a result of the Diaz memorandum, NYCHA no longer must provide subsidized units solely in developments that they own. Rather, NYCHA will change its tenant mix to include higher-income families. And, master leased subsidized units in privately owned developments will replace those units lost in the NYCHA portfolio.

NYCHA's objectives are clearly articulated and measurable. Simply counting units will reveal whether the 181,000 subsidized units were maintained and new units created. Resident Councils will provide immediate feedback on the quality of housing and services. Resilience against political change over time will reveal NYCHA's self-sufficiency.

2. Respond to the external operating environment. Forced to search for new sources of capital, NYCHA plans to take the opportunity to (a) expand the total number of units that it manages and (b) broaden its base of political support. The strong condition of NYCHA's stock and the state of housing emergency in an exceptionally strong housing market create an opportunity that other PHAs might not have.

On the other hand, a strong housing market reduces vacancies and limits housing choices. As a result, an increasing number of families go homeless. And HUD requires that PHAs serve the homeless. Given that NYCHA rents 11,000 units per year overall and 1,150 units per year to homeless families, fully 10% of all rentals is to homeless families. Since a majority of the homeless suffer from mental illness and drug addiction, these tenants require intensive program-related support.[93]

Despite the relatively good condition of NYCHA's stock, there are substantial modernization needs. NYCHA owns 181,000 units and requires $7 billion in capital investment. This translates to approximately $38,000 per unit. However, these modernization needs are much lower than the BHA's.

Rather than wait for the environment to change, NYCHA proposes to instigate change. It created a plan for an asset management system and is lobbying for the legislative changes that will support the plan. With repeal of the Brooke Amendments, imposition of ceiling rents, and changes in PFS, NYCHA would be able to retain increased revenue and create the potential to access other sources of private capital.

3. Separate roles to ensure accountability. NYCHA supports asset management through some existing structures and organizational change. Currently, there are no asset or portfolio

managers at NYCHA. Asset Management and Private Market Operations is not part of Operations; it is a task force.

Asset management implies concentrating or coordinating activities that are currently dispersed within NYCHA's bureaucracy. Divisions have been created to administer each of the HUD funding streams. These divisions do not facilitate coordination between capital planning, operations, and administrative controls. Each division applies to HUD separately for funding. A single individual or unit does not maintain continuity between the various decisions.

Decision-making and policymaking are held by executives in the central office and borough offices. But there have been some clear attempts to restructure operations. Operations has been decentralized to borough-based offices. And waiting lists are now borough-based rather than centralized. However, considering the scale of New York, borough-based waiting are still centralized waiting lists. With 181,000 units in five boroughs, each borough's public housing stock is likely to be larger than the BHA's.

NYCHA faces a formidable property management task. With 181,000 units in 341 developments, the average development has 534 units. These high concentrations of poor families were shown to incur high costs in the HABC study due to additional service requirements, i.e. security and maintenance. Yet, NYCHA is reputed for its management ability. Existing property management appears to be quite strong.

Accountability in property management service is maintained through Resident Councils. Service quality can be ensured through feedback from these tenant-based groups that are an integral part of the organizational structure. Interviewees considered the quality of housing service to be a valuable asset at NYCHA.

4. Analyze alternative asset strategies. NYCHA, which financed some of its early developments with private capital, today plans to enter into public private development partnerships. It intends to reduce its reliance on HUD funding. It appears that the idea of master leasing affordable units in mixed income developments and using the portfolio strength to lower the cost of debt makes NYCHA a forerunner in public housing finance.

Mixing income may be the initial policy shift that then creates further opportunities for new development. Or if new development is the primary goal, mixing income is the means to achieve that goal. Regardless, NYCHA, with its "access to capital" and proactive orientation, is addressing challenges in the external operating environment as opportunities.

NYCHA is completely committed to mixing income as a goal. Under its plan, it will not only convert existing developments to mixed income, but also engage private developers looking for project cash flow in mixed income developments.

5. Formalize reporting. The current stock assessment program undertaken by NYCHA is another necessary step towards the formalization of an asset management program.

NYCHA has a formalized system for engaging its tenants through Resident Councils that report to the central office. Operations, on the other hand, reports through the borough office. For example, Local Development Managers report to District Managers who, in turn, report to the borough executives. District Managers have the potential to assume the role of asset managers within this hierarchy. But, strategic planning does not appear to be engaged at the borough level and most operational decision-making seems to occur in the borough office.

BHA

Having had a troubled past, the BHA has taken a cautious step in the direction of asset management. It plans to institute asset management principles incrementally. The BHA is redeveloping or rehabilitating its most distressed properties through pilot projects and HOPE VI. The organization intends to generate income from existing assets in order to attract private capital. A primary concern is "access to capital" that will allow the BHA to continue its service mission. Private sector affordable housing management is seen as the benchmark with which to compare its performance. At the same time, the BHA is also preparing a long-range plan that will circumscribe future individual asset decisions.

1. Define Objectives. The primary goal of the BHA, service improvement, is an operations-related goal. It does not imply analyzing asset alternatives. It implies managing better. However, the objective of maintaining stock clearly relates to asset management. In contrast to NYCHA, whose plans are predicated on having "access to capital," the BHA holds "access to capital" as an objective. As further evidence of the BHA's service mission, it is committed to housing the poorest-of-the-poor in existing developments. Consideration of mixing incomes has been limited to pilot projects insulated form the existing portfolio.

2. Respond to the external operating environment. The stock exhibits significant modernization needs. The BHA owns and manages 15,000 units and requires $1 billion in capital investment. This translates into approximately $67,000 per unit, nearly the cost of building a new unit. It has limited ability to attract higher-income families without modernization. However, the local real estate market is expanding.

"Access to capital" was clearly the primary concern at the BHA. Federal cutbacks appear to be driving a short-term response to bolster this loss of public capital with private capital.

3. Separate roles to ensure accountability. The BHA is involved in numerous activities. The BHA has separate departments that handle Section 8, HOPE VI[94], community initiatives, capital design and construction (CDC), and finally operations. Unlike most PHAs it also has its own Police. Most of these departments are program driven. CDC administers CGP and operations handles day-to-day operations.

With 15,000 units in 700 developments, the average development has 214 units, considerably less than NYCHA's 534. Also, a density of 214 units per development is at the upper bound of what is considered cost efficient in the HABC study. In addition, the BHA portfolio includes a number of smaller developments. Interviewees have said that these smaller developments are also cost-effective.

4. Analyze alternative asset strategies. West Broadway is a significant step towards establishing an asset management program. But it may not be indicative of what future asset management efforts might occur. Since the West Broadway units are currently vacant and there is no funding committed to them, the BHA had latitude to experiment. There was nothing to lose.

The BHA seems constrained in its ability to institute portfolio level planning. It does not exhibit the latitude that NYCHA does.

5. Formalize reporting. Detailed financial information exists at the BHA. The BHA did not appear to have difficulty in tracking expenses to the project.

Understanding of the physical real estate asset and financial performance are separated. Cluster Leaders of family developments occupy the position that an asset manager would between property management and ownership. Spending approximately one day a week in the central office, Cluster Leaders are an information conduit for Fiscal Affairs which maintains close control over property management. However, budgeting is designed and monitored by Fiscal Affairs at the central office. Development Managers and Cluster Leaders are consulted in the budgeting process but they do not make the budget. Field personnel then work within the projected budget.

The strategic management plan (SMP) prepared every year is another element of the BHA's property management system that is a step towards asset management. Again, Fiscal Affairs provides the focal point.

Figure 4-1. Implementation of Asset Management Principles at NYCHA & BHA

Principle	NYCHA	BHA
1. Define objectives. Clear objectives are used to guide strategy and operations. Are they consistent with the mission? Who is the tenant? Will the stock be preserved?	Commitment to 181,000 units. Units will not be lost, but "transferred." Quality of life improvement. Tenant involvement is part of the mission. Resident Councils are part of the organizational structure. Self-sufficiency. Be able to carry out mission regardless of political situation. Attain economic self-sufficiency. Create additional housing opportunities. "Expand the pie."	Service improvement. Become better landlords. Meet private sector standards. To help poor people. Orientation is towards social service. Expand services to include day-care and job training. Maintain existing stock. Mission is to serve the poorest-of-the-poor. "Access to Capital." Required to meet service mission.
2. Respond to the external operating environment. What are the significant challenges posed by the external operating environment?	Stock. Existing structures are well maintained. Modernization needs are $38,000 per unit. Strong housing market. Extremely low vacancies. Units are marketable to higher income families. Underfunding. Has not adversely affected the portfolio as other funds have been accessed. CGP declined from $435 to $347 million in three years. 89% PFS Homelessness. Adverse effect of strong housing market. HUD requires PHAs to engage the homeless population. 10% of rentals are to homeless.	Stock. Significant modernization needs of $67,000 per unit. Real estate market is expanding. Planning unit is searching for opportunities to partner with foundations, corporations, and REITs. Underfunding. Particularly a problem for a portfolio with high capital needs. CGP declined from $35 in 1995 to $28 million in 1997. Receivership in 1979. Stock has declined from 17,000 then to 15,000 in 1997.

Figure 4-1. Implementation of Asset Management Principles at NYCHA & BHA (cont'd).

Principle	NYCHA	BHA
3. Separate Roles to ensure accountability. Asset decisions are facilitated by the structure. Are elements of the "Management Triad" visible? Are tasks and responsibilities delegated? Are required skills present?	Large multi-layered bureaucracy. Decentralization of operations is in process: management has moved closer to Local Development Managers and Waiting lists have become borough-based. Some downsizing has also occurred. Some property management has been contracted out. Housing police was spun-off. Centralized decision-making. Decisions are made by borough and central office Executives.	Mid size bureaucracy. Decision-making and monitoring is highly centralized. The Planning Unit was created in June 1997. Some Elderly / Disabled property management has been contracted out. Highly centralized decision-making. Operations reports directly to the Administrator.
4. Analyze alternative asset strategies. What hold/reposition options meet the objectives?	Raise revenue by mixing income. At a portfolio level, vacant units upon attrition will be converted to use by higher income tenants. HUD permitting, additional income can be retained and used to enter into joint ventures for new developments to replace the low-income units lost through conversion. It is believed that those units can be replaced at 1.5 for every 1 lost. But, the total number of units in the portfolio will increase. Cut costs. Evict as required. Collect rent diligently. Create low-cost tenant mix. Reduce utility expenses.	Raising revenue. Respond to underfunding of operations and modernization needs. Anticipate welfare reform further reducing revenue. Alternative potential capital sources in West Broadway include the following: federal enhanced enterprise zone, federal main streets, land lease, private debt and equity. Cut costs. Reduce utility expenses. Modernization of physical structure.

Figure 4-1. Implementation of Asset Management Principles at NYCHA & BHA (cont'd).

Principle	NYCHA	BHA
5. Formalize reporting. What is the financial and physical condition of developments and neighborhoods? What reporting systems need to put in place?	Stock Assessment. All 341 developments and surrounding neighborhoods have been reviewed and visited in person. Each was scored and ranked according to objective and subjective criteria. The 60 developments most suitable for federal programs will be selected for reinvestment or repositioning. Borough based property management. Local Development Managers report to Field Directors who report to The Borough Director. Resident Councils provide direct feedback.	Stock Assessment. Family developments have been visited. History, site maps, area maps, zoning regulations, and demographics have been collected. Centralized fiscal control. Fiscal affairs monitors property management directly and designs budget. Cluster Leaders do not make budgets. Invest in management. Tenant organizations and outreach. New technology for property management.

A Foundation of Property Management

The existing property management infrastructure in both PHAs appears to be able to accommodate asset management. Each PHA is already an established property manager. They both have over 60 years of property management experience under adverse circumstances. The external operating environment consisted of inadequate funding, tenants with substantial service needs, distressed neighborhoods, deteriorated stock, and large scale multifamily developments. Also, legislative constraints on operations further curtailed the ability of PHAs to address many of its problems.

Both PHAs already perform many of the functions of asset management (see p. 25): managing cash flow and bank accounts, reporting correctly and on time, monitoring physical condition/capital improvements, hiring/replacing professionals, and monitoring contract compliance. Both have taken recent steps to introduce elements of asset management. Both perceive that development opportunity exists through public private joint ventures. Both illustrate that public asset alternatives are a subset of hold/reposition because of the mission to preserve public housing stock.

Challenges Ahead

Instituting a formal asset management system implies organizational change for PHAs. The primary difficulties to public asset management lie in modifying the existing property management system. The asset manager's role does not exist. It is also not clear from which department that role might emerge. Integrated skill sets would be required.

> At the base of any effective real estate management system must come objective definitions and understanding of processes and goals. Any real estate asset management system that does not begin here will inevitably return here, once decision-making slows, because of inadequate commitment to the process. Understanding the value of an asset management system also provides the ability to educate others about its value – a buy-in which is the beginning of creating an effective system.[95]

Interviewees in both Boston and New York believe that asset management implies a revolutionary change in public housing. "Asset management would be a triage for public housing authorities." Other personnel stressed the importance of buy-in and commitment. These statements seemed to confirm the frame-breaking change implied in Rick Pederson's "Establishing a Real Estate Asset Management System." Pederson advocates nothing less than a rapid and complete top-down reorganization.

The organizational change required seems to depend largely on factors in the external operating environment. The control that HUD exerts over the budgeting process creates an organizational structure that can be viewed as restricting the competitive ability of PHAs. NYCHA and the BHA are bureaucratic organizations with program-driven departments. Most departments administer one of the HUD subsidy streams. One department prepares the capital plan. Another operates the property. Another prepares and monitors the budget. Yet another makes policy.

Misaligned incentives exist as a result of PFS, one for one replacement, the Brooke Amendments, and restrictions on debt and tenancy. Also, the system of funding requires application to HUD for approval of various programs. Each of these funding streams is non-fungible. NYCHA has made its plan contingent to these changes.

> Governmental entities should be proactive in dealing with real estate. An agency that only responds to requests bypasses the chance to influence value and maximize use, but very few public agencies have compiled an inventory of what they own to allow them to plan the best course of action.[96]

As a result of its strong position, NYCHA has proposed a portfolio level strategy that is growth-oriented. The organization has the capacity to lobby for federal incentives that provide incentives to seek out development opportunities. They are willing to let individual asset decisions be driven by overall objectives. And they appear to have access to capital. Perhaps more basic than the issue of asset management at the BHA is the issue of access to capital. Facing more fundamental problems than NYCHA, the BHA is concerned with finding new revenue sources to replace federal ones.

The mission guides both PHAs. More than one interviewee expressed, "I'm here to help poor people." Another staff member stated, "I feel like a social worker sometimes." However, there were differences in the interpretation of the mission in respect to asset management. Some viewed asset management as completely contradictory to the mission. Others viewed it as being a vehicle for necessary changes to the way PHAs operate. Those opposed, viewed public housing as a resource for only the poorest-of–the-poor. Perhaps there is more need for this approach today than in the past due to the widening of the income gap between the lowest and highest income families. Those supporting asset management accepted that underfunding of subsidies would eventually diminish the quality and quantity of units. They believed action had to be taken immediately. The issue was survival of the public housing program altogether.

Notes:

[93] Jencks, Christopher. "The Homeless," *The New York Review of Books.* April 21 & May 12, 1994.
[94] HOPE VI is the Federal subsidy for severely distressed public housing redevelopment. HOPE is an acronym: Home Ownership for People Everywhere.
[95] Pederson, p. 62.
[96] Pederson, Rick. "Establishing a Real Estate Asset Management System." *American City & County*, April 1980, p. 60.

Exhibit
Legislative Impediments to Asset Management.

Performance Funding System (PFS) – Operating subsidies are reduced for any increase in revenue. There is no incentive to reduce costs or increase income.
Brooke Amendments - Rents are capped at 30% of income.[97] Families are ineligible after income exceeds 80% of MSA median. They do not have an incentive to seek employment and increase income since they will be evicted.[98]
Non-fungibility of funding streams – PHAs receive separate subsidies for modernization, operating, drug elimination and major rehab for troubled projects (HOPE VI). They do not have discretion over use of resources.
Annual appropriation bills - Funding is subject to change every year. The operating environment is constantly changing so PHAs tend to act with only a one year horizon.
Aggregated reporting - There is limited breakdown of costs and expenses by individual assets upon which to do a performance analysis.
One for one replacement - Any unit lost through disposition or demolition must be replaced on a unit-for-unit basis.
Community-wide waiting lists - Property managers do not have discretion over tenant selection and no incentive to improve physical characteristics of the development. Also, tenants don't have a choice. They can be placed in a development with undesirable physical or geographic characteristics.
One-year authorization language - Some legislative changes are not permanent. PHAs cannot base long-term strategy on temporary legislation.
No funding for asset management - In the private sector, profits pay for the asset manager who adds value to offset the cost.
Limited ability to evict bad tenants - Federal statute and regulation require court action to evict a tenant for "serious or repeated violation of material terms of the lease, or for other good cause."[99]
Public Housing Management Assessment Program (PHMAP) - Ability to manage properties is not captured.

Notes:

[97] Originally when proposed in 1969, the limit was 25% and was modified in the 1981 Omnibus Budget Reconciliation Act.
[98] Maher, Eric M., M. Housing Authority of Portland Low-Rent Public Housing Analysis & Recommendations, 1995.
[99] Maher.

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