Beyond Housing of Last Resort: Adopting a Private Sector Model and Utilizing Alternative Sources of Capital for the Delivery of Public Housing

by

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ABSTRACT

This thesis considers the capacity of Public Housing Authorities (PHAs) to adopt market fundamentals and tap new sources of capital as federal financial support dries up. Motivated by ideology and fiscal constraints, the federal government is cutting funding and rethinking such basic questions as the population to be served by public housing and the manner in which to serve them. More significantly, Congress and HUD are looking to the private sector not just as a model for how to delivery housing efficiently, and effectively, but as a source for the development, financing, and ownership of public housing.

Congress's and HUD's vision of a private sector model for public housing presupposes three essential requirements: (1) that PHAs have the statutory and regulatory space to be entrepreneurial and creative to cut costs and tap alternative sources of financing; (2) that a ready supply of capital exists waiting to flow into public housing; and (3) that PHAs have the institutional capacity to make the transformations necessary to take advantage of the opportunities afforded them and to compete for private funds. This thesis explores the dynamics among these three issues generally, describing the options available to PHAs, the concessions necessary to access new capital, the limits to the transformation to a private sector model, and the obstacles preventing PHAs from taking advantage of the opportunities now provided them. This thesis also examines, from a more localized perspective, the options and strategies available to PHAs, and the requirements for moving to a private market-orientation and for accessing alternative sources of capital, using the Boston Housing Authority (BHA) and the Cambridge Housing Authority (CHA) as case studies.

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To Wednesday Nights, Everywhere

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AUTHOR'S NOTE

Much of the information contained in this thesis is extremely time sensitive. Congress and HUD are continually redefining public housing policies. Even during the writing of this thesis some analysis had to be discarded because Congress drafted new legislation or HUD altered another regulation. Readers must be aware that some of this information may be soon outdated.

TABLE OF CONTENTS

Introduction

This thesis considers the capacity of Public Housing Authorities (PHAs) to adopt market fundamentals and tap new sources of capital as federal financial support dries up. Motivated by ideology and fiscal constraints, the federal government is cutting funding and rethinking such basic questions as the population to be served by public housing and the manner in which to serve them. More significantly, Congress and HUD are looking to the private sector not just as a model for how to deliver housing efficiently, and effectively, but as a source for the development, financing, and ownership of public housing.

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Overview

Congress and HUD are aggressively advocating the private sector as both a model and a source for the delivery of public housing, and are actively implementing policy changes to achieve this end. The mass of reforms allowing PHAs to be entrepreneurial, and to follow a private sector model, are a reflection of: (1) pressure to balance the federal budget, and (2) an effort to enact affirmative public policy changes to address real issues in public housing.

Political pressure to balance the budget has resulted in severe cuts in funding for public housing. Since 1994, Congress has reduced its total commitment to public housing by 20% (24% in 1996 dollars) and cut modernization funding by 24%.[1] In FY 1996, Congress authorized operating subsidies at just 89% of actual need.[2] Additionally, for the second year in a row, Congress appropriated no money for new construction. (Exhibit A) In sum, these cuts suggest an effort by Congress to begin to divorce itself from the public housing business and to look to the private sector to make up the losses.

At the same time, however, there is an equally strong movement to enact affirmative policy changes to address significant problems in public housing. In an effort to "mark" housing to the market, i.e., to design and operate housing that is financially and physically compatible with neighborhood market standards, HUD is aggressively pushing PHAs to demolish outdated, physically distressed, and socially dysfunctional housing, and replace these units with more urbane housing typologies such as garden apartments and townhouses.[3] Key federal policy goals in remaking public housing are to use the private sector as a model, and to provide PHAs with greater opportunities to set their own priorities and to make their own decisions, with respect to tenancy composition and asset management.

Members of Congress and HUD officials seem to be split between advocating a private sector model for public housing as a progressive policy reform, and as a consequence of a harsh budgetary reality.[4] Some of the reforms represent necessary change of failed public housing policy; others simply are a reaction to reductions in funding. Many of the changes in

[1] Byrne 12.
[2] Each year Congress determines by formula, through the Performance Funding System (PFS), the amount of operating subsidies each PHA needs. In recent years however, Congress has only authorized partial payment of this sum. Currently, Congress is providing only 89% of PFS to PHAs. Exhibit E describes PFS in more detail. Byrne 12.
[3] Cisneros 4.
[4] Deborah Goddard, personal interview, July 26, 1996.

regulations, however, serve both purposes. It is difficult to say with certainty which reforms fall into which category. Is allowing PHAs freedom to demolish units without replacing them a beneficial reform that gives authorities more control over its assets, or is this change a reflection of Congress' interest in reducing its commitment to the public housing industry? These distinctions depend on one's perspective, and it is not the purpose of this thesis to try to answer such questions; it is simply important for the reader to recognize that this controversy exists, and that one person's reform is another's budget cut.

Regardless, emulating the private real estate industry has both fiscal and policy merits. From a policy perspective, the public housing industry can learn a great deal from the private sector about asset management, economic efficiency, and property valuation. From a fiscal perspective, many of these principles will become more necessary as PHAs struggle to survive on less funding from the federal government. For some PHAs, moving to a private market orientation is an opportunity and for others, a necessity; for many, it is both.

Space for PHAs to Be Entrepreneurial and Creative

To realize their vision of a private sector model for public housing, Congress and HUD are trying to create space for PHAs to be entrepreneurial and creative, and to explore new methods for financing, developing, owning, and managing public housing. The scope of change is a mixed bag of both legislative (Congress) and regulatory (HUD) policy measures that allow PHAs to cut costs and improve efficiency, make decisions regarding specific assets that are in the best interests of the authority's portfolio as a whole, tap alternative sources of financing, and form partnerships with private real estate companies or other not-for-profit entities.

Congress and HUD have lifted, or are in the process of lifting, restrictions on operating subsidies, modernization grants, ownership structure, leasing preferences, demolition, and unrelated business income limits. Change will allow PHAs to attract private debt and equity, income mix housing populations, contract out more services, and raise additional revenues to support housing activities. The range of strategies a PHA can pursue to bridge funding gaps caused by dramatic cuts in operating and capital subsidies include: divesting or demolishing of high cost units/properties; increasing rental streams by renting to higher income tenants; reducing operating costs through improved efficiency, such as contracting with private management companies; securing outside subsidies; converting uses of some properties; and obtaining financing in the form of debt or equity from public, private, and other governmental sources.[5]

These reforms will support PHAs in their efforts to embrace a new mindset for the delivery of housing, but they are not sufficient to enable them to compete with the private sector. Transition to a more market-oriented approach will be an evolutionary process. As PHAs take advantage of the new reforms and become more entrepreneurial in seeking alternative sources of capital, new obstacles will emerge which will require additional change. This process is already occurring with respect to public housing affordability requirements. HUD regulations require privately held public housing to remain affordable for forty years. New legislation recently passed by Congress mandates that HUD reduce this requirement to a shorter time frame.[6] This theoretically should allow private capital to flow more smoothly into public housing.

Chapter One, **Current Reforms in Public Housing**, discusses the myriad of reforms that Congress and HUD have implemented to allow PHAs to become more entrepreneurial and to emulate the private sector. Chapter One also identifies some additional reforms Congress and HUD can consider to help PHAs make the transition to a private sector model and ease the flow of private capital into public housing.

[5] List taken in part from Byrne 61.
[6] Deborah Goddard, personal interview, July 26, 1996.

New Sources of Capital

If Congress's and HUD's vision for a private sector model for public housing is to become a reality, PHAs must not only have access to alternative sources of capital, but investors must be willing to supply funds for public housing activities. Access to private financing was established in an April 8, 1994 memorandum on the use of public housing funds to leverage private financing from Nelson A. Diaz, General Counsel for HUD, to Joseph Shuldiner, then Assistant Secretary for Public and Indian Housing. This document asserted that the Housing Act of 1937 does not prohibit PHAs from combining equity and debt with federal public housing funds to pay for capital construction costs. The subsequent Interim Rule on Mixed Financing, issued by HUD on May 2, 1996, corroborated this finding, and made it an official policy position of the Department.

The occasion for the notice, and the subsequent Interim Rule, was two separate requests, one from the Fairfax County, Virginia Redevelopment Authority, and the other from the St. Louis Housing Authority, to syndicate Low Income Housing Tax Credits (LIHTCs) to raise equity for redevelopment projects. Both authorities requested coupling tax credit equity with HUD grants to redevelop existing properties.[7] The positive ruling opened the door for other PHAs to seek private financing for public housing ventures.

Investors have responded by supplying capital to PHAs in the form of tax credit equity, conventional debt, and soft debt. New capital is being utilized for major redevelopment, new construction, acquisition, and energy improvement projects. The attraction to public housing for investors is primarily the tax effects that flow from the on-going operations of public housing, i.e. losses (largely depreciation benefits) or cash flow (which is rare).[8]

Equity and debt for various public housing ventures have different risks and benefits, advantages and disadvantages, and may require rearrangements of financing and ownership

[7] Diaz Memorandum, April 8, 1994, 6.
[8] Helen Barney, personal interview, July 3, 1996. Deborah Goddard, personal interview, July 26, 1996.

structures, management systems, and tenancy composition. It is important to remember, however, that while these changes are common to basic real estate transactions involving these funding sources, they are not common to PHAs that rely predominantly on grant funding for operational and development expenses. Failure to understand the risks of different sources of capital or the rearrangements required by their use, could cause some PHAs to lose control of its stock, and/or put the long-term affordability of its properties at risk.

Tapping alternative sources of capital is an essential piece of the market-driven model envisioned by Congress and HUD in the restructuring of public housing, yet it lies at the far end of the spectrum of new opportunities for PHAs. Utilizing equity and debt should be the culmination, not the origination, of entrepreneurial activities. A PHA that pursues financing ventures with alternative capital in a piecemeal fashion without performing the preliminary and necessary functions to acquire these new funds runs the immediate danger of being taken advantage of by entrepreneurs, and the long term risk of losing its assets. Prior to engaging with private investors, PHAs must make the necessary transformations to avoid making irreparable mistakes with their resources.

Chapter Two, **New Sources of Capital**, identifies the sources of debt and equity that are flowing into public housing to support major redevelopment, new construction, acquisition, and energy improvement projects, and the rearrangements in ownership and financing structures, management systems, and tenancy composition that may be required by different financial vehicles. A key aim of this analysis is to describe how these new arrangements draw, or do not draw, on scarce resources thereby effecting the overall supply of affordable housing. This chapter reviews those obstacles identified in Chapter One that are particular to encumbering a more efficient flow of capital into public housing, and the reforms Congress and HUD can implement to rectify some of these impediments.

PHA Transformations

If PHAs want to maximize the options now available to them and adopt a private sector orientation for the delivery of housing, they may have to reorganize, especially to attract private capital. PHAs that seek to make the transition should understand the manner in which the private real estate industry operates, and incorporate some of these principles into its business practices. The transformation process may be extensive and lumpy, and can include changes in corporate philosophy, reporting systems, budgeting, and personnel.

In moving to a market approach, PHAs should consider themselves as private real estate companies: as property owners, managers, and landlords, and think about the cost of delivering a "unit" of housing.[9] Like a private company, a PHA should consider its properties as a portfolio of assets and compare the costs of providing housing at different developments. A PHA can then make decisions on individual assets that maximize the value and durability of its portfolio as a whole. Technical changes such as site-based management and development-specific budgets, will be required to access private funds as well as run operations more efficiently.

Changing markets involves a whole new set of actors with different investment priorities, criteria, risk levels, and tolerances. At the very least, a PHA which chooses to access alternative sources of capital will have to model a not-for-profit community development corporation (CDC), or, at the more extreme, a for-profit private real estate company, because both of these entities deal with debt and equity finance instruments that are currently unfamiliar to the public housing industry.

Chapter Three, **PHA Transformations for a Private Sector Model**, describes the changes PHAs must make with respect to corporate philosophy, reporting systems, budgeting, and personnel in moving to a private sector orientation and/or attracting alternative sources of capital. This chapter reviews those barriers related to funding streams

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[9] Byrne 59.

and accounting systems that impair PHAs ability to make a more successful transition to a private sector model.

BHA and CHA Transformation to Private Sector Model

The ultimate test of whether or not Congress's and HUD's vision of a private sector model for public housing will be successful is the extent to which individual PHAs can engage in new strategies and implement the required changes necessary to tap alternative sources of capital and embrace a new way of delivering housing. Ultimately, the choices each PHA will make will be shaped by its institutional and political context, i.e. its corporate culture, market demographics, local politics, and community support.

As PHAs make the transformations to a private-market orientation, they should not lose sight of their fundamental mission, which Congress and HUD have given them much leeway to redefine. In this new environment, PHAs can change the composition of their tenancy, and they can divest of properties without replacing them. Each PHA must determine its role in the overall housing market, the population it wishes to serve, and the role of social services in its mission. Each authority should answer for itself, such fundamental questions as: Should the authority pursue mixed housing or concentrate on serving the most needy only? Should the authority create permanent housing through homeownership programs or continue to offer only transitional accommodations? Are project-based or tenant-based subsidies more cost efficient? To what extent can the activities of the authority stimulate neighborhood renewal by leveraging additional resources for community development? The choices each PHA makes in this new environment should honor the mission of the authority with respect to the answers to these questions.

Chapter Four, **BHA and CHA Transformation to Private Sector Model**, explores how the BHA and CHA, two significantly different PHAs, both operationally and demographically, are organizing for change in this new environment, by examining each

Authority's vision for the future, the strategies and options under consideration at each authority, and the changes in corporate philosophy, reporting systems, budgeting, and personnel each is implementing in pursuing its goals. A key aim of this chapter is to identify how opportunities, necessities, and market forces dictate the range of options the BHA and the CHA can, or cannot, undertake.

Final Note

The purpose of this thesis is to identify the options and strategies currently available to PHAs, particularly with respect to tapping new sources of capital, to describe the transformations housing authorities must make to implement new ventures, and to document, through case studies, the extent to which two large urban PHAs, the BHA and the CHA, can, and are, taking advantage of the opportunities now provided them. This analysis should shed some light on the "success" of, and limits to, Congress's and HUD's vision for a private sector model for public housing.

Ultimately, the limiting factor to the implementation of Congress and HUD's vision for a private sector model is the breadth of the changes that individual PHAs choose to embrace. Regardless of how many statutory and regulatory changes Congress and HUD enact, or how willing the private sector is to supply capital for public housing ventures, the ultimate limit to the movement to a private sector model is the individual PHA's own policy goals and objectives and its opportunities, necessities, and market characteristics supporting those changes. This is perhaps the most important message in this thesis for the future of public housing.

CHAPTER ONE: CURRENT REFORMS IN PUBLIC HOUSING

Introduction

Congress's and HUD's vision of a private sector model for the development, financing, ownership, and management of public housing presupposes three essential requirements: (1) that PHAs have the statutory and regulatory space to be entrepreneurial and creative and to tap alternative sources of financing; (2) that a ready supply of capital exists waiting to flow into public housing; and (3) that PHAs have the institutional capacity to make the transformations necessary to access these resources and emulate the private sector. While none of these three themes can be separated entirely from the others, this chapter explores primarily the first issue, the reforms that Congress and HUD are enacting for PHAs to cut costs, improve efficiency, make decisions with respect to tenancy composition and individual properties that maximize the value and durability of an authority's portfolio as a whole, access new sources of capital, and form partnerships with private real estate companies or not-for-profit entities. Additionally, this section identifies many of the statutory and regulatory obstacles, including: (1) need based funding, (2) a lack of incentives to cut costs, (3) annual appropriations, (4) labor policies, (5) non-fungibility of funding sources, and (6) aggregated accounting systems, that still hinder PHAs from becoming more entrepreneurial and adopting, more easily, the private sector model envisioned by HUD. Efforts on the part of the federal government to address these issues will also increase, and smooth, the flow of capital into public housing.

Overview

Today, Congress and HUD are rethinking the delivery of public housing and turning to the private sector for assistance, as both a model and a source for development, financing, and management. At the core of this transformation is a movement to apply market fundamentals to public housing, to make PHAs more efficient, demand driven, and fiscally responsible. Under new rules, PHAs can contract out more services, change the income mix of their developments, convert properties to alternative uses, and hand capital and operating subsidies over to private entities.[10] PHAs are no longer constrained by prohibitions on disposition, or forced to serve a pre-defined resident population.

> In the past, PHAs had little flexibility with respect to funding sources and assets they possessed, they were expected to provide housing to a specific number of families in specifically identified buildings, using whatever resources HUD gave them. All this is changing. PHAs can continue to own and manage property or they can dispose of them, they can contract out management...sell off properties to other entities, [and] they can enter into partnerships with private [companies] and not-for-profits.[11]

In sum, the world of public housing is being turned on its head, and PHAs now have much leeway to redefine their mission, priorities, and policies.

Change in this new environment flows from the twin goals of: (1) reducing the federal budget, and (2) enacting progressive policy reforms to address legitimate problems in public housing. As described in the **INTRODUCTION**, it is not always clear which reforms fall under which category. Many of the reforms represent both an effort to reduce the federal government's commitment to public housing and an attempt to make progressive changes in policy to solve real issues in public housing. Again, this thesis will not try to identify the true motivations for these new policies. Instead, this thesis takes the reforms as given and tries to determine how PHAs can best respond to them.

What is more important, however, is for the reader to recognize that the current changes are in many ways simply an evolution of past events. The federal government's financial support of public housing has rarely been consistent. Exhibit A shows that total spending has been particularly volatile over the last six years, indicating a pattern of Congress trying to reduce its commitment to public housing. Furthermore, since the creation

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[10] Byrne 66.
[11] Byrne 66.

of the federal housing program under the Housing Act of 1937, Congress and HUD have continuously vacillated on the fundamental issues of public housing including: the population to be served, whether to provide transitional accommodations or permanent housing, whether to allocate subsidies for capital or current account, and whether project-based subsidies or tenant-based assistance is more cost effective. At various times, Congress has answered these questions differently, in pursuit of alternative goals or in solving new problems, and has often turned to the private sector for assistance managing, developing, and financing public housing.[12] From this perspective, the changes occurring now are merely representative of a continual pattern in public housing.

Those with experience in the public housing field however, believe that the current transformation is more permanent, and far reaching, than past efforts. No one can say with certainty how long this climate will last, but those with tenure in the industry are unanimous in their belief that the changes today, are as large, as deep, and as revolutionary, as anything they have seen in public housing's history.[13] The depth and permanence of the transformation should be a clear message to PHAs that they must prepare for, and respond to, a new era of fiscal austerity and revolutionary change in the delivery of housing services.

Reforms

The scope of change in this new environment is a mixed bag of both legislative (Congress) and regulatory (HUD) policy measures that fall into two broad categories: (1) policies applying to operations and the resident population, and (2) policies applying to development and control of the physical assets. The former represents efforts on the part of Congress and HUD to allow PHAs to raise revenue and have more control over the

[12] Please see the Appendix for a short history of public housing -- how policies have changed over the years and how the private sector has been involved in the delivery of housing.

[13] Jim Stockard, personal interview, March 28, 1996. John Stainton, personal interview, June 18, 1996. Howard Cohen, personal interview, January 10, 1996.

composition of their tenancy. The latter demonstrates efforts to permit PHAs to engage in asset management practices and to form partnerships with non-governmental organizations.

Policies Applying to Operations and Resident Population

The principal policy changes regarding operations and the resident population include allowances for PHAs to set minimum rents and ceiling rents, develop employment incentives, create homeownership opportunities, eliminate federal preferences, and retain surplus income (discussed below in more detail). In sum, these reforms provide new opportunities for PHAs to stimulate employment among residents, foster community and promote economic diversity within developments, and raise revenue.

To make families take more responsibility for their living accommodations, PHAs can require tenants to pay minimum rents of $25 per month, regardless of their total income. To increase community within developments, PHAs can convert some public housing apartments into homeownership opportunities. To stimulate employment, a PHA can offer incentives for working families through income and rent adjustments, without a corresponding reduction in the authority's operating subsidy. To achieve mixed-income, economically diverse populations within developments, PHAs can rent to higher income families. PHAs are no longer restrained by federal preferences which mandate that priority for housing be given to those most in need.[14] Finally, to entice higher income stable families to stay in public housing, PHAs can impose ceiling rents based on local market comparables or Section 8 Fair Market Rents (FMRs).[15] PHAs are no longer required to charge every household 30% of its income for rent regardless of how much money the family is earning.

[14] Please see Appendix for description of federal preferences.
[15] CLPHA, March 22, 1996, 1-6.

Performance Funding System (PFS) Revenue Retention[16]

An additional reform that belongs to the operations/resident population category that merits special attention is retention of surplus revenue. This is a significant step on the part of HUD to encourage PHAs to be more entrepreneurial. As an incentive for PHAs to increase revenue, HUD has instituted an income retention program that allows authorities to engage in income-producing activities without a reduction in PFS operating subsidies.[17] This ruling is a pilot program running over the next three years. Under the announcement, entitled *Performance Funding System Policy Revision to Encourage Public and Indian Housing Authorities to Facilitate Resident Employment and Undertake Entrepreneurial Initiatives*, PHAs can retain income from: (1) increases in total rental income (whether derived from existing residents' earnings, or through leasing to a higher income population), and (2) non-rental income earned through entrepreneurial activities, such as rental of roof space, income from billboard advertising, profits from vending machines and laundry rooms, and user fees for community space, without a corresponding reduction in the authorities' PFS.[18] This is a major departure from the past, in which PHAs were not allowed to keep any additional revenue; all entrepreneurial proceeds were simply deducted from a PHA's PFS subsidy agreement.

Policies Applying to Development and Control of the Physical Assets

A second set of reforms applies to the development and control of the physical assets. These policy changes include: increased scope of eligible uses of federal funds, elimination of one-for-one replacement, and tapping new sources of capital/forming partnerships with non-governmental entities (discussed below in detail). These reforms encourage PHAs to be more

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[16] Performance Funding System (PFS) is the formula by which HUD calculates the amount of operating subsidy a PHA should receive. A description of PFS is contained in Exhibit E.
[17] Over the past several years, Congress has not appropriated 100% of PFS. PHAs are allowed only to retain earnings up to 100% of PFS, anything over 100% reverts to HUD as a reduction in PFS.
[18] HUD Notice. *Performance Funding System Policy Revision to Encourage Public and Indian Housing Authorities to Facilitate Resident Employment and Undertake Entrepreneurial Initiatives.*

entrepreneurial and to adopt an asset management perspective in making expenditure decisions about individual developments.

To encourage PHAs to take actions in the best interests of the authority's portfolio, Congress has increased the scope of eligible uses of public housing funds to include a greater range of redevelopment activities such as demolition, site preparation, and relocation.[19] In the same vein, Congress eliminated one-for-one replacement requirements so that PHAs can dispose of assets (subject to HUD's approval) that drain the authority's resources.[20] Previously, PHAs could not demolish or divest properties without replacing them with new units. Where funds, or land, were unavailable for new construction, many developments in large urban centers would, and still do, sit empty and abandoned -- eyesores for communities, and fodder for those promoting the view that public housing does not work. This no longer is necessary. Furthermore, if a PHA chooses to sell an asset (subject to HUD approval, see footnote twenty), it can retain the proceeds from the sale.

Tapping New Sources of Capital/Forming Partnerships With Non-Governmental Entities

Most significant of the reforms in this category, however, is the ability of PHAs to tap new sources of capital for public housing ventures and to form partnerships with private and not-for-profit entities. In an April 8, 1994 memorandum on the use of public housing funds to leverage private financing, from Nelson A. Diaz, General Counsel for HUD, to Joseph Shuldiner, then Assistant Secretary for Public and Indian Housing, Diaz specified that, according to the Housing Act of 1937, there was no requirement that housing assisted by a PHA be owned by the PHA:

[19] Byrne 9.
[20] One-for-One Replacement was eliminated by the 1995 federal recessions bill. Several caveats remain in place however. PHAs cannot demolish or divest properties without HUD approval which the agency will give for one of three reasons: (1) the property adversely effects the health or safety of tenants; (2) disposition will allow for more, or better, equivalent housing thus preserving the total amount of lower income housing stock; or (3) other factors that are consistent with best interests of tenants, yet are not inconsistent with provisions of the Housing Act of 1937. Byrne 9.

> There is no requirement that the housing that is being assisted also be owned by the PHA. Consequently we do not see any statutory prohibition against the use by a PHA of public housing development funds in conjunction with private capital for the development of a public housing project that will be owned by an entity other than the PHA.[21]

Implicit in this statement is the notion that a PHA does not have to own a housing unit for the unit to receive capital and operating subsidies. Assistance may go to a privately owned unit which is developed and operated in accordance with the Housing Act of 1937.

Diaz did note that the manner in which the unit is transferred to the private entity does matter.[22] According to Diaz, the Housing Act of 1937 specifies that publicly assisted housing must remain affordable for its expected life, which is defined as forty years.[23] Thus any transfer of ownership from a PHA, to a private entity, must include a forty year commitment that the property remain affordable and be operated under the terms of the Annual Contributions Contract (ACC) agreement, with protection in the event of a foreclosure.[24] On a minor note, because the Act exempts all properties from property tax, projects receiving ACC funding must also be exempt from real estate property taxes.[25]

In sum, Diaz's memo paves the way for (1) public-private partnerships between PHAs and private entities; (2) privately owned public housing; and (3) mixed income developments of public housing and market rate units.[26] Diaz's ruling applies to all new housing constructed under development grants and all existing public housing redeveloped under HOPE VI grants.[27] (See below) The Interim Rule on Mixed Financing, issued by HUD on May 2, 1996, corroborated Diaz's memo, and made the ruling an official policy of the Department.

[21] Diaz Memorandum, April 8, 1994, 7.
[22] Diaz Memorandum, April 8, 1994, 7.
[23] Diaz Memorandum, April 8, 1994, 7.
[24] The ACC agreement is the mechanism by which HUD agrees to support a property with operating subsidies.
[25] Soloman 2. PHAs can pay a Payment in Lieu of Taxes (PILOT) fee instead.
[26] So long as public funds are not used to support market units.
[27] Deborah Goddard, personal interview, July 26, 1996.

HOPE VI

Many of these operational and development reforms are being implemented through HOPE VI, a comprehensive grant program targeting large distressed properties. Created in 1993, in the wake of the National Commission on Severely Distressed Public Housing's (NCSDPH) report about the depth of distress in the nation's public housing stock, HOPE VI represents a departure from the normal granting procedures of HUD.[28] Today, HOPE VI encapsulates HUD's vision for how public housing should be delivered.

HOPE VI recipients are given large amounts of money, between $20 and $50 million, and maximum flexibility to use these funds to physically, economically, and socially redevelop properties. HOPE VI encourages PHAs to use grant money for off-site neighborhood redevelopment to improve the overall quality of public housing neighborhoods, and to leverage relationships with other community actors.

> It is the intent of this demonstration [HOPE VI] to allow the greatest degree of flexibility on the part of the PHA in determining the approach likely to be most successful in treating the development it has selected...[the plan] should incorporate boldness and creativity in addressing difficult issues... PHAs are encouraged to seek a broad spectrum of participation from local and state governments, neighborhood organizations, businesses, nonprofit corporations, social service agencies, and residents of the developments.[29]

Since this original Notice of Funding Availability (NOFA), HUD has widened the scope of the program to allow PHAs to involve the private market and leverage alternative sources of capital.

Secretary Henry Cisneros is unequivocal in his advocacy of HOPE VI as the catalyst for defining the future of public housing production and management.

> HUD has pursued two tracks to physically redesign public housing. First HUD has aggressively implemented HOPE VI, a large scale initiative to provide localities with

[28] NCSDPH authored a report in 1992 which found that the nation's modernization backlog totaled $28 million.
[29] HOPE VI NOFA.

maximum funds and flexibility to reshape public housing neighborhoods...from A to Z. Second. HUD has relaxed existing program and funding rules to speed the reconstruction of public housing...[30]

Of the Vaughn Development in St. Louis, Cisneros writes:[31]

> Vaughn exemplifies the Administration's model of tomorrow's public housing: leveraging federal funds with private and public resources to build a new community of garden-style apartments; creating market rate housing for mixed-income families; and seeking private management for the development.[32]

Congress seems to share Cisneros' enthusiasm for the program. While the federal government seems to be reducing its commitment to public housing, it has continued to fund HOPE VI. Congress authorized an initial outlay of $300,000,000 for the program in 1993. This was followed by $778,000,000 in 1994; $500,000,000 in 1995; and $280,000,000 in 1996.[33] (Exhibit A) Initially, funds were earmarked for the forty largest cities plus those on HUD's Troubled Authority List. (Exhibit B) Currently, 33 cities have been awarded HOPE VI grants for 45 different developments. (Exhibits C and D) Congress has also awarded 26 HOPE VI Planning Grants, seven of which went to projects in cities unrepresented by HOPE VI grants.

HOPE VI's favor with Congress and HUD symbolizes the significance the program holds for redefining public housing. HOPE VI embodies HUD's and Congress's vision for the future, offers a laboratory for experimenting with new ideas, and represents in some cases a complete transition to a market-orientation by looking to the private sector to simultaneously develop, own, and manage public housing. HOPE VI thus far has been the primary program for experimenting with many of the operational and development reforms, particularly tapping new sources of capital, as will be detailed in the next chapter.

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[30] Cisneros 4.
[31] Technically, Vaughn is not one of the original HOPE VI sites. Vaughn is being redeveloped under a development grant but is implementing reforms similar to those that many HOPE VI sites are proposing. Vaughn is being redeveloped by the same entity that is redeveloping Techwood Homes in Atlanta, the first HOPE VI site, and the process is virtually the same.
[32] Cisneros 7.
[33] Year indicates fiscal year. Dollar figures are in nominal terms.

Obstacles

Although Congress and HUD have instituted a number of reforms to provide PHAs with room to be entrepreneurial and creative, and to adopt a private sector model, several barriers still impede a PHA's abilities to effectively cut costs, engage in asset management practices, and raise alternative sources of capital. These impediments include: (1) need based funding, (2) a lack of incentives to cut costs, (3) annual appropriations, (4) labor policies, (5) non-fungibility of funding sources, and (6) aggregated accounting systems. Efforts on the part of the federal government to address these issues will increase the capacity of PHAs to adopt a new model for the delivery of public housing, and will increase, and smooth, the flow of capital into public housing.

Need Based Funding

All major public housing streams: Comprehensive Grants, HOPE VI, Drug Elimination, and Owned Rental are premised on need: PHAs with more distressed properties, higher operating costs, and more drug problems receive greater funding. HUD distributes Congressionally-appropriated Comprehensive Grant funds for rehabilitation of existing developments to each PHA in an amount equal to its share of the total modernization needs of the nation's public housing stock. A PHA that has a larger percentage of the total modernization work will receive a larger amount of Comprehensive Grant Funds. HOPE VI grants are available primarily to large PHAs with severely distressed properties. The greater the volume of distressed properties, the greater a PHA's chances of receiving HOPE VI funds. Drug elimination grants fund PHAs with large drug problems in their developments. Operating subsidies, entirely need-based, cover the difference between a PHA's total operating expenses and the rent collected from residents. PHAs receive operating subsidies through the Performance Funding System (PFS). The larger the financing gap, the larger the

PFS award; the smaller the shortfall between revenue and expenses, the smaller the PFS outlay.

Need based federal funding streams are an impediment to economic efficiency. PHAs do not receive extra funding for good performance. Reducing costs and improving efficiency is a zero-sum game. If a PHA has fewer needs, it will receive less funding. The new Revenue Retention ruling that allows PHAs to keep increases in income is a good example of how HUD can encourage PHAs to explore entrepreneurial activities. Similar thinking, on a larger scale, would further promote PHAs to become more economically efficient.

Lack of Cost Reduction Incentives[34]

Through the PFS retention program, HUD now provides incentives for PHAs to raise revenue, but does not provide them with incentives to reduce expenses.[35] PHAs are not provided with incentives to eliminate bad properties (except for one-time only reversion proceeds), engage in preventive maintenance, cut overhead, eliminate positions, fire employees, reward performance and productivity, or any other measures routinely employed by private real estate firms to reduce costs and improve efficiency.

The elimination of one-for-one replacement rules purports to allow PHAs to save funds by demolishing severely distressed properties, but this is not correct. A PHA that eliminates a distressed property will lose the operating subsidy stream for that property in perpetuity, and will also receive less Comprehensive Grant funds due to a reduction in the PHA's share of the nation's total modernization needs from the elimination of this property. Thus there is no financial incentive for PHAs to eliminate units, only an improved public image incentive.

[34] The absence of cost reduction incentives is essentially the same idea as need based funding. Cost reduction is treated as a separate category here to focus on the new policies HUD is implementing with respect to improving efficiency and reducing costs, and to show that these measures are not as progressive as they could be. Need based funding has long been the policy of the federal government and so it is discussed as a separate category. Later in Chapter Three, these two categories are consolidated.

[35] The energy savings program discussed in the next chapter seems to be the only cost reduction program HUD now provides.

Further, HUD has not produced incentives to spur PHAs to engage in preventive maintenance activities or cut overhead to reduce expenses.

Annual Appropriations

Each year, Congress can, and does, change the amount of funding for public housing. (Exhibit A) Without firm knowledge of the resources they will receive, PHAs have difficulty planning over the long term. More specifically, with respect to moving to a private sector model, annual appropriations impair a PHA's abilities to form partnerships with private entities and leverage alternative sources of capital. Unsure of their federal subsidies beyond one year, PHAs cannot safely guarantee steady yearly transfers to private entities for the management or development of public housing. Annual appropriations make it difficult for PHAs to convince equity investors to provide capital to public housing ventures, where the units are firmly restricted to a limited income-eligible population and the investors are counting on annual transfers for development or operating expenses. Conventional lenders also require steady cash flows to ensure timely interest payments.[36] If PHAs are unsure of their funding levels, pledging resources over multiple years to make debt obligations is not necessarily wise. Annual appropriations essentially prohibit PHAs from capitalizing modernization or operating subsidies to leverage resources for redevelopment or management services.

Labor Policies

Public housing falls under the Davis-Bacon Act, which states that federally assisted or financed projects are subject to minimum wage rates set by the Department of Labor.[37] Developing, operating, and managing public housing is therefore more expensive than building and running conventional housing, whose providers are not necessarily encumbered

[36] Daniel Watson, personal interview, July 5, 1996.
[37] Abt 14.

by such high compensation requirements. Even private management firms operating public housing developments using public housing subsidies are required to pay Davis-Bacon wages. Congress's and HUD's efforts to push PHAs to "mark" housing to the market, to make public housing financially competitive with conventional neighborhood housing, will be hindered by these salary constraints. With Davis-Bacon, public housing developments will always be more expensive to own, and operate, than privately financed buildings. This impacts the affordability of the stock and the populations PHAs seek to serve. By relaxing Davis-Bacon, Congress and HUD would further the goal of marking housing to the market and would allow PHAs to compete more effectively for alternative sources of capital.

Non-Fungibility of Funding Streams

HUD does not allow full fungibility of the funding streams it provides to PHAs. Currently, Owned Rental operating subsidies can be used to finance modernization, but, except for a 20% cap on management improvements, no Comprehensive Grant monies can be used for operating expenses.[38] Development grants cannot be used for acquisition or modernization without HUD permission. Pure fungibility, the ability to mix funding streams, would allow PHAs to be more entrepreneurial, to act like a private real estate company, and to take on asset management functions more freely. Substitutability of funding streams would permit a housing authority to use its funds for whatever activities would maximize the value and durability of its portfolio as a whole, not the activities required by particular funding streams.[39]

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[38] Byrne 23.
[39] Congress is considering legislation that would provide more flexibility to PHAs to mix subsidies. This bill would consolidate public housing funding into two programs: a Public Housing Operating Fund, which would roll operating subsidies and drug elimination funds into one pool of money, and a Public Housing Capital Fund, which would aggregate Comprehensive Grant funds, HOPE VI monies, and development grants into another. Other small funding programs are included in these pots, but they are not included here because they are not referenced elsewhere in this thesis.

Aggregated Accounting Systems

HUD accounting requirements do not promote site-based budgeting, which is an essential step in cost control and asset management. Operating and modernization funding programs hold PHAs as single entities.[40] PHAs report most expenses to HUD on an aggregated basis, consolidating development and central office costs. HUD does not require development-specific cost breakdowns as a prerequisite for funding, and disperses funds to PHAs based on aggregate figures of the authority's ongoing operational and rehabilitation needs. The PHA then is responsible for distributing these funds among its developments.[41] Without project-specific budgeting, most PHAs do not know the true costs of operations at different developments. Access to this information is crucial for PHAs to make decisions with respect to individual properties that will maximize the value of their portfolios.

HUD does not prevent PHAs from implementing site-based budgeting, but any efforts to break down costs at the development level is an extra accounting measure an authority must implement on its own. With need based funding, however, there is hesitation on the part of some PHAs to create project-based budgets due to the fear that HUD might reduce subsidies for properties performing well, instead of allowing authorities to use any excess funds to subsidize properties that are performing poorly.[42]

Summary

Congress and HUD have taken significant steps to create the statutory and regulatory space for PHAs to be entrepreneurial and creative, to set their own priorities and goals with respect to tenancy composition and asset management, to tap alternative sources of capital, and to form partnerships with non-governmental entities. Congress and HUD have lifted, or

[40] Byrne 20.
[41] Byrne 19.
[42] The 1990 National Affordable Housing Act did require PHAs to establish project-based accounting systems, but "this provision is so vague that it is virtually unenforceable and remains essentially unobserved." Byrne 23.

are in the process of lifting, restrictions on leasing preferences, demolition, ownership structures, and unrelated business income limits. New reforms allow PHAs to attract private debt and equity, transfer public housing subsidies to non-governmental entities, income mix housing populations, contract out more services, and raise additional revenues to support housing activities.

However, if Congress and HUD want to continue to move public housing to a private sector model, additional reforms are necessary. Policy changes with respect to need based funding, annual appropriations, labor policies, non-fungibility of funding sources, cost reduction incentives, and aggregated accounting systems, will increase the ability of PHAs to follow a private sector model and to access new sources of financing.

Chapter Two: New Sources of Capital

Introduction

Congress's and HUD's vision of a private sector model for the development, financing, ownership, and management of public housing presupposes that PHAs have the space to be entrepreneurial and creative, that a ready supply of capital exists waiting to flow into public housing, and that PHAs have the institutional capacity to make the transformations necessary to access these resources. This chapter focuses primarily on the second issue, exploring the alternative financing options currently available and being implemented by PHAs, the reorganization of fundamental public housing arrangements necessitated by new capital funds, and the obstacles preventing more capital from flowing into public housing.

The supply of alternative sources of capital for public housing activities is available and growing. PHAs are accessing both debt and equity in addition to government grant funds. Private investors are supplying capital for public housing ventures primarily for the tax effects that flow from the on-going operations of public housing, i.e. losses (largely depreciation benefits) or cash flow (which is rare).[43]

Presently, new sources of capital are flowing into public housing for major rehabilitation, new construction, acquisition, and energy improvement projects. Debt and equity instruments for each of these ventures have different advantages and disadvantages, and risks and benefits, and involve varying levels of reorganization of basic public housing relationships, including financing arrangements, ownership structures, management systems, and tenancy composition. It is important to remember that while these changes are common to basic real estate transactions involving these funding sources, they are not, however,

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[43] Helen Barney, personal interview, July 3, 1996.

common to PHAs that rely predominantly on grant funding for operational and development expenses.[44]

Major Redevelopment Projects

The Diaz memorandum and subsequent Interim Rule on Mixed Financing, issued by HUD on May 2, 1996, and described in the previous chapter, *allows* PHAs to implement alternative financing schemes for major redevelopment projects. Lack of sufficient federal resources to redevelop distressed properties due to budget cuts *requires* PHAs to take advantage of this ruling. This notice permits PHAs to combine equity and debt with federal public housing grants to pay for capital construction costs, and then utilize HUD operating subsidies to support on-going expenses.

Investors are responding to PHAs' need for capital by supplying both equity and conventional debt to PHAs to finance major redevelopment projects. Equity sources available to PHAs include the syndication of Internal Revenue Service Low Income Housing Tax Credits (LIHTCs) or 4% Associated Tax Credits attached to tax-exempt bonds.[45] Conventional debt sources include commercial bank, FmHA, and Federal Home Loan Bank loans, as well as taxable and tax-exempt bonds. PHAs are also utilizing soft, or interest free, debt, including HOME monies, Community Development Block Grant (CDBG) funds, and municipal loans as additional construction financing. Not all of these sources however, can be combined in the same financing structure.[46] For example, legal restrictions prohibit the "double dipping" of government tax reduction vehicles, i.e. LIHTCs cannot be used with tax

[44] Deb Goddard, personal interview, July 26, 1995.
[45] A note on terminology -- LIHTCs refers to the IRS tax credit program. Associated 4% Tax Credits refers to tax credits attached to tax exempt bonds. I use the term "tax credits" by itself more loosely to refer to the general category of tax credit equity which includes both LIHTCs and Associated 4% Tax Credits.
[46] Deborah Goddard, personal interview, July 26, 1996.

exempt bonds.[47] A PHA that wants to use tax exempt debt, with tax credit equity, is permitted however to raise tax exempt bonds and syndicate the 4% Associated Tax Credit attached to the bonds.[48]

Financing Available for Major Redevelopment By Type and Source

Type	Source
Equity	LIHTCs
	4% Associated Tax Credit (with tax exempt bonds)
Debt (Conventional)	Tax Exempt Bonds
	Taxable Bonds
	Commercial Bank Loans
	Federal Home Loan Bank Loans
	FmHA Loans
Debt (Soft)	Municipal Loans
	CDBG funds
	HOME grants
Public Housing Grants	HOPE VI Grant
	Development Grant
	Operating Subsidies

Most of the major redevelopment projects utilizing alternative sources of capital are occurring through the HOPE VI program because grant funding in many cases is not sufficient for redevelopment. Some PHAs with HOPE VI grants are entering, or will be entering, into

[47] According to Deborah Goddard, HOPE VI Administrator for the Mission Main and Orchard Park developments in Boston, these funding sources can be used together on the same project only if the development is dividing into separate legal entities and the two funding sources are used for the different parts.
[48] Deborah Goddard, personal interview, July 26, 1996.

partnerships with private real estate companies and leveraging their HOPE VI funds to access and syndicate LIHTCs.[49] One PHA, the St. Louis Housing Authority, entered into an identical partnership but leveraged a development grant instead of HOPE VI funds to access and syndicate LIHTCs.[50] Syndication proceeds combined with the HOPE VI or development grant money will represent the primary source of capital for redevelopment of existing stock and construction of new units.[51] Additional construction capital will come from conventional and soft debt sources. On-going HUD operating subsidies will flow to the development over the life of the project.

Several HOPE VI deals involving alternative sources of capital are being negotiated around the country but only one has closed so far -- Techwood-Clark Howell Homes in Atlanta. Other sites, including those in Boston, Baltimore, New Haven, and Washington D.C., are pursuing deals incorporating many of the same principles. Each of these sites will combine equity and debt from different sources. Regardless of how these funding sources are agglomerated, the key variable with respect to rearrangements of public housing relationships in these new financing structures is the utilization of tax credit equity. Tax credits require major readjustments in finance and ownership structures and can, but do not necessarily, require rearrangements in management systems and tenancy composition.

Finance Structure

The typical financing model for HOPE VI sites using tax credit equity differs from a standard public housing turnkey development model by reversing the sources of funds for construction and permanent financing. Most HOPE VI sites are proposing using the HOPE VI redevelopment grant, plus soft and conventional debt, as bridge financing for

[49] Only one such deal has closed so far, Techwood Homes in Atlanta. Many deals are currently under negotiation proposing to enter into similar partnerships and leveraging funds in a similar manner. This explains the sometimes confusing alternation between the future and present tenses.
[50] Diaz Memorandum April 8, 1994, 1.
[51] Technically, LIHTC equity is permanent financing and will flow into the development when the project is placed in service. HOPE VI funds, other government grants or soft loans, and conventional bridge loans can be used as construction financing.

construction.[52] Permanent financing to take out conventional debt, i.e. "bridge" loans, will come from the syndication of tax credits.[53] This differs from the typical turnkey project model which requires construction financing to be supplied by the private developer while permanent financing is provided by the public housing development grant. Putting in HUD money first, with HOPE VI funds, instead of last, as a PHA would with a development grant under a typical turnkey arrangement, increases the liability of the authority for the redevelopment of the property.

On-going operating subsidies will continue to flow to these redeveloped properties as they have in the past. Prospective investors however are expressing concern that Congress may continue to cut operating subsidies and partnerships will have trouble meeting debt service obligations and/or maintaining the affordability of the units.[54] As an example, to remedy this fear, McCormack Baron/The Integral Group, the development partner in the Techwood deal, negotiated with the Atlanta Housing Authority (AHA) to guarantee a constant stream of operating subsidies over the life of the project regardless of the overall level of funding the AHA receives from HUD.[55] If HUD reduces subsidies in the future, other AHA developments will bear the loss, while Techwood will receive its current amount in perpetuity. Additionally, McCormack Baron/The Integral Group is requiring the AHA to establish a reserve equal to three times the annualized amount of the operating subsidy, an amount far in excess of normal reserve levels, to protect against losses in federal subsidies over the life of the project.[56] McCormack Baron/The Integral Group can also tap reserves if the AHA cannot make monthly operating subsidy payments. If reserves dry up, they have the prerogative to convert public housing units to tax credit rate apartments to meet

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[52] Deborah Goddard, personal interview, July 26, 1996.
[53] Deborah Goddard, personal interview, July 26, 1996.
[54] Russell Tanner, personal interview, January 15, 1996.
[55] Regulatory and Operating Agreement for Techwood-Clark Howell Homes between Atlanta Housing Authority and Legacy Partnership I, November 6, 1995.
[56] Efforts to confirm this were futile. Based on my knowledge of public housing, I feel confident that I can safely assume that holding reserves three times the annual operating reserve is far in excess of what most PHAs can afford to keep on their properties.

operating expenses.[57] Neither operating subsidies guarantees or reserve funding levels are required by the new financing structures; these issues are subject to negotiation. Other PHAs that choose to utilize tax credit equity need not replicate these measures.

Ownership Structure

The inclusion of tax credit equity in a financing scheme necessitates a rearrangement of the ownership structure. Investors can only receive tax credit benefits from a project if they have an ownership interest in the development.[58] Accordingly, any deal using LIHTCs or 4% Associated Tax Credits must be structured so that the equity investors have an ownership stake in the property.[59] This can occur through a limited partnership, composed of limited partners (LP), the tax credit investors, who supply equity in exchange for credits, and a general partner (GP), who is responsible for the redevelopment of the site and the daily operations of the property. At a minimum, the buildings and improvements must be owned by the partnership because investors receive tax credits only for the value of buildings.[60] Land can, but does not have to be, owned by the partnership; in a tax credit syndication, land has no value.[61] A ground lease is a standard legal vehicle PHAs can use to convey title to buildings and improvements to the partnership, while keeping ownership of land in the hands of the authority. Under federal law, the limited partnership must maintain an interest in the property for a minimum of fifteen years.

Relinquishing ownership does not necessarily mean sacrificing control. Within a limited partnership ownership structure, there is much flexibility for a PHA to have control over the management of the development, tenancy composition, and/or final disposition of the

[57] Regulatory and Operating Agreement for Techwood-Clark Howell Homes between Atlanta Housing Authority and Legacy Partnership I. November 6, 1995.
[58] Peabody and Brown, I-1.
[59] Peabody and Brown, I-1.
[60] Deborah Goddard, personal interview, July 26, 1996
[61] Deborah Goddard, personal interview, July 26, 1996.

property.[62] A PHA can be a party within the general partner entity, as a sole GP with control equal to the rights of full ownership; a co-general partner, sharing control with another entity; or a special, "silent" partner, that will assume the GP interest at disposition.[63] The use of a ground lease, considered the most effective legal tool for encumbering a property, provides PHAs with an additional means of exercising control.[64] Through a ground lease, the PHA can dictate the composition of the tenancy, protect the long term affordability of the units, specify the status of buildings at reversion, and outline other measures that may provide the authority with more control over the development.[65] Control measures are issues of negotiation between the parties involved in the redevelopment effort. How much control the PHA will have over the site, and the long term affordability of the units, ultimately depends on the relative negotiating strength of the PHA, the development partners, and the investors.

Management Systems

For major redevelopment projects financed with tax credit equity, the entity responsible for property management is determined by the GP of the limited partnership.. If the PHA is the GP, it can select itself as the property manager, or it can contract management services with a private firm. Similarly, if the PHA is not the GP, it can still be designated as the property manager. In the Techwood deal, a private management firm has been commissioned that will be responsible for all leasing, occupancy, and tenant eligibility issues.[66] Private management is not required by the limited partnership structure, but as more HOPE VI sites choose this method of financing, it would not be surprising to see most of the equity investors and development partners require private management. HOPE VI

[62] A major issue with any LIHTC deal is what happens to the property at the end of the fifteen year tax credit compliance period.
[63] Deborah Goddard, personal interview, July 26, 1996.
[64] Deborah Goddard, personal interview, July 26, 1996.
[65] Deborah Goddard, personal interview, July 26, 1996.
[66] Regulatory and Operating Agreement for Techwood-Clark Howell Homes between Atlanta Housing Authority and Legacy Partnership I, November 6, 1995.

authorities, by definition, are more distressed PHAs and many have poor management capabilities. Development partners and investors may seek private management as further protection for their investment.

Tenancy Composition

Tax credit equity does not mandate a tenancy composition different from that which currently exists in public housing. The resident population, like issues of control, is subject to negotiation between the parties involved in the redevelopment. Tenancy composition will depend on the policy goals of the authority, the aims of the private owners, and any cash flow requirements necessitated by the new financing structure.[67] If conventional debt is utilized, the development may have to rent to higher income residents to generate positive cash flow to cover debt service payments. Under federal law, up to 80% of units in tax credit financed deals can be market rate.

Summary Observations: Financing Major Redevelopment with Alternative Capital

The new financing arrangements PHAs are implementing for major redevelopment projects have a number of advantages and disadvantages. On the positive side, tax credits create a rich supply of capital for financing affordable housing, and, in the absence of sufficient funding from Congress and HUD, make redevelopment of severely distressed properties feasible. In some cases, leveraging additional capital can add new units to a PHA's portfolio, thus increasing its total stock and its ability to provide affordable housing to more people. Additionally, PHAs are working with private investors, forming new relationships and expanding their knowledge of real estate development and financing principles. On the downside, the new financing structure puts the property at risk of foreclosure and could threaten the long term affordability of the stock. The Diaz memorandum specifies that privately financed public housing must maintain 40 years of affordability. Recent legislation

[67] Deborah Goddard, personal interview, July 26, 1996.

however negates this ruling, and Congress has requested HUD to draft new regulations softening the affordability horizon.[68] In some, but not all, cases, redevelopment will reduce the number of units for public housing residents through demolition or market rate conversions. (See Exhibit D) If private management is retained, jobs can be taken away from authority employees. Finally, if a PHA duplicates the negotiations of the Techwood deal, the entire authority's portfolio of properties will be put at risk through guaranteeing operating subsidies to the property regardless of any potential decreases in HUD funding over the life of the project.

From a public policy perspective, the utilization of tax credits for redevelopment adds no new units to the overall supply of affordable housing stock. LIHTCs are a capped resource, and although 4% Associated Tax Credits are not limited, the inclusion of them in a financing structure puts the PHA under the state cap for tax-exempt bonds. (Recall that 4% Associated Tax Credits can only be accessed with (private activity) tax exempt bonds). With tax credit equity, a development is not 100% owned by a government entity and any tax exempt bonds that flow to the property are therefore considered private activity bonds, i.e. the beneficiary of the bonds is a private entity. Private activity bonds fall under the state volume cap for tax exempt bonds.[69] Each state is entitled to a fixed per capita allotment of LIHTCs and private activity tax exempt bonds.[70] The use of tax credits or private activity tax exempt bonds by a PHA merely involves a transfer of resources from a private or not-for-profit owned housing development to a public housing project. From a macro-economic affordable housing stock policy perspective, tax credit equity for public housing development is a zero-sum game.[71] Major redevelopment projects that do not use tax credit equity can raise tax exempt bonds that are not capped or other debt instruments and avoid this zero-sum game.

[68] Deborah Goddard, personal interview, July 26, 1996.
[69] Daniel Watson, personal interview, July 5, 1996.
[70] LIHTCs are capped at $1.25 per person per state. I do not know what the current cap is on private activity tax exempt bonds.
[71] Deborah Goddard, personal interview, July 26, 1996.

New Construction

Since Congress is no longer providing development grants, PHAs must mine other resources if they want to add new units to their total stock. Some PHAs are putting together alternative sources of capital and constructing new units without HUD capital or operating subsidies. Without HUD funds, these properties are not subject to HUD rules, but they also do not have federal operating subsidies. Any new project therefore must generate enough rental revenue to cover operating expenses and any debt service. Few PHAs have adopted this method, and those that have are concentrated in the Northwest. The Portland Housing Authority seems to be the most savvy PHA at implementing this model. Other PHAs that have employed this model, include, Kings County Housing Authority, Kings County, Washington; Salem Housing Authority, Salem, Oregon; Boulder Housing Authority, Boulder, Colorado; Montgomery County Housing Authority, Montgomery County, Maryland; San Antonio Housing Authority, San Antonio, Texas; and the Vermont State Housing Authority.[72]

The financing sources PHAs are using for new construction, with the exception of HUD dollars, are identical to those used in major redevelopment projects. For new development projects, PHAs are also accessing tax credit equity, conventional debt, and soft debt. Equity sources include the syndication of LIHTCs or 4% Associated Tax Credits.[73] Conventional debt includes commercial bank, FmHA, and Federal Home Loan Bank loans, as well as taxable or tax-exempt bonds. PHAs are also utilizing HOME monies, Community Development Block Grant (CDBG) funds, and municipal loans as soft debt. Here again, the same prohibitions on mixing certain funding sources apply.

Changes in financing and ownership structures, management systems, and tenancy composition necessitated by the new capital sources mirror those of major redevelopment

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[72] Collected from "Sources and Uses" Statements for various projects provided by Scott Hoekman, of the Enterprise Social Investment Foundation.
[73] Helen Barney, personal interview, July 3, 1996.

projects. Tax credit equity is again the key variable driving changes in ownership structure. Financing arrangements are similar to a standard PHA turnkey model for development with the exception that tax credit equity, and conventional and soft debt, are substituted for public housing grant dollars. Changes in property management and tenancy composition, as they are in major redevelopment projects, are subject to negotiation. Without operating subsidies, however, tenancy composition becomes more important from a cash flow perspective, and negotiations may be more constrained by fiscal reality than policy goals. In general, the key difference is the absence of public housing dollars, which, as will be documented below, represents both advantages and disadvantages.

Financing Structure

Financing new construction with tax credit equity, conventional debt, and soft debt is similar to a typical public housing turnkey development process. The PHA contracts with a private developer to construct new units for an up-front fixed price. As standard in a turnkey process, the developer assumes pre-sales and construction risk, and finances development with commercial bank debt and personal equity.[74] Upon completion of the project, permanent financing, consisting of some combination of tax credit equity, LIHTCs or 4% Associated Tax Credits; conventional debt, tax-exempt or taxable bonds, and conventional bank loans; and soft debt; takes out the construction loans and the developer's equity. Again, legal restrictions on double-dipping prohibit the mixing of some sources of funds, such as LIHTCs and tax-exempt bonds. Consequently some PHAs that have developed new units using this method are combining LIHTCs with taxable bonds; others are pooling tax exempt bonds with the 4% Associated Tax Credits.

As is standard for a typical private market real estate development deal, the PHA is required to obtain "binding" commitments for permanent financing from lenders or equity contributors prior to construction. Often this commitment can be satisfied by a letter from a

[74] Patrick Howard, personal interview, July 1, 1996.

lender. However, if bond funds are used as permanent financing, the developer may require that the bonds be floated before construction begins and the proceeds escrowed. Tax exempt bonds are more difficult to obtain and developers may want to insure that the financing will be available when the property is complete. Similarly, the PHA will transfer a large percentage of the permanent financing to the developer upon receipt of a Certificate of Occupancy (C.O.). The balance of payment, essentially the developer's fee, is paid when the property is fully leased-up or a similar target is met.[75] The primary risk to the PHA is the escrowed permanent financing which must be repaid to investors and lenders with a penalty if the development is not completed. The Portland Housing Authority, which uses tax exempt bonds in its financing structures, has found that taking on more of the construction risk by paying the developer for development costs during construction with bond proceeds, and then taking out the tax exempt bonds with tax credits at reversion, reduces the overall cost of capital, because the PHA does not have to reimburse the developer for his or her own equity and the more expensive conventional debt he or she would receive from a commercial bank.[76] As with any standard construction project, to mitigate some of the construction risk the Portland Authority assumes through this method, the PHA procures a performance bond on the contractor and obtains a letter of credit for the bond from a local bank.[77]

Ownership Structure

PHAs can only develop new properties without HUD grants if they can access tax credit equity. As stated above, tax credit equity requires a limited partnership ownership structure, in which a PHA may, or may not, be a party. Control issues of affordability, tenancy composition, and property disposition, are again subject to negotiation. A key difference with new development funded without HUD dollars is that the ownership arrangement need not be encumbered by federally mandated deed restrictions on affordability, such as those in

[75] Helen Barney, personal interview, July 3, 1996.
[76] Helen Barney, personal interview, July 3, 1996.
[77] Helen Barney, personal interview, July 3, 1996.

the Diaz memorandum, or the new restrictions currently under formulation by HUD, because no operating funds or development grants are involved in the project. Affordability restrictions must be implemented by the PHA, or be attached to other government funding streams (municipal loans, HOME, or CDBG) if these sources are utilized. While this may not be a very interesting distinction functionally, it does indicate that PHAs have greater latitude in determining affordability.

Management Systems

Recall as well, that the GP of the limited partnership is responsible for selecting the property management company. Regardless of whether a PHA is a party to the GP, it can still retain management of the development. Again, this issue is subject to negotiation. However, without subsidies, these properties are operating close to the margin and keeping overhead and maintenance costs as low as possible is essential. Contracting out management services to private firms which are unencumbered by union wage rates and bureaucratic operating procedures can be more efficient and reduce expense.

Tenancy Composition

Tenancy composition for new construction projects financed without HUD operating subsidies is driven primarily by fiscal constraints. Tenancy must consist of a population which generates enough net operating income (NOI) to cover any debt service and operating expenses because there are no subsidies. In all likelihood the resident population will not reflect those living at other PHA-owned developments or the authority's waiting list. The Portland Housing Authority however is required by state law to house only low-income residents. Bond counsel for the Authority has interpreted this to mean families below 80% of median income. So far this has not presented a problem for the Portland Housing Authority, which does not operate its non-HUD financed developments at a loss. Oregon state law does not mandate that rent be set below 35% of a resident's income, so Portland has some leeway to raise rents to cover expenses.[78] If fiscal constraints do not dictate the resident population, tenancy composition will be subject to negotiation between the parties involved in the redevelopment effort.

Summary Observations: New Development Projects

Financing new construction projects without HUD dollars offers both advantages and disadvantages. From a public policy perspective, the use of tax credit equity creates the same zero-sum game to the overall housing stock as described above. On the positive side, this model offers the benefits of turnkey development without using scarce public housing resources. Under standard arrangements, the developer assumes full construction and partial lease-up risk which limits the exposure of the PHA only to repayment of the escrowed permanent financing funds if the project is not completed. As a new construction project, the PHA will be increasing the stock of available housing and creating new jobs. Without public housing operating subsidies, however, development and ownership essentially falls outside the parameters of the federal public housing program; this offers both advantages and disadvantages. This financing arrangement does not risk taking away operating resources from other developments in the PHA's portfolio. Further, the property will be insulated from any proposed changes in regulations HUD makes in the future with respect to funding levels or tenancy requirements. On the negative side, pushing the project beyond the scope of the federal program poses questions of ownership structure, i.e. how the PHA can hold title to the property, and limits the ability of the PHA to draw on HUD resources if the project is in jeopardy. So far HUD has not raised the ownership issue with the Portland Housing Authority, and Portland holds these properties in its portfolio with HUD-supported developments. With private equity and conventional debt these properties are at risk of foreclosure. Without federal support, there is no reason to assume HUD will rescue these properties if the authority has trouble meeting its financial obligations.

[78] Helen Barney, personal interview, July 3, 1996.

Acquisition Projects

Instead of developing new units, some PHAs are adding to their portfolios by acquiring existing properties. Without development grants however, which are used for acquisition, PHAs must access alternative capital to purchase existing properties. For new acquisitions, PHAs are also utilizing tax credit equity, conventional debt, and soft debt, and are pursuing two basic financing strategies for combining these funds: (1) a "debt only" model which uses tax-exempt bonds and soft debt, and (2) a "debt plus equity" model, which uses tax exempt bonds, soft debt, and 4% Associated Tax Credit equity. Neither model employs HUD public housing dollars.[79] The only difference between these two is the use of 4% Associated Tax Credit equity in the second model. PHAs have found that some acquisitions are just not feasible without equity, and tax credits can provide the extra capital to close a deal.[80]

Acquisition is a much less risky enterprise than new development, simply because the product is a known quantity.[81] Consequently the pricing for alternative capital is much less expensive. The absence of public housing dollars reduces investor fears. Without the influence of the federal government, private investors understand that PHAs are much freer to change the income structure of the acquired properties or make other changes necessary to meet operating expenses and protect their investment.[82]

Few PHAs are using tax exempt bonds to finance acquisitions of existing properties; those that have are again concentrated in the Northwest, many being the same as those using tax credits and tax exempt bonds to finance development. Kings County Housing Authority, Seattle, Washington, is one of the most aggressive PHAs at using tax exempt bonds to purchase new properties, having completed twelve such purchases.[83] The Portland Housing

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[79] Daniel Watson, personal interview, July 5, 1996. Helen Barney, personal interview, July 3, 1996. Patrick Howard, personal interview, July 1, 1996.
[80] Helen Barney, personal interview, July 3, 1996. Patrick Howard personal interview, July 1, 1996.
[81] Helen Barney, personal interview, July 3, 1996.
[82] Helen Barney, personal interview, July 3, 1996.
[83] Daniel Watson, personal interview, July 5, 1996. Kings County serves cities just outside Seattle, but not Seattle itself which has its own housing authority.

Authority, Portland, Oregon; Vancouver Housing Authority, Vancouver, Washington; and Washington County Housing Redevelopment Authority, St. Paul Park, Minnesota; are also actively using this model.[84] Much of the description below comes from the experiences of Kings County.

Acquisition Financing Models

Model One: Debt Only	**Type**	**Source**
	Conventional Debt	Tax Exempt Bonds
	Soft Debt	Municipal Loans
		CDBG
		HOME
Model Two: Debt Plus Equity	**Type**	**Source**
	Conventional Debt	Tax Exempt Bonds
	Soft Debt	Municipal Loans
		CDBG
		HOME
	Equity	4% Associated Tax Credit (with Tax exempt bonds)

Because the two models for acquisition of existing properties, the debt only and the debt plus equity, share the same basic financing structure, what follows is a single description of the acquisition process, and the required restructurings of the financing, ownership, management, and tenancy composition relationships, noting the special requirements for tax credit equity when it is included in the financing structure.

[84] From Standard and Poors Documentation.

Financing Structure

Financing acquisition with tax credit equity, tax exempt bonds, and soft debt is a straight-forward procedure. PHAs look for an existing property for sale and perform due diligence to ensure that the development is financially feasible, i.e. operating expenses and debt service can be supported by a lower-income population without losses. The PHA then raises the revenue necessary for the purchase. Often a PHA can secure 100% financing for acquisition with debt; where 100% financing constitutes overleverage of the property, the PHA will need equity from investors. Equity is available in the form of tax credits.

Generally PHAs can raise more money from the syndication of tax credits and bonds with acquisition projects than they can for new construction or major redevelopment. Because acquisition is a less risky investment than new construction or redevelopment, investors will pay more for credits and bonds used to finance existing properties than they will for properties not yet constructed or fully redeveloped.[85]

Ownership Structure

Ownership restructuring is only an issue if tax credit equity is utilized to make the acquisition. Recall that tax credit benefits can be used only by investors that have an ownership stake in the property, and this necessitates a limited partnership structure. Recall as well, however, that ownership does not mean relinquishing control. As a GP, through a ground lease and/or other measures, a PHA can control the affordability, tenancy, and disposition of the property. If a PHA can acquire a property without tax credit equity, it can own the development wholly on its own account.

Management Systems

Management changes may be necessary, but are not required if tax credits are involved in acquisition financings and the development is owned by a limited partnership. The

[85] Deborah Goddard, personal interview, July 26, 1996.

decision to contract with a private management firm rests with the GP. If the PHA has the GP interest, then management responsibilities remain the prerogative of the authority and the PHA chooses the property management entity. Kings County has found that, whether or not it has control over management, contracting with a private company to operate the property is more expedient than retaining this function for themselves.[86] Because these properties have no operating subsidies, are highly leveraged, and must maintain a set debt service coverage ratio (DSCR) to avoid defaulting on debt obligations, keeping overhead and maintenance costs as low as possible is essential. Kings County Housing Authority, despite its ranking among the top five public housing managers in the country, has found that private management, which is unencumbered by prevailing wage rates and bureaucratic operating procedures, can manage these properties more effectively, and efficiently, than the authority could manage them.[87]

Tenancy Composition

In most cases, the tenancy composition of new acquisitions, like new development ventures without HUD operating subsidies, will not reflect the resident composition of other developments or the PHA's waiting list. To achieve rents that support operations and debt service, properties acquired through debt and tax credit equity, in most markets, must lease units to higher income working families.[88] Renting to working families also allows the PHA to set a fixed monthly rent close to market rates instead of charging tenants 30% of their income. Monitoring lease-up to ensure a proper mix of incomes to generate enough revenue to cover operations is therefore not necessary.[89] Fixed rents produce a steady income stream to support debt service coverage ratios and ease investors' concerns about potential variability of cash flows. The inclusion of tax credits in the financing structure does not have

[86] Daniel Watson, personal interview, July 5, 1996.
[87] Daniel Watson, personal interview, July 5, 1996.
[88] Daniel Watson, personal interview, July 5, 1996.
[89] Daniel Watson, personal interview, July 5, 1996.

any additional effect on the tenancy composition.

Summary of Acquisition of existing Projects Utilizing Alternative Sources of Capital

Acquisition using the debt only or the debt plus equity model has advantages and disadvantages similar to those of new development financing structures. Acquisition using tax exempt bonds with or without the 4% Associated Tax Credits creates jobs and adds units to a PHA's portfolio without using scarce public housing resources. Like new development financed without public housing operating subsidies, however, ownership falls beyond the bounds of the federal public housing program, which, as described above, provides both risks and benefits. On the positive side, without operating subsidies, acquisitions do not take away resources from other developments in the PHA's portfolio; without HUD funding these properties are protected from future changes in federal regulations. On the negative side, pushing the project outside the parameters of the federal program further limits any protection the authority could receive from HUD in avoiding a possible foreclosure. If a PHA cannot meet its debt obligations, it cannot tap HUD resources to cure the default; without on-going operating subsidies the PHA may have to lease to a resident population that does not mirror the authority's other developments or the waiting list.

The purchase of existing properties using the debt only model, i.e. tax exempt bonds, adds to the overall supply of affordable housing without utilizing scarce tax credit, or tax exempt bond, resources. From a public policy perspective, this model represents a distinct advantage over the debt plus equity model for acquisition which uses tax exempt bonds and 4% Associated Tax Credits. (Recall that tax exempt bonds cannot be mixed with LIHTC equity, hence any project that employs tax exempt bonds and tax credit equity must use the 4% Associated Credits as equity.) If the PHA does not use tax credit equity, then the development is 100% owned by the PHA, and the authority can issue tax-exempt bonds that do not fall under the state volume cap. Such bonds are called essential governmental purpose bonds and there is no limit to these issues. PHA that use governmental purpose bonds to finance acquisition are not taking resources away from not-for-profits and private developers.

Energy Improvement Projects

Public and private funding is also flowing into public housing to support capital improvement projects for energy conservation measures. Utility costs are a passthrough for PHAs to the federal government. Unlike operating costs, PHAs are reimbursed in full by HUD for all gas and electrical charges for common spaces, laundry rooms, hallways, outdoor areas, and any other costs that are not the responsibility of individual residents. Many developments built over forty years ago are extremely inefficient and the cost to the federal government to heat and light these buildings is tremendous. As an incentive to encourage PHAs to reduce energy consumption, HUD offers a "shared savings program" called Performance Contracting in which HUD pledges to split savings that accrue from the installation of energy improvements with the PHA for a ten year period. The PHA can then use these funds for other housing related activities and/or to pay for improvements. Improvements range from window weatherproofing to utility conversion, i.e. switching from electrical to gas powered energy systems. In a typical Energy Performance Contract arrangement, a PHA will contract with an Energy Service Company, an ESCO, to perform an energy audit of a development, recommend energy improvements, calculate the savings that would accrue due to proposed changes and current utility rates, and then install the recommended changes for a fee. The key issue for PHAs is how to finance the upfront capital costs of the improvements.

Financing Structure

Financing improvements requires up-front capital outlays to install energy efficient equipment. Non-HUD sources currently available to finance these purchases include several debt instruments, namely, tax-exempt bonds, commercial loans, and tax-exempt lease-purchase financing.[90]

Financing processes and requirements are essentially the same for all three of these vehicles. The investor escrows the issue proceeds at the beginning of the project and then disburses payment to the ESCO during construction as improvements are accepted and approved by the authority.[91] The PHA simultaneously makes regular debt payments either on a monthly or quarterly schedule to the investors from its energy savings contributions from HUD. Investors generally require payments less than the total savings from HUD, often around 70%, to provide a repayment cushion in the event of higher costs or reduced savings.[92] The primary discriminating factor among the three sources of funds is the cost of capital. For smaller projects, under $5 million, purchase-lease financing or commercial bank loans are more advantageous, because PHAs can avoid investment banking underwriting and bond agency rating fees. For larger projects, tax exempt bonds become more economical despite these fees.[93]

Investors will provide capital without the property pledged as collateral or a general obligation pledge from the PHA.[94] As credit enhancement, investors rely on the creditability of the ESCO performing the improvements, an installation performance bond, an insurance policy secured by the ESCO for the projected savings, HUD's pledge to return energy savings to the PHA, a PHA debt service reserve fund, and an implied, but not an explicit, guarantee that the PHA will honor its debt obligations.[95] Depending on the deal and the reliability of

[90] Handouts from Anthony Tucker Incorporated.
[91] Handouts from Anthony Tucker Incorporated.
[92] Handouts from Anthony Tucker Incorporated.
[93] Holly Andreozzi, meeting at Cambridge Housing Authority, June 27, 1996.
[94] Holly Andreozzi, meeting at Cambridge Housing Authority, June 27, 1996.
[95] Handouts from Anthony Tucker Incorporated.

the parties involved in the process, some of these enhancements are waived.[96] However, for more troubled authorities with a less reliable record, investors may also want a letter of credit from a bank guaranteeing a portion of the issue as further debt support.[97] Purchase lease financing investors secure the additional commitment of the energy equipment as collateral.[98]

Summary: Financing Energy Improvement Projects

PHAs are undertaking energy improvement projects throughout the country. The primary obstacle to their implementation is the ten year shared savings commitment of the federal government. Many energy projects, especially utility system conversions, have payback schedules in excess of ten years.[99] Without the shared savings, PHAs must use scarce federal resources or profits from income producing activities to meet debt service payments beyond ten years.

Standard Modernization Projects

Alternative sources of capital are available and flowing into public housing to support major rehabilitation, new construction, acquisition, and energy improvement projects. Conspicuously absent, however, is alternative financing for basic modernization of existing stock. While theoretically feasible, alternative funding for rehabilitation is not functionally possible given current regulations. Borrowing against a property to fund its modernization is not possible if the development operates at a loss (without subsidies), as most public housing does. Unless new higher income residents are brought in as a result of improvements, there is no positive cash flow in these projects to support debt service.

[96] Holly Andreozzi, meeting at Cambridge Housing Authority, June 27, 1996.
[97] Holly Andreozzi, meeting at Cambridge Housing Authority, June 27, 1996.
[98] Handouts from Anthony Tucker Incorporated.
[99] Pepper White, meeting at Cambridge Housing Authority, June 27, 1996.

Equity financing is more possible, but equally less practical for modernization. Tax credits can be syndicated for rehabilitation, but this requires a transfer in ownership. More importantly, syndication is an expensive process and PHAs use large up-front capital HOPE VI or development grant funds to reduce the amount of equity necessary for redevelopment.[100] For modernization, HUD provides funding through the Comprehensive Grant program, which cannot supply the magnitude of funding for a particular development as it does a HOPE VI or even a new development grant.[101] Capitalization of Comprehensive Grant funds might allow PHAs opportunities to access alternative capital for modernization projects by using lump sum payments similar to HOPE VI grants to write down rehabilitation costs.

Obstacles

Despite HUD rulings and Congressional legislative reforms to allow PHAs to raise capital, as described in Chapter One, a couple of obstacles still impede PHAs' ability to access alternative forms of financing (in addition to those detailed above obstructing the flow of capital for standard modernization projects). These impediments were documented in Chapter One as general hindrances to adoption of a private sector model for public housing. Those of particular relevance to raising alternative forms of capital include: labor policies and the instability associated with annual appropriations.[102] HUD efforts to reduce these barriers will increase the efficient flow of capital into public housing.

Labor Policies

Developing, operating, and managing public housing is more expensive than building and running conventional housing, because public housing employees must be paid Davis-Bacon

[100] Deborah Goddard, personal interview, July 26, 1996.
[101] Arthur Jemison, personal interview, June 20, 1996.
[102] Peabody and Brown 15.

Act prevailing wage rates. Even private management firms operating public housing developments using public housing subsidies are subject to Department of Labor compensation requirements. With Davis-Bacon, public housing developments will always be more expensive to own and operate than privately financed buildings which impacts the affordability of the stock and the populations PHAs seek to serve. By relaxing Davis-Bacon, HUD would allow PHAs to compete more effectively for alternative sources of capital.

Annual Appropriations

Annual appropriations make it more difficult for PHAs to form partnerships with private entities and convince equity investors or lenders to provide capital to public housing ventures. With variable annual appropriations, PHAs cannot guarantee steady yearly transfers to private entities for the management or development of public housing. In the cases documented in this chapter, investors rely on these transfers to house a limited income population. As detailed above, the uncertainty of federal subsidies forced the Atlanta Housing Authority to make a number of concessions to McCormack Baron/The Integral Group in the Techwood deal, including establishment of an operating reserve fund equal to three times the current annual operating subsidies for the site. Conventional lenders also require steady cash flows to ensure timely interest payments.[103] If PHAs are unsure about their funding levels, pledging resources over multiple years to make debt obligations is not necessarily wise. Annual appropriations essentially prohibit PHAs from capitalizing modernization or operating subsidies to leverage resources for redevelopment or management services. Loan guarantees from Congress or other entities might allow PHAs opportunities to capitalize some of their expected subsidy streams.

[103] Daniel Watson, personal interview, July 5, 1996.

Summary

Alternative sources of capital are available and flowing into public housing to support major rehabilitation, new construction, acquisition, and energy improvements. A fundamental question is whether Congress's and HUD's changes in the rules and regulations have facilitated the flow of these capital sources. PHAs have been able to access equity and debt for major rehabilitation and energy improvement projects without eliminating HUD sponsorship. This suggests that federal changes are easing the flow of capital for major rehabilitation and energy improvement projects, and that Congress's and HUD's vision for a more private sector approach to developing, financing, owning, and managing public housing is not negated by a lack of supply of new capital. New development and acquisitions, however, are happening without federal public housing support: regulatory and legislative change is therefore not responsible for these financing arrangements.

Congress and HUD can increase, and smooth, the flow of capital into public housing and extend the private sector's role in the delivery of public housing by relaxing Davis-Bacon wages, providing multiple year appropriations, and/or providing loan guarantees for capitalized subsidy streams.

CHAPTER THREE: PHA TRANSFORMATION FOR A PRIVATE SECTOR MODEL

Introduction

Congress's and HUD's vision of a private sector model for public housing depends on the institutional and regulatory space created for PHAs to be entrepreneurial and creative, a ready supply of alternative capital, and the capacity of PHAs to implement the transformations necessary to use these funds effectively and efficiently. The previous chapters explored primarily the former two issues, describing the reforms implemented by Congress and HUD, the financing options available to PHAs, the rearrangement of basic public housing arrangements mandated by the use of new funding sources, and the regulatory and legislative obstacles preventing the further flow of capital into public housing. This chapter turns primarily to the third issue, exploring the institutional capacity of PHAs to utilize alternative capital in a prudent manner, the transformations necessary to mimic the private sector and handle new financing streams, and the obstacles preventing PHAs from maximizing the options available to them. PHAs that seek to make the transition to a private model, as well as tap into alternative sources of financing, must understand the manner in which the private real estate industry operates and incorporate some of these principles into their business practices. The ability of PHAs to stage such a transition will determine the extent to which Congress's and HUD's vision of a private sector model for public housing can be realized.

The transformations necessary for a PHA to move from one market to another, from a public to a private market perspective, cannot be overstated. Howard E. Cohen, former General Counsel for the Cambridge Housing Authority and current President of Beacon Residential Properties, likens the change to his own company's movement from a privately-held real estate company to a publicly-owned Real Estate Investment Trust (REIT) with shares on the stock market.[104] Conversion to a REIT took over one year and involved changes in reporting systems, financial structure, and organizational hierarchy. Changing markets involves a whole new set of actors with different investment priorities, criteria, risk levels, and tolerances.[105] At the very least, a PHA which chooses to access alternative sources of capital will have to model a not-for-profit community development corporation (CDC), or, at the more extreme, a for-profit private real estate company, because both of these entities deal with debt and equity finance instruments that are currently unfamiliar to the public housing industry. The transformation process may be extensive and lumpy, and will involve changes in corporate philosophy, reporting systems, budgeting, and personnel.

Corporate Philosophy

The corporate philosophy of the private real estate sector is significantly different from that espoused by the public housing industry. Quite simply, the difference lies in the contrast between a market and a non-market approach to housing delivery. The first step for PHAs committed to embracing the corporate philosophy of the private sector is understanding the fundamental differences between a market and a non-market approach. The second step is implementing the private sector's core values of cost control and asset management.

Contrast Between a Market and a Non-Market Approach to Housing

A market approach stresses economic efficiency, cost control, and productivity. The market approach is demand-driven and supply-constrained: success is determined by financial gain. A non-market approach is less discernible. In a non-market approach incentives are not necessarily tied to results. Success is not determined by financial gain, but by a social mission, which is not as easily quantifiable, and which may not be as economically efficient.

[104] Howard Cohen, personal interview, January 10, 1996.
[105] Howard Cohen, personal interview, January 10, 1996.

Conventional multi-family housing is demand-driven; if landlords cannot provide quality service at a commensurate price, consumers will choose to live elsewhere. Real estate providers that cannot deliver desirable housing will not raise funds from investors to develop more units. Real estate professionals are therefore concerned with delivering the highest quality of service at the lowest possible cost, and have demand (resident) and supply (investor) -induced incentives to monitor expenses and operate efficiently. PHAs, with long waiting lists and as providers of housing for families that might otherwise be homeless, do not have the same demand-driven pressure to perform.[106] Need-based federal funding does not provide incentives for PHAs to operate efficiently to raise additional capital. Without demand or supply-induced incentives, PHAs have no motivation to be cost-effective.

Cost Control and Asset Management

PHAs that seek to implement a private sector corporate philosophy and become more economically efficient, should embrace the industry's core values of cost control and asset management. While cost control as a concept is more intuitively obvious, asset management is a somewhat broad and ambiguous idea that requires clarification.[107] Asset management, defined by Greg Byrne, former Director of the Dade County Department of Housing, is "a process of making investment decisions for a collection (or portfolio) of assets."[108] In other words, asset management for a PHA, as for a private sector real estate company, means considering its properties as a portfolio of assets, and making decisions with respect to individual sites that maximize the value and durability of the portfolio as a whole.

A prerequisite for cost control and asset management is understanding development and operational costs at the site level. By comparing costs of providing housing at different developments, a PHA will better understand the cost of deliver a "unit" of housing and the

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[106] Sandra Henriquez, personal interview, July 10, 1996.
[107] Michael Feloney, personal interview, May 31, 1996.
[108] Michael Feloney, personal interview, May 31, 1996. Byrne 1.

market value of each property in its portfolio.[109] Given this information, a PHA can make more enlightened decisions regarding changes at specific developments. The PHA might find that the overall value of its portfolio, and the ability to deliver more units, to more people, will require disposing of some assets and converting the uses of others from residential to commercial or industrial. Calculating costs at the development-specific level will require new reporting systems that most PHAs do not currently employ. This will be discussed in detail in the **Real Estate Reporting Systems** section below.

Real Estate Reporting Systems

Moving to a private sector model for the delivery of housing may require PHAs to implement a number of reporting systems that may not be familiar to them, including project- or site-based budgeting and pro forma statements. These new systems will facilitate asset management practices, help PHAs control costs, and allow PHAs to work more closely with the private sector.

Site-based Budgets

Site- or project-based budgets are a staple of the conventional housing market that allow real estate owners and managers to track monthly cash flows, indicate how well the property is performing, flag any risk of losses or inabilities to meet debt service, and compare operating costs across developments. Implementing project-based budgets requires calculating the sources and uses of income at each site. For public housing developments, the difference between revenues and expenses represents the operating subsidy required to break even. This figure compared with the operating subsidy provided by HUD, disaggregated per development, will give the PHA some indication of the economic efficiency of different sites.

[109] Byrne 20.

Ascertaining accurate operational expenses at the development level, however, has proven to be elusive for many PHAs. For most PHAs, site-specific information does not exist, and where it does, it is often limited, and thus not in a form useful for analysis.[110] PHAs that choose to implement project-based budgeting may find the task monumental because lump sum federal funding mechanisms for development-wide expenses do not lend themselves to a project-specific budgeting model. For many budget line items, PHAs will have to disaggregate, or prorate, revenues and expenses across developments.

In general, calculating sources of income at each development is easier than allocating uses of income. Using the conventional housing model, sources of revenue consist of rent, additional income, and interest on reserves. Rent is simply the sum of the site's lease payments. Additional income includes laundry room receipts, vending machines, and community room charges. Some PHAs carry capital or operating reserves, and any interest from these accounts should be added to the total revenue for the site. Where PHAs hold development-specific reserve accounts, it is easy to calculate interest income. In most cases, PHAs hold reserves in one general account, or several small accounts, for subgroups of developments, and interest income must be prorated across sites.

Allocating uses of funds and disaggregating costs is the more cumbersome task for PHAs. Uses of funds includes administrative costs (salaries, benefits, and general office expenses, i.e., phones, supplies, travel), maintenance expenses (labor, materials, and equipment); social services, security costs, utilities (gas, electric, and, water and sewer), and central office overhead (salaries, benefits, and general office expenses of central office employees; insurance; and taxes (P.I.L.O.T. fees)). Administrative costs, maintenance expenses, and utilities, are straight-forward charges that can be calculated at the development level. Social services and security may not be quite as development-specific, but should still not pose a great problem to allocate across sites for most PHAs. With the exception of insurance and taxes (P.I.L.O.T. fees), general overhead is more challenging. HUD's accounting system

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110 Byrne 20.

requires PHAs to consolidate project-specific and central office expenses.[111] PHAs must identify for themselves how central staff time should be charged to developments. For those employees that work with development-specific projects, this probably can be accomplished through timesheets that require staff to allocate their time per development. For non-development-specific personnel, the challenge is more daunting and these costs will have to be prorated.[112]

Pro Formas

PHAs interested in tapping alternative sources of capital must understand pro formas and sensitivity analysis which are relied upon by private real estate owners and investors in determining financial feasibility. Before committing to a project, investors put together a pro forma statement which indicates the development's expected cash flows given a certain set of assumptions with respect to lease-up, cost inflation, and other variable factors. Multiple pro formas, under different sets of assumptions, provide investors with best and worst case scenarios for how well their investment is expected to fare. This sensitivity analysis provides investors with necessary information as to whether or not a project is a good investment.

Without investors, and without the risk of debt and foreclosure, PHAs have no reason to produce pro formas or project-based budgets that track monthly profits and losses per development. PHAs are not concerned about returns or performance under various scenarios. Getting comfortable with these reporting systems is critical for PHAs in dealing with private entities. Expertise in analyzing these various reporting systems will provide PHAs with more leverage in negotiations with private developers.

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[111] Byrne 28.
[112] Byrne 28.

Budgeting

PHAs interested in pursuing a private sector model for housing delivery, particularly with respect to utilizing alternative sources of capital, may also need to implement new budgeting line-items for individual developments, such as capital reserves, operating reserves, management fees, property taxes, and marketing expenses, none of which have been of relevance to PHAs in the past. Most investors will expect these line items to be fully funded, but with some, namely capital and operating reserves, the ability of PHAs to provide money to expense these accounts may be fiscally impossible. Management fees, property taxes, and marketing expenses, however, are already part of a PHA's normal expenditures; the key is quantifying them as a line item in operating budgets.

Capital and Operating Reserves

Most conventional multifamily housing developments have line items for capital and operating reserve funds for unexpected expenditures. Capital and operating reserves are essential line items for maintaining the stability of a development. Reserves provide protection against shortfalls in cash flow for debt service and operating expenses due to unanticipated occurrences such as emergency maintenance or sudden drop-offs in lease-up.

In theory, HUD requires PHA-owned properties to carry reserves, but due to years of underfunding, reserves in many cases have been depleted to cover routine maintenance expenditures.[113] Allocating reserves for properties will be the difficult part for PHAs, as was indicated in the previous chapter by the experiences of the Atlanta Housing Authority in the Techwood deal. Limited funding makes reserves a luxury for many PHAs. Allocating reserve funds for individual developments for many PHAs will commit resources that would otherwise go to maintenance needs for other sites. Without guaranteed future funding levels from

[113] Byrne 20.

Congress, pledging reserves on projects to appease private financiers could have a deleterious effect on a PHA's overall portfolio, as was discussed in the previous chapter with respect to the Techwood deal.

Management Fees, Property Taxes, and Marketing Expenses

Private market housing budgets also contain line-items for management fees, property taxes, and marketing expenses. Most PHAs have historically not considered these as separate expenses. PHAs that provide their own management services generally do not pay themselves a fee for this function. Federal law exempts PHAs from property taxes. With waiting lists PHAs do have advertising expenses to market units.

Greg Byrne argues that all of these expenses are already part of a PHA's operations, and can, and should, be charged separately on a per development basis. PHAs do not pay property taxes, but do pay P.I.L.O.T., Payment in Lieu of Taxes, fees. P.I.L.O.T. fees are calculated on a per unit basis and can be added easily to a site-specific budget as a separate line item. Additionally, PHAs incur expenses monitoring the wait list, verifying income eligibility, and screening tenants for occupancy. These costs can be calculated as marketing expenses. Finally, Byrne argues that overhead costs can, and should, be aggregated and considered a management fee.[114]

Personnel

PHAs that want to maximize the options now available to them, and implement the changes described above, particularly in regard to new reporting systems and attracting new capital, may have to reorganize and make alterations in personnel. PHAs may have to decentralize many functions to cut costs and improve efficiency. PHAs that lack staff willing to respond to decentralization, capable of designing new reporting systems, or

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[114] Byrne 28.

competent to handle new sources of capital, will have to provide training for existing employees or hire, or contract with, outside professionals. The primary obstacles to making personnel changes will be union opposition, available resources, and current personnel who may be unmotivated to cut costs and improve efficiency or threatened by employees hired to develop new systems and new ways of thinking about financing projects.

New Personnel for Alternative Capital

Most PHAs that seek alternative sources of capital will have to hire new personnel or contract with outside consultants. To access new sources of funds, PHAs must have personnel that understand private sector values of risk and return and the financial and collateral requirements for debt and equity investments. Private market funds are entirely new sources of capital for PHAs that have always relied on grants to finance public housing development, rehabilitation, and operations. PHAs need to understand how to handle equity and debt, what guarantees investors require, what reporting systems are necessary, and what priority each finance instrument takes with respect to reversions (sale) or foreclosures. PHAs not familiar with private debt and equity will not have the proper resources to negotiate with investors and could lose permanent control of their properties and/or the long term affordability of their assets.

Existing Personnel for Decentralization

For existing employees, the most significant changes will come from decentralization of current functions and processes to cut costs, improve efficiency, and create reporting systems geared to the project-based level. This will require changing the responsibilities of some staff, pushing more employees into the field, and giving on-site managers and maintenance staff more responsibilities and control. The capacity of a PHA to implement these changes will be partly a function of its ability to motivate employees. PHAs may need to reward employees for performance, fire workers for incompetence, and eliminate unnecessary positions. For many authorities, an unmotivated staff may be the primary impediment to controlling costs and improving efficiency.

Union Opposition

Union opposition may be the greatest obstacle to PHAs seeking to make personnel adjustments to embrace a private sector approach to housing. PHAs, as quasi-governmental entities, have stringent rules and procedures for eliminating employees or changing their responsibilities. Most cannot dismiss workers unless they can establish a pattern of incompetence through paper trails documenting abuse or ineptness and unless they have given the employee sufficient time to reform his or her work habits.[115] Similarly, some PHAs may have constraints on merit-based advancement programs to motivate employees, where promotions must follow a strict seniority system. If a PHA cannot implement reward or promotion programs, fire employees, or eliminate positions, it must rely on the personal commitment of employees to the mission of the authority.

Obstacles

Although Congress and HUD have begun to implement reforms to encourage PHAs to emulate the private sector, several obstacles remain preventing PHAs from fully embracing a market orientation for housing delivery. These impediments were documented in Chapter One. Several of those barriers: aggregated accounting systems, non-fungibility of federal funding streams, and need based funding/absence of cost reduction incentives are recounted here, because they directly relate to the capacity of PHAs to reduce costs and institute asset management practices -- two policy changes necessary to deliver housing from a more market-oriented approach.

[115] Sandra Henriquez, personal interview, July 10, 1996.

Aggregrated Accounting Systems

HUD accounting systems do not encourage site-based budgeting, which is an essential step in cost control and asset management. PHAs report most expenses on an aggregated basis, consolidating development and central office costs.[116] HUD then distributes funds to PHAs based on these aggregate figures of the authority's ongoing operational and rehabilitation needs. HUD does not prevent PHAs from creating site-specific accounting systems, but any efforts to implement project-based budgeting is an additional accounting measure an authority must implement on its own. Limited resources impede PHAs' ability to institute their own budgeting procedures in addition to those they must follow for HUD requirements. Efforts on the part of HUD to change its reporting requirements, or to encourage PHAs to adopt project-specific budgeting, would help housing authorities identify the true costs of operations at different developments and make more informed asset management decisions.

Non-Fungibility of Funding Streams

Currently HUD does not allow full fungibility of the funding streams it provides to PHAs. The ability to completely mix funding streams would allow PHAs to be more entrepreneurial, to act like a private real estate company, and to take on asset management functions more freely. Substitutability of funding streams will allow PHAs to use their funds for whatever activities will maximize the value of the PHA's portfolio as a whole, not the activities required by the funding stream.

Need Based Funding/ Absence of Cost Reduction Incentives

All major public housing streams. Comprehensive Grants, HOPE VI, Drug Elimination, and Owned Rental are premised on need, which is an impediment to economic efficiency. PHAs with more distressed properties, higher operating costs, and more drug problems,

[116] Byrne 20.

receive greater funding. If a PHA has fewer needs, it will receive less financial support from the federal government (with the exception of the new Revenue Retention ruling that allows PHAs to keep increases in income). HUD does not provide PHAs with financial incentives to eliminate bad properties (except for the one-time only reversion proceeds), engage in preventive maintenance, cut overhead, eliminate positions, fire employees, reward performance and productivity, or take any other measures routinely employed by private real estate firms to reduce costs and improve efficiency. Without financial incentives, there is little motivation for PHAs to increase the efficiency of their operations. If Congress and HUD create non-need based funding streams, PHAs will have more motivation to watch the bottom line, and will have greater incentives to act more like private real estate companies.

Summary

PHAs that wish to emulate the private sector and tap new sources of capital will need to make a number of transformations with respect to corporate philosophy, reporting systems, budgeting, and personnel. The capacity of PHAs to make these transformations is dependent on their own institutional capabilities and the space and support provided by HUD. Continued transformation is dependent upon the evolution of PHAs as they become more familiar with private market practices, particularly those essential for tapping new sources of capital, and the further breakdown of obstacles by HUD allowing PHAs to be more cost effective, entrepreneurial, and creative.

Much of what a PHA can do with respect to asset management and cost control will be determined by the resources available. Training employees, rewarding performance, developing reporting models, adding budget line-items, and hiring additional personnel will require additional funds. Limited funding from HUD will impede a PHA's ability to implement all of these changes.

Ultimately the limit to the transformation process and the entrepreneurial and creative ideas a PHA seeks to implement will be a function of the organizational capacity of the PHA given its history, corporate culture, resident population, demographics, personnel, local politics, community support, and the underlying mission of the authority. It is the benefit, or impediment, of these factors that will determine what a PHA can do. In sum, the policies a PHA can implement will be a function of its opportunities to make changes, necessity to implement reforms, and the market forces supporting or hindering these alterations. How these three issues impact the choices and strategies specific PHAs will make for the future forms the basis of the next and final chapter of this thesis. The Boston Housing Authority and the Cambridge Housing Authority will serve as two case studies for this analysis.

CHAPTER FOUR: BHA AND CHA RESPONSE TO PRIVATE SECTOR MODEL

The realization of Congress's and HUD's vision of a private-market orientation for public housing depends on the space provided by Congress and HUD for PHAs to be entrepreneurial, creative, and economically efficient, the willingness of private investors to supply capital for the development and financing of public housing, and the capacity of PHAs to implement the transformations necessary to emulate the private sector. The preceding chapters analyzed the dynamics among these three issues with respect to the options, limits, concessions, and obstacles for PHAs to take advantage of the opportunities now provided them. This chapter locates the findings of those previous sections within the context of two specific PHAs, the Boston Housing Authority (BHA) and the Cambridge Housing Authority (CHA), to ascertain how two particular authorities are responding to Congress's and HUD's vision for a new approach to public housing. This analysis examines from a more localized perspective the degree to which PHAs can embrace a private sector model, tap new sources of capital, and be entrepreneurial and creative in cutting costs and implementing asset management practices.

A key aim of this section is to describe how the strategies and options each authority is considering for the future, are shaped by its institutional and political context, i.e., its corporate culture, market demographics, local politics, and community support. Accordingly, this chapter explores how the BHA and CHA are organizing for change in this new environment by examining each Authority's vision for the future, the strategies and options under consideration at each authority, the required changes in personnel, and some of the obstacles each is encountering in realizing its goals.

Background on BHA and CHA

The BHA and the CHA share a similar past, but a contrasting present and an unknown future. Both are among the oldest PHAs in the country, constructing their first housing soon after Congress created the federal public housing program: the CHA with Newtowne Court in 1938, and the BHA with Old Harbor Village, now Mary Ellen McCormick, in 1937.[117] Both are considered among the largest PHAs in the country, the BHA with 12,777 apartments represents the eighth largest PHA in the country, and the CHA with 1,866 apartments, the one hundredth largest.[118] Together they formed the Council of Large Public Housing Authorities (CLPHA) in 1975, an organization that works with Congress and housing authorities on issues particular to large urban PHAs.[119]

Each authority has gone through great periods of success, turmoil, and despair. The nadir for both happened around the same time. The CHA, due to a cryonistic board and a patronistic staff, flirted with Receivership in the mid-1970s.[120] In 1975, a reorganized Board of Commissioners asked Harry Spence, a young Harvard Law School graduate and former Executive Director of the nearby Somerville Housing Authority, to head and resurrect the CHA, which according to all accounts he did amazingly well.[121] Five years later, the BHA, under similar woes, did succumb to Receivership, and Spence, due to the strengthen of his work at the CHA, was appointed by the Court to rejuvenate the BHA.[122] Common accord indicates he restored order once again. Since Spence's departure, however, the two authorities have traveled different paths. Today, the CHA enjoys the respect of its peers as

[117] Mission Main Baseline Case Study 2. CHA Development Handbook 15.
[118] The BHA actually has approximately 18,000 units, 12,777 of them are federal, the remainder are state supported. Similarly the CHA has 2800 units, 1866 of which are federal. For the purposes of this analysis I am ignoring the state portfolio. Rankings are based on federal stock only. There are 3500 PHAs in the country including those in United States Territories.
[119] Yves Djoko, personal interview, August 2, 1996.
[120] Daniel Wuenschel, lecture, Cambridge Housing Authority, August, 1995.
[121] Jim Stockard, personal interview, March 28, 1996.
[122] Adams 3.

one of the more accomplished PHAs in the country, while the BHA continues to struggle, recently emerging once again from HUD's "Troubled List" of housing authorities.

The differences between the two are significant, with respect to the size and condition of their assets, as well as, their management capabilities, institutional capacity, and corporate culture. Several BHA developments have more than 500 units each; only one CHA development has over 300 units.[123] The BHA's stock is more distressed and in need of greater rehabilitation than the CHA's stock. Accordingly, the BHA receives almost nine times the amount of Comprehensive Grant money as the CHA, despite having just less than seven times as large a stock.[124] Two BHA properties, Mission Main and Orchard Park, are severely distressed HOPE VI sites; no CHA property qualifies for this designation. The BHA vacancy rate is 13%, and it takes management 45 days to turn a unit around for reoccupancy.[125] The CHA vacancy rate is 10%, and it takes management 16 days to turn a unit around.

Institutionally, the CHA has a stability of leadership that the BHA does not share. Dan Wuenschel has been the Executive Director of the CHA for eighteen years, ever since Spence left. Sandy Henriquez, the fourth Executive Director since Spence left the BHA in 1984, has a tenure of only four months.[126] When she assumed office, five senior staff positions were vacant.[127] Wuenschel works with a five member Board of Commissioners, two of whom were instrumental in hiring Spence and have remained on the Board since.[128] Henriquez has no Board and serves at the pleasure of the Mayor.

These differences in asset condition, management capabilities, and institutional capacity will influence the choices the two authorities will make for the future and their ability to

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[123] Adams 3. CHA Development Handbook.
[124] BHA's Comprehensive Grant Funding for 1995 is $35,805,794; CHA's Comprehensive Grant Funding for 1995 is $4,108,127. Size ratio is based on federal units only.
[125] Abt 22.
[126] Technically Henriquez's title is Administrator, but she serves the same function as an Executive Director, so for the purposes of this analysis, I will refer to her as Executive Director.
[127] Sandra Henriquez, personal interview, July 10, 1996.
[128] Jim Stockard, personal interview, March 28, 1996.

respond to HUD reforms. The balance of this chapter is dedicated to describing the two authorities' approach to the future and how these organizational attributes impact their goals and policies.

Vision

With radical change in federal housing polices and severe cuts in funding, PHAs have room to redefine their mission. No longer required to serve the poorest of the poor, PHAs can change the composition of their tenancy and convert properties to commercial or industrial uses. Yet neither the BHA nor the CHA is in a rush to implement wholesale the changes now offered by HUD with respect to elimination of federal preferences and one-for-one replacement, imposition of ceiling rents and minimum rents, income mixing, disposing and conversion of assets, and tapping alternative sources of capital. Both Executive Directors are approaching this new environment with apprehension and caution and have a very clear vision of their agency's role within the community, the populations they wish to serve and the manner in which they want to serve them, and the role of social services in their mission. The CHA's commitment to that vision appears more consistent, or less flexible, depending on one's perspective, than the BHA's, which seems appropriate, as will be discussed, given the enormity of the physical distress issues confronting the BHA, market opportunities, and the resources available from HUD.

Both the BHA and the CHA are clear that their role in the community is foremost to provide decent, safe, and affordable housing for low income families. For the BHA, this message has taken on a particular focus. The BHA's underlying mission is to provide high quality, client-centered service to its residents à la a private real estate management company.[129] The BHA is committed to improving and developing its core competencies which are: property ownership and management of large scale housing developments. This

[129] Sandra Henriquez, personal interview, July 10, 1996.

sentiment is echoed throughout senior staff by Sandra Henriquez, Administrator; and Rebecca Plaut, Chief of Staff; as well as by Arthur Jemison, Financial Analyst, Operations Division. Accordingly, the BHA has, or is in the process of, eliminating all functions and activities not related to its primary mission of owning and managing large housing complexes, including selling the authority's auto repair shop and roofing agency; eliminating the in-house construction crew, Force Account; and contracting out as many resident service functions as feasible.[130] In addition, while many PHAs are looking to scattered-site housing as an alternative to large scale developments, the BHA is looking to dispose of these assets because they lie beyond the BHA's core competencies.[131] Resident services do not have a place in this mission. While the BHA executive staff will not deny the value of services, they do believe they are secondary to the primary mission of the authority.[132]

The CHA shares a similar view of its mission as housing provider for low-income families. For the CHA, its core competencies revolve around the ownership, management, and development of smaller scale housing. In contrast to the BHA, the CHA is adding scattered-site units to its portfolio, most recently through the development of eight units of family housing in one neighborhood. In the future, the CHA will invest in a condo acquisition program, looking to purchase several condominiums in privately-owned multi-family buildings. Like the BHA, resident services fall outside the authority's core competencies. While the CHA does offer some resident services, limited funding in the future will mostly likely flow to the expansion of the stock and the improved management of existing housing, before supporting additional resident service programs.

Similarities persist with respect to the population the two authorities wish to serve and the manner in which they want to serve them. Despite new leeway to rent to higher income families, the Executive Directors share a belief in housing for low income families. While both Directors speak of the communal and financial benefits of income mixing, each feels

[130] Rebecca Plaut, personal interview, June 4, 1996.
[131] Rebecca Plaut, personal interview, June 4, 1996.
[132] Rebecca Plaut, personal interview, June 4, 1996.

constrained by the enormity of their waiting lists. The common view is that admitting higher income residents is inappropriate given the preponderance of families waiting for housing, over 20,000 families for BHA owned apartments, and 4,500 families for CHA residences.[133] Furthermore, both Directors believe that their agencies can, and should, serve residents themselves, without contracting out ownership and management functions.

Both Executive Directors share the fundamental belief that the assets of the authority are sacred and must be protected and retained throughout this rapidly changing environment and severe cuts in funding. Wuenschel has the full support of the Board of Commissioners in this decision. If necessary, the Board has made a commitment to lease units to as high an income population as required to preserve the stock, with the understanding that when funding resumes, the CHA will again be able to provide housing to low-income residents. For Henriquez, the commitment to protect the assets flows from the fiduciary responsibility she feels the authority has to the taxpayers, residents, community, and city at large.[134] At the same time, this responsibility requires the authority to make decisions in the best interests of its portfolio, which may require disposition or demolition of some properties. In theory, Henriquez would not yield any units, but financial reality dictates that this is not possible, or economically beneficial. The authority's actions with respect to the HOPE VI projects (in which the BHA will be losing units, discussed below) and a proposed use conversion of one property from residential to commercial (also discussed below) are examples of flexibility to this stock preservation goal.

Strategies and Options

Both the BHA and the CHA are implementing, or exploring, albeit cautiously, a wide range of the operational and asset management policy changes available to them. For the

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[133] Adams; CHA Monthly Report, August 1996.
[134] Sandra Henriquez, personal interview, July 10, 1996.

most part, both authorities are selecting options that honor its vision of its role within the community. Recall from Chapter One, strategies now available to PHAs fall into two broad categories: (1) policies applying to operations and the resident population, i.e. minimum rents, ceiling rents, and the elimination of federal preferences; and (2) policies applying to the development and control of physical assets, i.e. elimination of one-for-one replacement, use conversion, and tapping new sources of capital. With respect to the former, both authorities seem concerned that the imposition of any new operational measures respect the rights of current tenants not to be displaced; and families on the waiting list not to be eliminated from consideration. With respect to the latter, both share an equal concern that changes do not sacrifice the authority's assets, or the ability to maximize resources to serve as large a population as possible. The BHA however, has been more proactive than the CHA in leveraging alternative sources of capital. As will be shown below, the CHA is pursuing ideas for the financing and repositioning of assets; however, neither HUD programs, nor the market characteristics of Cambridge, support its ability to implement new strategies, such as using HOPE VI funding to add homeownership opportunities at one development. The BHA's "success" in pursuing and achieving new strategies, in contrast, is a consequence of the opportunities available to them from HUD and a greater necessity to redevelop some severely distressed properties.

Operational/Resident Population Policies

On the operations/resident policy side, both the BHA and the CHA view reforms as important community building initiatives more than revenue opportunities. According to John Stainton, Director of Development for the CHA, there is an inherent tension created by "pressure [from the federal government] to reduce operating subsidies and establish more viable communities, and public housing's primary mission to house the most needy."[135] PHAs can raise revenues and build community, in part, by renting to working families, but

[135] John Stainton, personal interview, June 18, 1996.

this denies those most in need from access to quality housing. Both the BHA and the CHA seem to be responding to this dilemma by emphasizing community over housing the most needy, but not from the perspective of increasing the bottom line. Accordingly, both authorities have, or soon will, establish minimum rents, to make residents more responsible for their accommodations; set ceiling rents, to encourage more stable working families to stay in public housing; and rescope federal tenancy preferences, not simply to admit higher income families, but to give each authority the flexibility to admit families from a wide range of income backgrounds if they desire.

As evidence of its position that these measures are community building tools more than income generators, the BHA chose to adopt minimum rents of $25 dollars per month, instead of the $50 per month allowed by HUD.[136] Similarly, the CHA, chose to impose ceiling rents, despite the real possibility that this could actually reduce the authority's income over the long term. Anecdotal evidence suggests that some CHA residents willingly pay more than market rates because the quality of their apartments is higher than that of the private units in their neighborhood. In the short term, Wuenschel is convinced that ceiling rents will reduce revenue, but believes that over the long run, the CHA will benefit. Wuenschel is concerned that the abolition of rent control could create a two-tiered community in Cambridge, of extremely wealthy families and poor public housing families.[137] Ceiling rents can diversify the public housing population by retaining higher income families. In this way, Wuenschel believes the CHA can assist the city maintain a more economically diverse population.

In setting ceiling rents and reshuffling federal preferences, both directors are making implicit statements about the beliefs that public housing should be reserved for the poorest of the poor, and that public housing should be transitional living. The elimination of federal preferences will allow the authorities to provide housing to working families; ceiling rents will

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[136] Sandra Henriquez, personal interview, July 10, 1996.
[137] Daniel Wuenschel, personal interview, June 18, 1996.

encourage them to stay. In effect, the authorities are offering permanent housing options to a mixed income population. This represents a fundamental change with respect to (recent) past thinking about the role of public housing as transitional living for the most needy. Through ceiling rents and federal preferences, both directors are acknowledging that the benefits of mixed income housing and the necessity to build stable communities outweigh the desire to provide housing to those most in need.

Physical Asset Policies

With respect to policies related to physical assets, the BHA is more aggressive than the CHA in exploring and implementing options to maximize the value of its portfolio. The BHA is creating development-specific budgets, demolishing units without replacement at two sites, considering a use conversion at another, tapping new sources of capital for energy improvement projects and major redevelopment, and seeking entrepreneurial opportunities to increase revenues, such as leasing roof space for satellite dishes and renting out community rooms for fees.[138] In contrast, the CHA is considering (but has yet to implement) site-based budgeting, exploring asset management practices, and tapping new sources of capital for energy improvement projects, but will not demolish units without replacement and has tried to increase revenue more on the margin through greater efficiency and elimination of waste.

Much of this difference in approach revolves around three themes: (1) opportunity; (2) necessity; and (3) market forces, particularly, but not solely, with respect to tapping new sources of capital. Each theme is detailed below. Because of these three factors, the BHA is able to think more broadly about options available to it, while the CHA remains focused on more conservative goals that are feasible with respect to its assets and market characteristics.

[138] Rebecca Plaut, personal interview, June 4, 1996.

Opportunity

Because Boston is one of the forty largest cities in the country, the BHA is a HOPE VI eligible authority.[139] This provides the authority with the opportunity to receive large grants to write down the cost of rehabilitation using LIHTCs. Recall from Chapter Three that HOPE VI grants make it more feasible for PHAs to access LIHTCs. The cost of redeveloping many severely distressed sites would be too expensive if financed entirely with equity and debt. HOPE VI grants provide additional funding which makes some redevelopment projects fiscally possible. The CHA does not have access to this valuable source of financial leverage, and this represents a distinct advantage for the BHA. Any major redevelopment effort the CHA wishes to undertake must be without the benefit of HUD resources.

Necessity

The severity of distress of the BHA's assets, coupled with the drastic reductions in modernization funding, necessitates the authority to pursue disposition and use conversion strategies that will maximize the value and durability of its overall portfolio. According to Jemison, the BHA's assets require approximately $1 billion worth of physical improvements, and this past year, the authority's Comprehensive Grant funding dropped from $38 million to $28 million.[140] While the CHA suffered similar cuts in funding, it does not own properties classified as severely distressed. Without distressed properties the CHA has less need for capital to rehabilitate its properties.

[139] HOPE VI NOFA.
[140] Arthur Jemison, personal interview, June 20, 1996.

Market Forces

Market forces present an additional obstacle to the CHA, particularly to acquiring new properties. According to Terry Lurie, Interdepartmental Projects Coordinator, extremely high property values in Cambridge prohibit the authority from buying market rate properties.[141] On the flip side, a strong market means that some of the CHA properties are extremely valuable and disposing of them could create a windfall. Additionally, the CHA in the future might borrow against some properties for rehabilitation. Without any severely distressed developments, however, the CHA has no need to sell any of its assets. While property values in Boston can be equally high, some BHA developments are located in weak markets.

The following discussion details four sets of activities: development-based budgeting, one-for-one replacement, tapping new sources of capital for development and energy projects, and entrepreneurial activities, and describes how the two authorities are proceeding in each of these areas vis-à-vis the opportunity, necessity, and market force themes.

Development-Specific Budgeting

The BHA has already implemented development-specific budgeting, primarily to provide managers with more control over their properties and to encourage them to take greater responsibility for cost identification. Cost reduction appears to be only a secondary concern. The necessity to address management deficiencies, and a desire to become more customer service oriented, appears to be the primary force driving the implementation of project-based budgeting. Consequently, the BHA development budgets are designed as tools to identify the activities and functions each manager will need to undertake or the materials they will need to have during the year, not vehicles to control the bottom line. While the CHA realizes the importance of understanding sources and uses of income at the site level, it

[141] Terry Lurie, meeting at Cambridge Housing Authority, June 27, 1996.

has yet to dedicate the staff time or resources to construct project-based budgeting across developments. The CHA views site-based budgeting more as a cost identification and reduction instrument than a management empowerment tool. That the BHA has already created site-specific budgets suggests that the CHA is not driven by the same necessity to implement project-based budgeting to reduce costs as the BHA is to use project-based budgeting to empower management. Given more resources, however, development budgets would probably become a higher priority for the CHA.

One-for-One Replacement

Demolition without replacement is another area in which the authorities differ, and the dividing line seems to be necessity. From a theoretical perspective, both executive directors reject demolition without replacement, but the BHA has found financial necessity sometimes makes this position untenable. Through the HOPE VI redevelopment projects at Mission Main and Orchard Park, the BHA will lose 363 total units and 458 public housing units, because even with LIHTCs, there is not enough funding available for reconstructing the same number of units that currently exists at either site.[142] (This is discussed in more detail below.) The BHA has found that comprehensive redevelopment requires sacrificing some units, a reality that many HOPE VI sites are encountering. Similarly, the BHA acknowledges that the drastic reduction in its Comprehensive Grant budget does not afford it the opportunity to redevelop all the sites in need of major rehabilitation.[143] In recognition, the BHA is proposing converting some of the land at one site from residential to commercial use because the authority believes its market potential may be significantly higher as a retail property.[144] In contrast, the CHA is interested in turning one of its larger complexes, the 284 unit

[142] Deborah Goddard, personal interview, April 4, 1996.
[143] Arthur Jemison, personal interview, June 20, 1996.
[144] BHA officials did not feel comfortable specifying which development, or how much of it, would be converted until the decision was reviewed with the residents and other community members.

Jefferson Park development, into a mixed income community with some homeownership opportunities.[145] Wuenschel insists however that the project will not proceed if demolition of existing stock is required and the net result is a loss in total units for public housing eligible tenants.[146]

Tapping New Sources of Capital

Among the asset management options and strategies PHAs can explore, the BHA and CHA appear to be most divergent around tapping new sources of capital. Much of this difference, as stated above, stems from opportunity, necessity, and market forces. A secondary source of discrepancy between the two authorities lies in philosophical differences regarding the meaning of private sector investment in public housing. Wuenschel feels private capital "gets the federal government off the hook" from its commitment to provide affordable housing per the intent of the Housing Act of 1937.[147] Wuenschel sees this option as a "Catch-22" situation, "if a PHA can leverage funds for capital improvements successfully, it says to the federal government, 'we do not need you, we can live without you.'"[148] His fear is that, the more successful PHAs are at exploiting new sources of financing, the more the federal government will reduce its commitment. Additionally, particularly with respect to HOPE VI deals, Wuenschel thinks many authorities are "caught up in a frenzy," and, lacking foresight, are going to make mistakes.[149] He fears these PHAs could wake up one day to find they have lost some of their stock. Wuenschel's tone should not be mistaken as opposition to private capital, but rather his fears and concerns reveal a cautionary approach. The absence of opportunity, coupled with a lack of necessity to rehabilitate distressed stock, allows the CHA to maintain this philosophical perspective.

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[145] Daniel Wuenschel, personal interview, June 18, 1996.
[146] Daniel Wuenschel, personal interview, June 18, 1996.
[147] Daniel Wuenschel, personal interview, June 18, 1996.
[148] Daniel Wuenschel, personal interview, June 18, 1996.
[149] Daniel Wuenschel, personal interview, June 18, 1996.

BHA senior staff share Wuenschel's concerns with respect to the possibility of losing assets and are working to ensure that the authority's stock is not sacrificed in accessing new capital, but economic necessity requires the BHA to take greater risk with its properties.

Some common ground around new sources of capital does exist between the two authorities. Opportunity and necessity converge for both around alternative capital for energy improvement projects. HUD incentives for energy conservation projects do not discriminate between distressed and non-distressed authorities. All PHAs can enter into shared savings programs with HUD whereby the authority and the federal government split all savings equally that accrue from energy improvement projects. Economically inefficient buildings require both authorities to explore options to reduce costs.[150] Accordingly, both the BHA and the CHA are implementing shared savings programs at some of their developments and using tax exempt bonds and/or the energy savings to finance the improvements. The BHA, due to its size, is even more aggressive in its financing strategy, looking to leverage the relationships it has with local utility companies to get them to finance improvements at a lower cost.[151] One example, shared by Jemison, involves using BostonGas to finance improvements at a lower cost of capital than tax exempt bonds. In return, the BHA commits to BostonGas service for the next ten years instead of "firm transportation" of its gas supply, i.e. using a non-local vendor to supply gas to the BHA at a lower cost, as federal law now allows institutions to do.[152]

The three themes discussed above: opportunity, necessity, and market forces come most strongly into play in differentiating the policies and approaches the BHA and the CHA are able to implement with respect to tapping alternative sources of capital for major rehabilitation and new construction projects. With no development grants and no opportunity from HUD to access HOPE VI funding, the CHA has difficulty accessing

[150] Because energy costs are a passthrough to the federal government, PHAs do not have an economic necessity to improve the efficiency of their buildings. There is great speculation that in the near future, PHAs will have to bear this cost, and this makes conservation a necessity.
[151] Arthur Jemison, personal interview, June 20, 1996.
[152] Arthur Jemison, personal interview, June 20, 1996.

alternative sources of capital for major rehabilitation projects. Market characteristics, primarily the unavailability of inexpensive land, prohibit the CHA from developing new properties on its own without HUD dollars. In contrast, the opportunity to access HOPE VI funds and the necessity to renovate severely distressed properties allows the BHA to utilize new sources of capital for major redevelopment projects. Lack of desire to create new units explains in part why the BHA is not accessing new capital for development. (See Vision section on core competencies, above.)

HOPE VI

The BHA has received two HOPE VI grants from HUD, one, a $50 million award for the redevelopment of Mission Main, a 822 unit family development, and the other, a $30 million award to renovate Orchard Park, a 711 unit family development.[153] Both projects will utilize LIHTCs, and be owned by a partnership that probably will not include the BHA as the GP. The particulars of both redevelopment deals are currently under negotiation. Deborah Goddard, the HOPE VI Administrator for the BHA, is cognizant of the problematic issues of the Techwood deal. (See Chapter Two.) Her primary concerns, echoed by HUD, are limiting the BHA's exposure on guarantees and operating reserves, i.e. reducing the amount of funds the BHA must escrow as reserves from those required in the Techwood arrangement, and moderating the ability of the LPs to tap into reserves if HUD operating subsidies diminish significantly.[154] Goddard and her staff are considering more discrete tiering of income levels as one measure to reduce any potential loss of units.[155] If financial difficulty emerges for investors, the income tiering would slow the conversion of units from public housing to conventional. Investors would be forced to convert small numbers of units at a time, i.e. tiers, to market rate, thereby preserving as many public housing apartments as possible, for as long as possible. Goddard also is troubled by the language of the Techwood

[153] Deborah Goddard, personal interview, April 4, 1996.
[154] Deborah Goddard, personal interview, April 4, 1996.
[155] Deborah Goddard, personal interview, April 4, 1996.

deal, which depicts the Atlanta Housing Authority as the negligent source in the event of operating subsidy shortfalls. Her goal in structuring the HOPE VI deals is to make it clear that Congress is responsible for operating funding, and any trouble the BHA may have making its annual contribution to the Management Agent, which could result in a loss of public housing units, or the property, is Congress's fault not the BHA's.[156] Regardless of the final negotiating details, if all goes well during the redevelopment process, the HOPE VI deals should net the authority two redeveloped mixed income developments.

From HUD's perspective, the ultimate success of the HOPE VI program is not simply renovated sites, but the adoption of an entirely new way for PHAs to develop and finance public housing both physically as well as operationally. The key is the ability of HOPE VI PHAs to leverage the experiences and relationships of the program to help them deliver better service at their other developments. The belief that such learning will occur at the BHA is mixed. Rebecca Plaut, Chief of Staff for the BHA, discounts any leverage of the HOPE VI efforts, saying "the BHA will get two successful developments out of HOPE VI; its [HOPE VI] main effect is to reduce operating subsidies for the rest of the authority."[157] Plaut sees few possibilities to duplicate the financial arrangements because tax credits, as a limited resource, are not conducive to renovating large developments of the size owned by the authority. She notes that the BHA could use all the tax credits allocated to Massachusetts in renovating its stock. Henriquez and Goddard have a different perspective on the HOPE VI program. Henriquez sees the HOPE VI efforts as a springboard for financing similar redevelopment projects at other BHA sites. Accordingly, she has hired a new Chief Financial Officer with public and private sector experience whose job will be to explore the bond markets and other investment vehicles to see what additional opportunities may exist for the Authority.[158] In the future, Henriquez would like to undertake HOPE VI type deals and would like to see the BHA as the managing agent in a partnership arrangement. Goddard sees

[156] Deborah Goddard, personal interview, April 4, 1996.
[157] Rebecca Plaut, personal interview, June 4, 1996.
[158] Sandra Henriquez, personal interview, July 10, 1996.

possibilities to leverage the HOPE VI experience as well, but is less bullish on the replication of financing arrangements using LIHTCs. Like Plaut she notes that LIHTCs cannot be a panacea for the authority given their limited availability, their expense, and the operating subsidy guarantees to private developers that they require.[159] Goddard does believe, however, that the HOPE VI program at Mission Main and Orchard Park can, and will, be a model for the nation and the BHA. She argues that the BHA will inherit an image and reputation for partnering successfully with the private sector, as well as developing a new manner of delivering services, that will be replicable for other redevelopment efforts.[160]

While the CHA cannot share in the HOPE VI experience, and Wuenschel does express reservations about the role and meaning of private sector capital in public housing, the authority has been exploring opportunities to use alternative funding. The CHA may be eligible for HOPE VI funding in the future, and has engaged in discussions with private developers and tax syndicators about the possibility of using LIHTCs or other financing vehicles to convert the Jefferson Park development into a mixed income community with some homeownership opportunities for residents.[161] Recall from above, however, that Wuenschel is only interested in adding units to Jefferson Park; he will not condone a plan that will reduce the number of units for public housing residents.

Entrepreneurial Activities

In general, the BHA and CHA are engaging in entrepreneurial activities from opposite perspectives. The BHA's efforts revolve around revenue generation, while the CHA seems more focused on cost reduction measures. The BHA is seeking to increase funds through bold strategies, such as leasing roof space for satellite dishes and billboard advertising, and renting out community rooms for fees. In contrast, the CHA is looking at greater efficiency and

159 Deborah Goddard, personal interview, April 4, 1996.
160 Deborah Goddard, personal interview, April 4, 1996.
161 Daniel Wuenschel, personal interview, June 18, 1996.

elimination of waste measures more on the margin, such as energy bill consolidation, preventive maintenance, and office computer networking. The CHA is also actively engaged in exploring asset management practices that reduce expenses and has assigned Senior Planner Mike Feloney to oversee this project. Feloney and Planner Mecky Adnani have produced two Request For Proposals thus far around this theme, one, for preventive maintenance services, and the other, for a five year capital improvement plan for the authority's developments. Neither the BHA nor the CHA, however, is fully exploiting the opportunity to retain residual revenue from increased rental income or other activities per the PFS Revenue Retention notice for keeping additional income as described in Chapter Three. Recall that this measure allows a PHA to retain any income it generates, up to 100% of PFS, over its existing income level. To maximize income under this measure the BHA and the CHA could rent to tenants that can pay ceiling rents until each authority reaches the 100% PFS threshold (PHAs are currently funded at 89% of PFS), yet neither authority seems to be considering this option.

Personnel Requirements

As described in the previous chapter, PHAs that seek to implement change in this environment may have to make personnel adjustments by hiring new employees, training existing workers to handle new responsibilities, or contracting with outside consultants. With respect to the BHA and the CHA, changes in personnel reflect the depth of transformations the two authorities are implementing. Thus far the BHA has hired several new employees, worked with current employees to expand their responsibilities, and contracted with numerous outside consultants. BHA personnel changes reflect a commitment to explore more entrepreneurial and financial opportunities and alter the tenor of the corporate culture to advance a more customer service orientation. In comparison, the CHA has chosen not to employ new workers, but instead is providing training to one in-house employee and has contracted, or is in the process of contracting with, outside consultants.

Henriquez is hiring new employees to enable the BHA to tap into more sources of alternative capital, and has recently selected a Chief Financial Officer (CFO) and a General Counsel (GC) with significant public and private sector experience and savvy with different financing vehicles.[162] Henriquez notes that these appointments merely continue the recent pattern of hiring employees that have a more financial, private sector, and entrepreneurial perspective, such as Chief of Staff Plaut and Financial Analyst Jemison. Henriquez is concerned, however, that in charging these new employees with exploring new financing opportunities, the authority could lose sight of its fundamental mission to provide high quality service to low income residents. Accordingly, Henriquez has realigned the organizational hierarchy of the BHA to separate those charged with management, from those responsible for entrepreneurial ventures.[163]

The BHA is also requiring current employees to take on additional responsibilities to change the corporate culture of the authority and is asking property managers to develop project-based budgeting and be more responsive to the needs of tenants. According to Henriquez, one of her biggest obstacles in changing the culture of the BHA to be more customer service oriented is creating a climate in which BHA employees feel respected, rewarded, and recognized for their work.[164] This has long been deemed a major obstacle to the authority's success. To that end, Henriquez is helping managers understand client-based management practices and working to improve the quality of their work environment, such as asking the incoming Press Secretary to profile BHA employees in their local neighborhood papers.[165] When employees feel valued, Henriquez believes, they will become more committed to serving residents according to a customer service model.

[162] Sandra Henriquez, personal interview, July 10, 1996.
[163] Sandra Henriquez, personal interview, July 10, 1996.
[164] Sandra Henriquez, personal interview, July 10, 1996.
[165] Sandra Henriquez, personal interview, July 10, 1996.

In addition to hiring new employees and changing the responsibilities of current employees, the BHA is also contracting out services to improve efficiency, and support new development and financing processes associated with the HOPE VI projects. Last year in response to charges of neglect and mismanagement, the BHA contracted out management services at eleven elderly developments to reduce costs and improve efficiency. With respect to the HOPE VI projects, the authority has contracted with several advisors for assistance writing the RFPs, selecting the development teams, and understanding the financing.

Due to its limited transformation agenda, the CHA has not needed to institute the level of personnel changes of the BHA. The CHA has no occasion to hire new employees to focus on tapping new sources of capital because few options are available to them. Training of current employees has been limited thus far to Feloney who has attended HUD classes on basic finance principles and development processes as preparation for any future opportunities that the CHA might have to exploit alternative sources of capital.[166]

The CHA has been more active in working with outside consultants to reduce energy expenses and to introduce asset management practices. Last year, the CHA retained the services of an energy consultant to oversee energy improvement projects, shared savings programs, bill consolidation, water from sewer charge separations, utility conversions, and gas transportation services to reduce energy expenses and reap savings from the federal government. In addition, as stated above, the CHA recently issued two RFPs, one for preventive maintenance services, and the other for a five year capital improvements plan. Both of these are asset management functions that the CHA hopes to contract out to consultants. In the future, if the CHA decides to access alternative capital, it will probably contract with outside consultants for assistance with the financing schemes and the development processes. With respect to any future changes related to management or project-based budgeting, it is unlikely that the CHA will make any significant alterations due

[166] Michael Feloney, personal interview, May 31, 1996.

to the widely respected management system and property managers already in place and working for the authority.

Union Opposition

Employees of both authorities speak of union rules as a general, but not a specific obstacle to performance. Henriquez refers to union policies as a barrier to adopting a more private market approach. According to her, the ability of private sector property managers to hire and fire workers at their pleasure, is an advantage that enables them to be more efficient.[167] Feloney refers to the imposition of union procedures for documenting and tracking grievances as a burdensome task that takes time from the real mission of the authority.[168] While neither Henriquez nor Wuenschel speak of union rules as a particular barrier to a policy that they wanted to implement, it seems that labor policies and procedures do have a general impact on the performance of the authority and are an obstacle to adopting a more private sector model for public housing.

SUMMARY

Neither the BHA nor the CHA is maximizing the options now available to them to be entrepreneurial and creative, to take on asset management functions, to cut costs and increase revenue, or to follow a private sector model for the development, management, and financing of public housing. For both the BHA and the CHA, the primary limiting factor to implementing the changes offered them by Congress and HUD seems to be their own stated goals and objectives. A commitment to house low income families and a vow to protect their assets, prevents both from implementing the full range of options now offered them by

[167] Sandra Henriquez, personal interview, July 10, 1996.
[168] Michael Feloney, personal interview, May 31, 1996.

Congress and HUD, because many of these ventures would require a reduction in total units or a leasing of units to higher income families. Confronted with enormous waiting lists, both Executive Directors generally show caution and restraint in making changes to either their assets or their tenancy composition.

The BHA and the CHA are taking different paths with regard to asset management and entrepreneurial revenue-generating strategies. The CHA is choosing to follow a more conservative approach and to make changes with respect to improving inefficiency and reducing costs on the margin. This distinction is primarily a product of the opportunities, necessities, and market forces confronting the two authorities. Because it has greater need; both with respect to its stock and to improving its management capabilities; and because it has access to more resources, the BHA is taking greater risks with respect to stock conversion and redevelopment strategies and making more personnel adjustments than the CHA. In the future, with greater opportunity from HUD, the CHA seems prepared to make more transformations with regard to tapping new sources of capital. Without the necessity for change, i.e., without severely distressed properties, however, any changes the CHA will make will probably not require any sacrifice of its current assets or its current tenant population.

CONCLUSION

Today, Congress and HUD are rethinking fundamental questions as to who should be served by public housing and the manner in which they should be served, and are looking to the private sector not just as a model, but as a source, for the development, ownership, management, and financing of public housing. The federal government's vision of a private sector model for public housing presupposes three key elements: (1) that Congress and HUD have provided statutory and regulatory space for PHAs to be entrepreneurial and creative, and to access alternative sources of capital; (2) that a ready supply of capital waits to flow into public housing; and (3) that PHAs can make the transformations necessary to access these funds and adopt a private market orientation. This section summarizes the findings related to these three themes, highlighting the dynamic relationships among them, and reflects on the future of the public housing industry and the private sector model for delivery of services.

Space Provided By Congress and HUD

Congress and HUD are providing opportunities for PHAs to be entrepreneurial and creative to raise revenue and cut costs to survive this era of fiscal austerity. Congress and HUD are encouraging PHAs to develop asset management practices and make decisions with respect to their properties that maximize the value and durability of their portfolios. Reforms available to PHAs fall into two broad categories: (1) policies applying to operations and resident population, and (2) policies applying to the development and control of physical assets. The former category represents efforts to encourage work, foster community, and promote economic diversity. Reforms include the imposition of minimum rents, ceiling rents, and employment incentives; and the elimination of federal preferences. The latter encourages PHAs to be more entrepreneurial and to adopt asset management practices.

Reforms in this category include increased scope of eligible uses of federal funds, elimination of one-for-one replacement, and retention of surplus revenue. In sum, PHAs can now demolish units without replacement, sell their assets, change the composition of their tenancy, retain surplus revenue, raise alternative sources of capital, and transfer operating subsidies to, and enter into partnerships with, non-government entities.

Despite these reforms, a number of regulations and legislative requirements still impede the ability of PHAs to adopt a more private sector model for the delivery of housing. These include need based funding, a lack of incentives to cut costs, annual appropriations, labor policies, aggregated accounting systems, and non-fungibility of funding sources. Efforts to address these issues will allow PHAs to become more economically efficient and implement more asset management practices. Additionally, changes in these policies will increase the flow of capital into public housing.

Alternative Sources of Capital

Conventional debt and tax credit equity are flowing into public housing to support major redevelopment, new construction, acquisition, and energy improvement projects. In many cases, new financing streams require rearrangement of development processes, management systems, ownership structures, and tenancy composition. Some financing structures, specifically those involving tax credits and private activity tax exempt bonds, will force PHAs to draw on limited resources, thereby taking away funding from other affordable housing providers. PHAs that seek alternative sources of capital must understand the risks and requirements associated with various debt and equity instruments. Failure on the part of PHAs to properly understand these financing structures could put the long term affordability of some of their stock at risk and/or result in a loss of resources.

Alternative sources of capital are not flowing into public housing to support standard modernization projects. Borrowing against a property is not feasible if the development operates at a loss. Unless units are leased to a higher income population as a result of improvements, there is no positive cash flow in these projects to support debt service. Equity financing is more possible, but equally less practical. Syndication is an expensive process and PHAs that sell credits generally use large up-front capital HOPE VI or development grant funds to reduce the amount of equity necessary for redevelopment. HUD does not provide the magnitude of funding through the Comprehensive Grant program as it does through the HOPE VI program, so similar cost write downs are not possible with Comprehensive Grant dollars.

By relaxing Davis-Bacon wage requirements and addressing the problems associated with annual appropriations, Congress and HUD can increase, and smooth, the flow of capital into public housing. If public housing becomes less expensive to own and operate, and if private investors can receive more security on the future of federal subsidy streams, public housing would become a more attractive investment. Loan guarantees could be used to help capitalize public housing funding streams which would make standard modernization projects more feasible, and would reduce the cost of capital to PHAs for both debt and equity funds.

PHA Transformations

PHAs that wish to move to a private sector model and tap new sources of capital must implement a number of changes with respect to corporate philosophy, reporting systems, budgeting, and personnel. PHAs that wish to emulate the private sector must understand the industry's core values of cost reduction and asset management. This requires a PHA to know the cost of delivering a "unit" of housing and to think about its properties as a portfolio of assets. Ascertaining the true cost of operations requires PHAs to implement project-specific reporting systems, such as income and loss statements that show the sources and uses of funds at different developments. Investors interested in supplying capital will look for other reporting systems currently foreign to PHAs, such as pro formas, which measure the cash flow potential of a particular project. Investors will also likely require new budgeting line items, namely reserves for operations and capital improvements. Additionally, PHAs may need to hire new personnel, contract out services, or train current employees to implement the transformations necessary to emulate the private sector and tap new sources of capital. Union rules however, may prevent PHAs from asking personnel to take on new responsibilities or firing others for incompetence.

By creating non-need based funding streams, changing public housing accounting systems, and allowing PHAs to mix funding streams, Congress and HUD can increase the capacity of PHAs to reduce costs and institute asset management practices. Need-based modernization and operating funding rewards PHAs with greater expenses and does not motivate them to take proactive actions on asset management. Aggregated accounting systems do not encourage PHAs to implement project-based budgeting, which is an essential requirement in understanding the true costs of operations at individual developments. Finally, non-fungibility of funding streams requires PHAs to apply funds to projects that are circumscribed by HUD rules. Prohibited from mixing funding sources, i.e. operating subsidies with modernization grants, PHAs cannot assign resources to projects they feel are most important. This prevents a PHA from making decisions at individual sites that maximize the value and durability of its entire portfolio. Together these changes will help PHAs emulate the private sector model for the delivery of public housing.

In general, the movement to a private sector model for the development, management, and financing of public housing is an evolutionary process, that in the future will require more changes in HUD rules, more transformations on the part of PHAs, and greater education for the private sector about the public housing industry.

Final Note for the Future

Among some scholars and industry experts there remains great fear that the current reforms and cuts in funding to public housing signify its end. Public housing has remained through sixty years of turmoil and policy modifications, and there is little reason to assume that the institution now has reached its demise. Jim Stockard, a leading member of the Cambridge Housing Authority Board of Commissioners and a renowned public housing consultant, believes this prognosis is premature.

> We are in a valley not a cliff. We have seen the end of the world before. Nixon put a moratorium on housing spending and we made it through that. We survived and had more money under Bush than we had ever had before. We will survive this too...[169]

His perspective should be inspiration for those that think otherwise.

If the past however is any indication of the future, public housing authorities should prepare for years of lean funding and a continued widening of the reforms available to them. For Stockard, this new era is an unwelcome, but necessary stage, in the development of the industry, and an opportunity to right the wrongs of the past:

> ...we can use the down time to do what we should have been doing for the last twenty years -- lean ourselves up, get rid of the bad properties, the bad authorities, and leave the majority of our assets intact, so we come out of the valley, better than we were before.[170]

As funding becomes tight, the key for PHAs is not to panic and sell off all their assets, but to make decisions that maximize the value and durability of their portfolios and are consistent with the mission of the authority. As Stockard advocates, this can be a time of opportunity for PHAs, a chance to tidy up their operations and prepare for a better future.

With the changes, freedoms, and new opportunities come occasions for PHAs to make mistakes that could put the long term affordability of some of their stock at risk or sacrifice precious resources to private entities. It is essential that PHAs consider the necessary

[169] Jim Stockard, personal interview, March 28, 1996.
[170] Jim Stockard, personal interview, March 28, 1996.

transformations described in this thesis, before becoming involved with the private sector. In the words of Greg Byrne,[171]

> After several decades of heavy-handed federal intervention, local communities can better shape their public housing programs to meet local needs... This increased discretion is long overdue. At the same time, these newfound freedoms, coupled with real funding cuts, could overwhelm PHAs when forced to operate in a much more deregulated and competitive environment.

How PHAs are responding to this new environment is the important question for the future of public housing.

The case studies of the BHA and the CHA present some evidence of what that response may look like. While the BHA and CHA may not be representative of all PHAs, they do typify two large urban PHAs and serve as good examples for how housing authorities are responding to the reforms offered by Congress and HUD. This study reveals that both the BHA and the CHA are approaching this new environment with caution and conservatism. An underlying commitment to house those without shelter, or in substandard accommodations, and a pledge to maintain the long term affordability of their assets prevents both the BHA and the CHA from adopting the full menu of options available to them. The choices and strategies the BHA and the CHA are implementing, both with respect to policies applying to operations and the resident population and policies applying to the development and control of physical assets, are further shaped by the opportunities HUD provides them to access federal funding grants, the necessity to alter their stock and personnel, and the market forces supporting or not supporting these changes. In sum, this analysis suggests that the PHA transformation process to a private sector model may be most limited by the specific attributes of the individual authority -- a combination of its goals and policy objectives, and its opportunities, necessities, and market characteristics.

In so far as these two authorities are representative of large urban housing authorities, the message for the future is clear:

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[171] Byrne I.

Regardless of how many regulatory changes Congress and HUD impose, or how willing the private sector is to supplying capital for public housing ventures, the ultimate limit to the movement to a private sector model is the individual PHA's own policy goals and objectives, and its opportunities, necessities, and market characteristics supporting those changes.

Exhibit A

History of Primary Public Housing Funding Streams (1980 - 1996)

Fiscal Year	Modernization Funding	Operating Subsidies	Development Grants	HOPE VI Funds	Drug Elimination	Total (Actual)	Total (1996 Dollars)
1980	552,867,654	755,300,000	n/a	79,000,000	0	1,387,167,654	2,922,453,033
1981	912,150,277	1,070,800,000	n/a	18,000,000	0	2,000,950,277	3,903,292,779
1982	882,148,115	1,490,906,000	n/a	4,000,000	0	2,377,054,115	4,309,447,844
1983	1,268,872,442	1,546,828,000	n/a	0	0	2,815,700,442	4,884,866,719
1984	782,985,398	1,717,738,000	n/a	0	0	2,500,723,398	4,159,562,161
1985	823,944,124	1,401,657,000	n/a	0	0	2,225,601,124	3,562,982,963
1986	752,819,563	1,158,544,000	n/a	0	0	1,911,363,563	2,947,897,392
1987	1,558,614,769	1,350,000,000	n/a	0	0	2,908,614,769	4,248,066,894
1988	1,774,565,870	1,450,000,000	n/a	0	0	3,224,565,870	4,380,946,309
1989	1,646,577,119	1,705,508,000	n/a	0	0	3,352,085,119	4,362,256,688
1990	1,975,594,605	1,865,031,000	n/a	0	0	3,840,625,605	4,769,104,837
1991	2,497,750,000	2,175,000,000	733,760,000	0	150,000,000	5,556,510,000	6,571,245,576
1992	2,602,959,137	2,267,000,000	573,983,000	0	165,000,000	5,608,942,137	6,269,615,240
1993	2,946,260,000	2,282,000,000	400,000,000	300,000,000	175,000,000	6,103,260,000	6,568,081,265
1994	3,100,000,000	2,620,000,000	598,000,000	778,000,000	265,000,000	7,361,000,000	7,741,151,484
1995	2,885,000,000	2,900,000,000	0	500,000,000	290,000,000	6,575,000,000	6,726,225,000
1996 (est)	2,500,000,000	2,800,000,000	0	280,000,000	290,000,000	5,870,000,000	5,870,000,000
Totals	**$ 29,463,109,073**	**$ 30,556,312,000**	**$ 2,305,743,000**	**$ 1,959,000,000**	**$ 1,335,000,000**	**$ 65,619,164,073**	**$84,197,196,184**

Notes: Development Grant figures from 1980 to 1990 were not available when this table was compiled.

Between 1979 and 1982, funding was available for severely distressed stock, although the program was not called HOPE VI.

Source: This table is from *Public Housing Asset Management* , by Gregory A. Byrne, April 1996, page 12.

Exhibit B

HOPE VI Eligible Cities and PHAs

Forty Most Populous U.S. Cities

New York, NY	Seattle, WA
Los Angeles, CA	El Paso, TX
Chicago, IL	Cleveland, OH
Houston, TX	New Orleans, LA
Philadelphia, PA	Nashville-Davidson, TN
San Diego, CA	Denver, CO
Detroit, MI	Austin, TX
Dallas, TX	Fort Worth, TX
Phoenix, AZ	Oklahoma City, OK
San Antonio, TX	Portland, OR
San Jose, CA	Kansas City, MO
Baltimore, MD	Long Beach, CA
Indianapolis, IN	Tucson, AZ
San Francicso, CA	St. Louis, MO
Jacksonville, FL	Charlotte, NC
Columbus, OH	Atlanta, GA
Milwaukee, WI	Virginia Beach, VA
Memphis, TN	Albuquerque, NM
Washington, DC	Oakland, CA
Boston, MA	Pittsburgh, PA

PHAS on Troubled List As of 3/31/92

Boston, MA	Virgin Islands
Bridgeport, CT	Cuyahoga, OH
New Haven, CT	Detroit, MI
Camden, NJ	Indianapolis, IN
Newark, NJ	Lucas County, OH
D.C. Department of Public and Assisted Housing	East St. Louis, IL
	Chicago, IL
Philadelphia, PA	Springfield, IL
Chester, PA	New Orleans, LA
Atlanta, GA	Kansas City, MO
Birmingham, AL	Los Angeles, CA
Jacksonville, FL	San Francisco, CA
Puerto Rico	

Source: *Keys to HOPE VI: A Local Research Affiliate Handbook* . Abt Associates, 1994.

Exhibit C

HOPE VI Sites

Atlanta
Techwood/Clark Howell

Baltimore
Lafayette Courts
Lexington Terrace

Boston
Mission Main
Orchard Park

Camden
McGuire

Charlotte
Earle Village

Chicago
Cabrini Homes Extension

Cleveland
King Kennedy Village
Outhwaite Hoomes
King Kennedy North

Columbus
Rosewind

Dallas
LakeWest

Denver
Quigg Newton Homes

Detroit
Jeffries Homes
Parkside Homes

El Paso
Kennedy Brothers

Houston
Allen Parkway Village

Indianapolis
Concord Village
Eaglecreek Village

Kansas City
Guinotte Manor

Los Angeles
Pico Gardens-Aliso

Memphis
LeMoyne Gardens

Milwaukee
Hillside Terrace

Newark
Walsh Homes

New Haven
Elm Haven

New Orleans
Desire

New York
Beach 41st Street Homes

Oakland
Coliseum Gardens
Lockwood Gardens

Philadelphia
Richard Allen Homes

Pittsburgh
Allequippa Terrace
Manchester

Puerto Rico
Crisantimos
Manuel A. Perez

St. Louis
Darst-Webbe

San Antonio
Mirasol Homes
Spring View Apartments

San Francisco
Bernal Dwellings
Yerba Buena Homes
Hayes Valley

Seattle
Holly Park Apartments

Springfield
John Hay Homes

Tucson
Connie Chambers

Washington D.C.
Ellen Wilson Dwellings

Exhibit D

HOPE VI Projects As of June 1996

Name of Project		Hope VI Funds	Orginal Number of Units	Total Replaced Units	Section 8	Total Final Units	Net Units	Cost per Unit
Techwood/Clark Howell*	$	61,812,635	1,081	390	489	879	(202)	70,322
Lafayette Courts	$	49,663,600	807	356	385	741	(66)	67,022
Lexington Terrace	$	22,700,000	677	416	108	524	(153)	43,321
Mission Main	$	49,992,350	822	822	346	1,168	346	42,802
Orchard Park	$	30,400,000	711	635	74	709	(2)	42,877
McGuire Gardens	$	42,177,229	367	367	0	367	-	114,924
Earle Village**	$	41,740,155	409	374	75	449	40	92,962
Cabrini Green	$	50,000,000	1,921	363	167	530	(1,391)	94,340
King Kennedy/Outhwaite	$	50,000,000	2,208	500		500	(1,708)	100,000
Windsor Terrace	$	41,053,408	442	372	70	442	-	92,881
Lakewest	$	26,600,000	3,500	335	165	500	(3,000)	53,200
Quigg Newton	$	26,498,288	400	400		400	-	66,246
Jeffries Homes	$	39,807,342	2,170	250	250	500	(1,670)	79,615
Parkside Homes	$	48,120,149	737	500		500	(237)	96,240
Kennedy Brothers	$	35,724,644	364	364		364	-	98,145
Allen Parkway Village	$	36,602,761	1,000	705		705	(295)	51,919
Concord Village	$	30,999,010	310	390	70	460	150	67,389
Guinotte Manor	$	47,579,800	418	418		418	-	113,827
Pico Gardens	$	50,000,000	577	481		481	(96)	103,950
LeMoyne Gardens	$	47,762,182	842	500	342	842	-	56,725
Hillside Terrace	$	44,689,446	596	338	39	377	(219)	118,540
Walsh Homes	$	49,996,000	630	358		358	(272)	139,654
Elm Haven	$	45,331,583	482	352	110	462	(20)	98,120
Desire	$	44,255,908	1,832	333	167	500	(1,332)	88,512
Richard Allen Homes	$	50,000,000	1,324	876		876	(448)	57,078
Aliquapppa Terrace	$	31,564,190						
Darst Webbe	$	47,271,000	1,000	758		758	(242)	62,363
Mirasol Homes	$	48,530,050	500	500		500	-	97,060
Springview Apartments	$	48,810,294	421	421		421	-	115,939
Bernal Dwellings	$	49,992,377	484	33	131	164	(320)	304,832
Hayes Valley	$	47,616,503	294	117	177	294	-	161,961
Holly Park Aprtments	$	47,616,503	893	500	393	893	-	53,322
John Hay Homes	$	19,775,000	731	299	300	599	(132)	33,013
Ellen Wilson Dwellings	$	25,075,956	134	134		134	-	187,134
Totals	$	**1,429,758,363**	**29,084**	**13,957**	**3,858**	**17,815**	**(11,269)**	**80,256**

* Includes $19,400,000 Development Grant

** Includes $7,055,000 Development Grant

EXHIBIT E

Performance Funding System (PFS)

Since 1975, HUD has determined operating assistance for PHAs through the Performance Funding System (PFS). PFS is the sum of the Allowable Expense Level (AEL) and the Allowable Utilities Expense Level (AUEL) less rent receipts and miscellaneous income. The sum of the AUEL and AEL represents the cost of operations; subtracting out rent and miscellaneous income equals the amount of operating subsidy a PHA is entitled to receive from HUD. The AEL is an estimated average, based on a sample of 205 PHAs, for what it *should* cost an authority to operate a given development in its portfolio, given the location and characteristics of the development.[172] The AUEL is an estimate of energy costs based on a three year rolling average at current utility rates. Miscellaneous income includes interest on reserves, laundry receipts, late fees, vending machines, and other revenue generators.[173]

The PFS is adjusted annually by an inflation factor based on a composite index of state and local government wage rates and goods and services.[174] Any increase or decrease in energy rates is shared equally by the PHA and HUD. HUD does not always fund 100% of PFS. Over the last three years, operating subsidies have been at 95%, 96%, and 90% of PFS respectively. PFS does not cover capital improvements or include allowances for replacement reserves.

[172] The Boston Housing Authority and theCambridge Housing Authority are included in the PFS sample. The PFS formula is heavily weighted by large PHAs.
[173] Byrne 13.
[174] Byrne 13.

APPENDIX A

Some scholars fear that the current reforms and severe cuts in funding signify the demise of public housing in America. This appendix however presents evidence to the contrary. This analysis suggests that Congress's and HUD's current redefinition of public housing is merely a continuation of two, among many, trends which characterize the history of the industry: (1) persistent change in the policies and goals of the public housing program, and (2) an increasing reliance on the private sector to support public housing.[175]

Original Financing Scheme

Under the original financing scheme for public housing, the federal government provided subsidies for development and local PHAs were responsible for operating costs and the balance of construction costs which they financed with rental income. The federal construction subsidy represented 90% of construction costs, including interest and amortization charges, which the government financed by floating forty-year tax exempt bonds through local PHAs.[176] Each year, the federal government would authorize an annual-contributions commitment to authorities to pay debt service. With no operating subsidies, PHAs had to admit working families with sufficient incomes to cover operating costs and the balance of the debt service on construction financing.[177] This population was in keeping with the target tenants of the Housing Act, the working or "deserving" poor.[178]

Richard Muth, a former Stanford economist, claims that under this financing structure, the public housing program was economically flawed from the beginning. With capital subsidies but no operating subsidies, PHAs were motivated to keep operating costs as low as

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[175] Bratt 61-62.
[176] Muth 17.
[177] Muth 17.
[178] Bratt 55.

possible and substitute capital for current expenditures.[179] The Housing Act placed limits on capital costs for construction and equipment per room, but did not restrict the amount a PHA could spend on site acquisition, site improvements, or total expenditures per room.[180] PHAs, not provided with incentives to keep total costs per dwelling as low as possible, overbuilt sites and used low maintenance, unaesthetic materials to reduce operating costs. In large inner cities where land prices are higher, overbuilding was even more excessive to raise density to the level demanded by expensive land costs. Developments built on slum cleared land, as much early housing was, per the requirements of the Act, added to the cost of construction and compensatory overbuilding.[181,182]

Without a cap on the annual contributions pass-throughs to PHAs, it is no wonder that in 1949 Congress found that development costs of housing authorities exceeded their expectations, and that authorities were choosing to develop new properties when they could possibly rehabilitate existing ones at lower cost.[183] A 1950 report, entitled *Low-Rent Public Housing Planning, Design, and Construction for Economy*, offered the following, as explanation for this trend:

> It is understandable that every local authority wishes to be proud of the project it sponsors and to see them endure...But there has undoubtedly been a tendency in some quarters to overstress the need for excessively heavy construction and to underestimate the effect of this upon costs. The product of this thinking has been the development of structural types for low income housing far more costly than are customary in private residential construction...[184]

Because of the legacy PHAs could create with large public housing developments and their ability to pass capital costs to the federal government, it was clear that PHAs would continue

[179] Muth 17.
[180] Fisher 139.
[181] The Housing Act of 1937 specified that a major component of public housing would be the clearing of "unsafe" and "unsanitary" housing.
[182] Muth provides three explanations for why housing on slum cleared land is more expensive: (1) slum dwellings were frequently close to downtown where land prices are higher; (2) slum structures must be acquired through eminent domain which necessitates full market value; and (3) demolition costs are incurred which are not necessary for housing built on undeveloped land. 10-11.
[183] Fisher 141.
[184] Fisher 141.

to substitute capital for current expenditure, and produce expensive, high density residences, instead of trying to rehabilitate perhaps less costly, and smaller scale, slum dwellings.

> As long as the annual contributions provision of the [Housing Act] underwrites capital outlays, demolition and rebuilding on slum sites [will] be favored rather than the detailed but possibly cheaper process of rehabilitating existing structures.[185]

From the PHA's perspective, this trade-off made sense in the short run; over the long term however it proved disastrous.

As PHAs overbuilt and used heavy construction materials, simultaneous pressure from the private market to "differentiate" public housing enforced the use of unattractive designs.[186] The 1937 Housing Act specifically stated that every "project shall be undertaken in such a manner that it will not be of elaborate or extravagant design or construction."[187] As a result, over time, large scale properties became architecturally unappealing, and consequently socially undesirable.

As housing became less desirable, the ability to lease to higher income residents became more difficult. Lower rentals strained PHAs' abilities to meet their financial obligations. Deferred maintenance and increasing rehabilitation costs weighed on the nation's housing stock. In 1949, under further pressure from the market to ensure that public housing not compete with private real estate, Congress solidified this financial imbalance by consenting to require PHAs to evict above-income families and to cap rents at 20% below the lowest local market rents.[188] The Housing Act of 1949 guaranteed that public housing would serve only the poorest of the poor, and that PHAs would struggle to meet current expenses and maintain the viability of their stock.

[185] Fisher 142.
[186] Bratt 56.
[187] Fisher 138.
[188] Bratt 56.

Introduction of Operating Subsidies

In the late 1960s, in response to the changing lower-income population of public housing, Congress instituted a number of measures to ease the growing financial burden to PHAs and to thwart their ability to pass rising costs to tenants. Congress's most significant policy change of the decade was the introduction of federal operating subsidies, through the Housing Act of 1969, to fill the gap between a PHA's expenditures and rental receipts. A year earlier, as an additional way to reduce expenses, Congress had increased development subsidies from 90% to 100%, dropping PHAs' construction contribution from 10% to 0%.[189] The Housing Act of 1969 also limited residents' lease payments to 25% of income to prevent gauging low income families to meet budget shortfalls.[190] The sum of these measures signified a recognition by Congress that public housing would not support a self-sustaining population, that residents should not be required to produce enough revenue to meet operating expenses, and that PHAs were not expected to meet on-going operational costs without additional federal support.

Around the same time, with rising costs, shrinking revenues, and deferred maintenance, the aging housing stock began to exhibit the first real signs of distress. Congress turned to the private market for help both operating and developing public housing. In an ironic twist, private industry was called upon to solve the crisis it helped create through its lobbying to differentiate public housing with unaesthetic designs and by narrowing the population to only the poorest of the poor.[191] In 1965, Congress implemented the Section 23 program, a precursor of the Section 8 Existing Housing Program,[192] which provided rental subsidies to low-income families that could find housing in the private market. Private landlords received rental payments directly from PHAs representing the difference between the market rate and

[189] In 1985, HUD retired all outstanding construction bonds on pre-1968 properties. Abt 15.
[190] Bratt 59.
[191] Bratt 62.
[192] The Section 8 Existing Housing Program was established in 1974.

the tenant's rental contribution. The same year, Congress created the "turnkey" development program by which private developers contracted with PHAs to build public housing units. PHAs would sell land to a private developer who would finance and construct units for the authority for an agreed upon price (not to exceed the development grant from HUD authorizing the new construction). Upon completion, the developer would sell the property back to the PHA for the pre-agreed upon price. In subsequent years, Congress passed additional turnkey programs, Turnkey II and Turnkey III, for the management of public housing, and for the development and management of public housing together, respectively.

Solidifying Public Housing as Housing of Last Resort

During the 1980s, Congress re-examined basic public housing goals and implemented far-reaching policy changes that reserved public housing units for the poorest of the poor, and reduced PHAs rental income. Public housing operating costs had been rising throughout the 1970s as the public housing population became poorer and the demand for housing assistance swelled. Despite this growing financial imbalance, Congresses of the early 1980s fully embraced the philosophy that public housing should serve the neediest of the poor. The 1981 Omnibus Budget and Reconciliation Act (OBRA) introduced a series of measures promoting this goal, including a requirement that 75% of all public housing admissions be to very-low income residents. OBRA also eliminated ceiling rents to encourage higher income tenants that could afford conventional housing to move out.[193] With the 1983 Housing and Urban-Rural Recovery Act (HURRA), Congress asserted a greater commitment to low-income tenants, requiring PHAs to house an even higher percentage of very-low income families through federal preferences for those waiting for housing. Priority was given to: (1) families paying more than 50% of their income on housing; (2) families in substandard

[193] Simultaneously, OBRA increased rents to 30% of income to be more commensurate with the market.

housing; and (3) involuntarily displaced families. OBRA, by eliminating ceiling rents, reestablished public housing as transitional accommodations, while HURRA, by establishing stricter federal preferences, prohibited PHAs from generating significant rental revenue from residents. Emblematic of the change, in 1937 a family could not receive public housing unless it was a two-parent household; by 1983, the same family could not receive housing if it was intact.[194]

Current Era

Today the two trends which characterize public housing, continuous change in policies and goals and greater reliance on the private sector, are coming together in a way that fundamentally transforms public housing. Congress and HUD are beginning to shift the basic orientation of public housing from a publicly-owned good to a privately-held market-driven asset. In an effort to "mark" public housing to the market, Congress and HUD are pushing PHAs to design housing that is financially and physically compatible with neighborhood market standards. Congress is also re-examining the basic goals and policies of the housing program such as whom should be served by public housing and whether housing should be transitional or permanent accommodations. Finally, Congress and HUD are turning to the private sector not just for assistance developing and managing, but for the ownership and financing of public housing and as a model for how PHAs should run their operations.

Conclusion

Congress and HUD have changed course numerous times on the basic goals and policies of the housing program including who should be served by housing and the most efficient and equitable way to finance its provision. In 1937, public housing was transitional housing

[194] John Stainton, personal interview, June 18, 1996.

designed for working families. PHAs could meet operating expenses through rental receipts, and there was no need for operating subsidies. PHAs relied on capital subsidies only from the federal government. In the 1960s, Congress embraced the idea that public housing should be transitional accommodations reserved for the poorest of the poor. Policies designed to push higher income residents out necessitated operating subsidies for PHAs. In 1969, Congress provided operating subsidies in addition to capital subsidies. Today, Congress and HUD want to reintegrate public housing economically and are allowing PHAs to impose ceiling rents and abandon federal preferences that mandated housing the poorest of the poor first. At the same time, however, Congress has reduced capital and operating subsidies which are extremely necessary to maintaining the viability of public housing as places higher income families would choose to live, and is expecting PHAs to tap private sources of capital to make up the losses.

The reforms today are essentially another phase in the changing nature of public housing with respect to whom PHAs should serve, and the manner in which they should serve them. Once again, Congress and HUD are changing course and looking to the private sector for assistance. This time, reforms and cuts are more deep and significant than they have been in the past.

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