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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

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From: Steve Redburn SR
Joseph Firschein JF

Date: July 3, 1995

Remarks:

The attachments provide background information on the problems of public housing and some proposed solutions. Attachments include the following:

(1) Memo to Director on Public Housing Problems. This memo was prepared at the Director's request shortly after HUD's takeover of the Chicago Public Housing Authority. It provides: an overview of public housing characteristics and structural problems; HUD's efforts to improve public housing; and recent HUD actions to take over troubled PHAs or promote court-appointed receiverships.

(2) Draft GAO Report on Public Housing Transformation. This report describes the cost implications of HUD's public housing transformation proposal and raises additional questions needed to determine the cost of HUD's proposal.

(3) HUD Memo on Principles of Public Housing Reinvention. This memo, prepared by Mike Stegman (Assistant Secretary for Policy Development and Research), provides an analysis of the cost difference between the current public housing system and a tenant-based certificates system. It also addresses the concerns raised by Rick Gentry (Executive Director, Richmond Housing Authority) regarding potential adverse effects of the HUD reinvention proposal on the continued viability of the public housing stock.

Attachment 1

MEMORANDUM FOR THE DIRECTOR

FROM: Robert E. Litan

SUBJECT: Public Housing Problems and Recent HUD Takeover Actions

At Wednesday's senior staff meeting, you requested background on the problems of public housing. This memo highlights some of the most relevant information.

The first attachment provides more details on three topics: (1) the Public Housing program's characteristics and structural problems; (2) HUD's efforts to improve public housing; and (3) two recent HUD actions to take over troubled Public Housing Authorities (PHAs) or promote court-appointed receiverships. Attachments B and C provide additional information on the Chicago Housing Authority takeover and HUD's rating of troubled PHAs.

As you know, the recent actions in D.C. and Chicago received national press coverage and highlighted the ongoing problems of managing and improving troubled public housing authorities. On May 2, 1995, HUD announced a receivership agreement with the District of Columbia transferring control of the Department of Public and Assisted Housing (DPAH) to a court-approved receiver. On May 31, 1995, Secretary Cisneros announced that HUD would legally assume responsibility for the Chicago Housing Authority (CHA), the Nation's third largest housing authority.

In reviewing this issue, my staff has highlighted the following points:

- <u>Most public housing is not troubled</u>. Although the public perception seems to be that all public housing is troubled, the available data contradict many common misperceptions about public housing. Most public housing units are not in large, high-rise buildings and are not concentrated in large developments that overwhelm neighborhoods. Most units compare well to private-market units on a number of objective measures of quality, although they tend to be located in poorer quality neighborhoods than private rental units. A new survey shows that, although most public housing tenants describe their public housing *units* as better than their previous homes, more report that their public housing *neighborhood* is "worse" (38 percent) than report it is "better" (32 percent) than their previous neighborhood.

- Some large-city PHAs are deeply troubled. A limited number of PHAs are severely troubled. By HUD's own index of management performance, these have consistently received a failing score on a multidimensional index of quality and management performance.[1] HUD intervened in Philadelphia, and Kansas City within the past few years. Other large troubled authorities that have not been taken over or placed in Court receivership include Puerto Rico, Detroit, and Atlanta. Large-city PHAs that have turned around include Boston, Cuyahoga (Cleveland), and San Francisco.

- There are structural problems with public housing. The public housing system has numerous structural problems. Public housing ties subsidies to specific units, with little incentive for PHAs to compete with private units or to operate efficiently. Limited appropriations for capital improvements have produced a multi-billion dollar backlog of capital needs and raised maintenance costs. Federal laws governing admission and income targeting have concentrated the very poor in public housing and have penalized public housing tenants who work. Federal regulation has substituted for local initiative. Historically, local officials, with Federal acquiescence, clustered public housing development, often in undesirable or isolated areas; HUD research has shown that such concentrations of very poor families contribute to serious problems of crime, violence, drug use, poor schools, and high operating costs.

- HUD's proposed reinvention strategy would fundamentally alter the way public housing operates. HUD's FY 1996 budget and legislative proposal addresses the structural problems of public housing.

[1] According to HUD, of the 3,400 PHAs nationally there are fewer than 100 PHAs with severe management deficiencies. As of January 1995, HUD considers the following eight large PHAs as "severely troubled": D.C., Philadelphia, Detroit, Puerto Rico, Chicago, New Orleans, Kansas City, and Atlanta.

The key change is to substitute tenant-based certificates, provided directly to public housing tenants, for the current Federal operating and modernization subsidies provided to PHAs for their units. This change would permit PHAs to operate more efficiently, to charge market rents, and to rent to tenants with or without housing certificates. In addition, PHAs would be permitted to demolish public housing units that cannot be made competitive with other housing in the local rental market. To handle severely troubled PHAs, HUD is seeking new legislative authority to establish conservatorships, to abrogate contracts, and to supersede local or State personnel, procurement, and other laws. Smaller, well-run PHAs would be deregulated, allowing HUD to refocus its limited administrative resources on the harder cases.

- For persistently troubled PHAs, more direct HUD or court action may be required. Secretary Cisneros has indicated that the Department should play an active role in taking over severely troubled developments or working with local officials to agree on a court-appointed housing receiver. However, such action is staff-intensive and requires long-term HUD support and technical assistance. Given staff and budget constraints, this option can only be applied on a limited basis unless and until HUD's legislative proposals are adopted.

Attachments:

A Additional Background on Public Housing

B HUD Press Release on Chicago Housing Authority Takeover

C HUD List of Troubled PHAs

Attachment A

Additional Background on Public Housing

This attachment provides additional details on the subjects listed in the first paragraph of the memo.

I. Public Housing Program: Characteristics and Structural Problems

Major characteristics of public housing can be estimated from the biennial HUD/Census Bureau American Housing Survey (AHS). The survey also allows comparisons between public housing and other assisted housing as well as private rental housing. The following is based on data from the 1991 AHS and HUD sources:

- Size of public housing inventory. Approximately 1.3 million households live in public housing developments operated by some 3,400 PHAs.[2] Since 1937, the Federal Government has invested some $90 billion in the public housing inventory. Initially the Federal Government provided financial assistance for the construction or acquisition. On an ongoing basis, the Federal government pays all of the costs for operation, maintenance, and utilities except for that covered by rent payments by tenants equal to 30 percent of income. HUD also pays for periodic capital improvements and crime control. The housing is owned by (usually) independent local agencies, Public Housing Authorities, established according to State law.

- Cost to subsidize. In 1995, Congress appropriated $3.2 billion for the operation of public housing and $4.3 billlion for capital improvements, crime control, and other support for residents. Based on 1995 appropriations, the monthly public housing subsidy per occupied units is $481 per month. For comparison, the monthly cost to serve the same families in the same localities with portable housing Certificates is estimated by HUD to be $440 per month. In addition, $598 million was appropriated in 1995 for the development of new public housing units.

[2] This only includes public housing units and excludes other Federally assisted housing (e.g., Section 8 vouchers) that provides low-cost shelter to low-income families.

- Who lives in public housing? Forty-three percent of the households in public housing are families with children (a slight majority of these families are single-parent households). Fifty-two percent of all public housing is occupied by elderly or handicapped households, with the balance of public housing occupied by nonelderly households without children. 5%

  Public housing tenants are very poor and have been becoming poorer relative to the population as a whole and to those receiving other forms of HUD assistance. In 1991, their median household income was $7,338 (substantially less than the national poverty level for a family of three of $10,799). Only 21 percent of public housing households reported income from wages and salaries. Forty-three percent reported receiving Social Security, while 44 percent reported receiving public assistance.

- Types of public housing structures. Public housing generally comes in three basic structure types: high-rise buildings, garden-style apartments, and single-family structures. The AHS data indicate that 40 percent of occupied public housing units are in buildings of three stories or less and 19 percent are in single-family units (either free standing or attached).

- Quality of public housing units. Most occupied public housing units compare well to private-market rental units on the quality tests used by the AHS. Only four percent of occupied public housing units have severe physical problems; the same percentage of all rental occupied units failed the test.[3]

Structural Problems of Public Housing. The design of Public Housing program contributes to its chronic problems. Here are some of the main design issues:

- Lack of tenant choice where to live. Under the present system, public housing ties subsides to specific units and projects. Funding is provided to

[3] The AHS judges a unit to have severe physical problems if any one of the following five conditions exists: lacks complete plumbing; heating equipment broke down for 24 hours within the past year; inadequate electrical wiring; seriously inadequate upkeep of unit; or seriously inadequate upkeep of common hallways.

PHAs based on the gap between tenant rents and operating costs. There is no incentive for PHAs to compete with private units since tenants cannot take their assistance to the private market. As a result, residents -- who are in the best position to identify management deficiencies and compel changes -- are denied the ability to "take their business elsewhere". No matter how poor the physical condition of the apartment, no matter how crime-ridden or economically distressed the neighborhood in which the public housing is located -- subsidies are tied to units and cannot be transferred.

- Federal laws concentrate the very poor. The average income of families living in public housing is currently around 17 percent of local area median income. This is much lower than average income in the early 1980s (around 33 percent of area median income). Congressional decisions during the past 15 years -- particularly Federal laws governing admissions and increasing income targeting -- compelled PHAs to serve those low-income families experiencing the greatest distress.

- Federal laws penalize public housing tenants who work. Federal laws discourage unemployed families from working and make it difficult for working families to stay in public housing. Public housing rents, set at 30 percent of a family's adjusted income, take away 30 cents of every additional dollar a family earns. In addition, rents charged for families who are already working are often far higher than that which the unit would command in the private market, since rents are based purely on income. As a result, residents who would provide the best role models have an incentive to leave at their first opportunity.

- Federal regulation focuses on process rather than results. The Federal method of overseeing the public housing industry aggravates the problem. Federal statutes regulate every aspect of public housing, including admissions, rents, evictions, resident rights, modernization, development, and procurement. These layers of bureaucratic complexity place excessive administrative burdens on all PHAs, particularly those that are small.

- Local officials have sited public housing in high poverty areas. The poverty and distress of public housing residents is exacerbated by the tendency of public housing to be located in areas lacking jobs and economic opportunities. These neighborhoods generally lack basic amenities, transportation, and other urban services.

II. HUD's Efforts to Improve Public Housing

Currently, HUD is proposing changes that would alter in fundamental ways the manner in which the public housing program operates. The following describes the broad changes proposed in the President's Budget and ongoing efforts to assist troubled PHAs.

- Reinvention proposal. The key change proposed by HUD in the FY 1996 President's Budget is to substitute tenant-based housing assistance ("Certificates"), provided directly to public housing tenants, for the current Federal operating and modernization subsidies provided to PHAs for their units. This change woulf require PHAs to operate in a more efficient manner, to charge market rents for their units, and to rent to tenants with or without housing certificates. PHAs would be permitted to demolish public housing units that cannot be made competitive with other rental housing in the local rental market.

- Efforts to assist troubled PHAs. In addition to HUD's public housing reinvention proposal, the Department has an ongoing effort to assist troubled PHAs. HUD measures PHA performance under the Public Housing Management Assessment Program (PHMAP) system. Those PHAs receiving a score of less than 60 are designated as "troubled" (see Attachment C). The Department has designed a five stage recovery process to help PHAs move from "troubled" to "standard" or "high" performer status within two years.

III. Federal Takeover and Receivership Actions

HUD's involvement in the ongoing management of most PHAs takes the form of technical assistance, monitoring, and payment of annual operating subsidies. However, this level of HUD assistance is often insufficient to turn around troubled PHAs. The following provides information on two recent cases where the Federal Government chose to intervene in the management of a troubled PHA, and the limitations of such actions.[4]

- District of Columbia Public Housing Receivership. Based on HUD's objective measure of housing authority performance, the Department of Public and Assisted Housing (DPAH) is among the most troubled PHAs in the Nation. DPAH tenants and D.C. residents filed a class action suit against DPAH based on the chronic problems of DPAH management.[5] Secretary Cisneros worked with the District to negotiate a voluntary receivership agreement with the plaintiffs. The receivership allows the receiver to take actions (e.g., terminate personnel contracts) to fundamentally change the management and operation of DPAH.

- HUD takeover of Chicago Public Housing. On May 31, 1995, Secretary Cisneros announced that HUD would legally assume responsibility for the Chicago Housing Authority (CHA), the nation's third largest housing authority. Unlike the D.C. action, this takeover involves direct HUD staff control over the operation of CHA rather than a court-supervised receivership. CHA operates 40,000 housing units in 17 major developments with an official population of 86,000 tenants. HUD staff have estimated that the takeover will last at least three or four years and involve radical changes in CHA's structure, decentralizing control by setting up public-private partnerships and resident corporations, and hiring private real estate managers.

- Limitations on takeover and receivership actions. A major constraint on the feasibility of HUD takeover of PHAs is the limited budget and number of qualified staff that HUD can dedicate to this purpose. In addition, local political constraints that limit the extent to which HUD staff can implement major changes. Finally, HUD bears full responsibility and may be blamed if the takeover

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[4] The Chicago and D.C. interventions are only the most recent cases of HUD or court action; other various actions have been taken in several cities including New Orleans, Philadelphia, St. Louis, Atlanta, Seattle, and Kansas City.

[5] The D.C. Superior court ruled that a receiver should appointed to oversee the District's public housing. D.C. appealed the ruling to the D.C. Court of Appeals.

does not lead to improvement of the PHA within a reasonable time period. While a court-appointed receiver provides greater power to change the operation of the PHA, the process of appointing a receiver is often time-consuming.

cc:

A. Rhinesmith
K. Kizer
J. Firschein
K. Meredith

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May 31, 1995

United States General Accounting Office

Attachment 2

GAO

Report to the Chairman, Subcommittee on Housing and Community Opportunity, Committee on Banking and Financial Services, House of Representatives

June 1995

PUBLIC HOUSING

Converting to Housing Certificates Raises Major Questions About Cost

Printed copies of this document will be available shortly.

GAO

United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-261495

June 20, 1995

The Honorable Rick A. Lazio
Chairman, Subcommittee on Housing and
Community Opportunity
Committee on Banking and
Financial Services
House of Representatives

Dear Mr. Chairman:

On May 1, 1995, the Department of Housing and Urban Development (HUD) submitted to the Congress proposed legislation entitled the "American Community Partnerships Act." If implemented, the act would transform how this nation has historically funded public housing. Federal assistance would no longer flow to public housing authorities, but instead would go to households in the form of housing certificates. These households would then have the choice of using their housing certificates to either stay in public housing or move to apartments available in the private rental market. HUD states that this shift in policy will result in significant savings and address several fundamental problems with the current public housing program, including (1) residents' lack of choice in housing, (2) the concentration of very poor people in very poor neighborhoods, and (3) a lack of discipline in the management of public housing because of its insulation from the marketplace.

In considering HUD's legislative proposal, you asked us to (1) describe the cost implications and the issues raised by transitioning from the current public housing program to one using housing certificates and (2) identify key factors that may affect HUD's plan to provide greater housing choice for the residents of public housing.

RESULTS IN BRIEF

After calculating the average costs of converting to housing certificates versus continuing the current public housing program, HUD concluded that the cost of using certificates will be less than that of funding public housing; however, these averages do not reveal the wide differences in the cost of these two options at individual public housing developments. For some developments, the current average cost to provide housing is less than half that of housing certificates. However, for those developments in the worst physical condition, the reverse in true. These wide variations in cost raise a number of important issues, including whether the federal government should pay for the rehabilitation of public housing developments when their rental revenues could finance it and whether housing certificates should be targeted initially to developments where they are clearly cost-effective. The actual costs of converting to housing certificates will depend on how these and other issues are resolved. But HUD has not performed the detailed analysis that would provide important information for deciding these issues.

Housing certificates by design are intended to provide public housing residents greater opportunity to select where they want to live. However, actual choice in housing depends on many factors, including the characteristics of the current tenants and their inclination to move, the availability of affordable housing, the willingness of private landlords to accept tenants with housing certificates, and the extent to which housing discrimination laws are followed and enforced.

BACKGROUND

Approximately 3,300 public housing authorities own and operate about 13,200 public housing developments with about 1.4 million units. These housing authorities vary in size and condition. Over 2,400 authorities, or over 70 percent, are small, with fewer than 300 units. On the other hand, there are about 210 authorities, or about 7 percent, with more than 1,000 units. These large authorities account for about 63 percent of the total number of public housing units. By HUD's assessment, most of the public housing authorities are reasonably well managed; however, HUD considers 92 authorities, or about 3 percent, to be "troubled." Thirteen of the troubled authorities are large urban housing authorities, managing about 14 percent of the total public housing stock and most of the stock that is in the worst physical condition.

HUD plans to carry out the transformation of public housing in three stages and to complete it by 2002. During the first stage, which would begin in 1995, HUD would consolidate the amounts provided for the multiple public housing programs into two funds--one to pay for capital and management improvements of public housing authorities and public housing developments and another to subsidize the operations of these authorities and developments. To be eligible for funding, public housing authorities would be required, during this stage, to develop a strategic plan that, among other things, identifies the rehabilitation needed for their public housing developments and establishes a timetable for completing it. Under HUD's proposal, these improvements would be paid for by the federal government from the capital fund.

During the second stage, HUD proposes to replace the capital and operating funds established in stage one with a program of project-based assistance, which would be tied directly to units.[1] Project-based assistance, which would be authorized for 1 year, is intended to help public housing authorities gain experience in managing and operating their housing when they are dependent on the revenues generated from the properties' rents, rather than from capital and operating subsidies provided by the current system and continued during stage one. The rents set by public housing authorities for their properties during stage two would reflect the properties' market values and any services provided by and paid for by the public housing authority, such as child care, so long as the rents are not greater than the fair market rent[2] established by HUD for the area.

During the third stage, project-based assistance would be replaced by tenant-based assistance, namely, housing certificates provided directly to the assisted households. The public housing residents would then have the choice of either staying in their public housing unit or moving to privately owned rental housing that meets certain cost and quality standards. HUD's proposal recognizes that some public housing developments, even after they are rehabilitated, will still be located in modest neighborhoods and, because they were built in an earlier era, will still lack certain amenities offered in privately owned rental housing. These developments, therefore, will tend to have market values below their area's fair market rent. Consequently, in order to enhance the competitiveness of these public housing developments with other rental housing, HUD has proposed giving families a "shopping incentive" that would reduce their share of the rent by the same percentage that the market rent of the public housing unit is below the area's fair market rent.

COST IMPLICATIONS OF REPLACING THE PUBLIC HOUSING PROGRAM WITH HOUSING CERTIFICATES

The Secretary of HUD testified on April 6, 1995, before your Subcommittee that it cost $440 per month on average to house a family with a housing certificate, compared to an average of $481 per month in public housing. HUD used these

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[1]To receive this assistance, a household must live in a designated unit.

[2]The fair market rent for an area is the amount that would be needed to pay the gross rent (shelter plus utilities) of privately owned decent, safe, and sanitary rental housing of a modest (nonluxury) nature.

averages to conclude that significant savings could result from converting the public housing program to one using housing certificates. However, these averages do not reveal the range of costs across public housing authorities and their developments resulting from differences in the age and condition of these developments, the efficiency of public housing management, and the housing markets in which these developments are located.

In computing the costs of the current public housing program, HUD used the sum of the 1995 appropriations for operating subsidies, funding for the modernization of properties, and grants to eliminate drug use to obtain an average per unit monthly cost. This computation tends to skew the average cost of public housing upward because of the high costs associated with the relatively small percentage of the public housing stock that is in the worst physical condition. This portion of the stock requires a disproportionate share of the modernization funding and is likely to have higher than average operating costs. On the other hand, because HUD's analysis considered the capital costs of public housing as sunk costs, it made no attempt to add an imputed debt service charge[3] to the cost of public housing. After an adjustment for vacant units, the analysis showed an average per unit cost for an occupied unit of public housing to be $481 per month. In the calculation of the average per unit cost of housing certificates, the analysis used the fair market rent at the 40th percentile,[4] which resulted in an average per unit cost of $440 per month.

These averages do not disclose the wide variations in the costs of the programs among public housing authorities and their developments. The data used in HUD's analysis show that for some public housing authorities, such as the one in Buffalo, New York, housing certificates would cost about $500 per unit per month. This is about 40 percent less than the current $900 average cost to operate an occupied unit at this housing authority. Conversely, for other housing authorities, HUD's analysis shows just the opposite result. For example, in Los Angeles, California, HUD estimates the per unit cost of the certificate program to be about $1,100 per month, compared to $930 for public housing. For other housing authorities, the cost variations are even greater. For instance, in the case of McDonough, Georgia, housing certificates were

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[3]The federal government has already paid for the construction of public housing. Accordingly, there are no mortgages on public housing developments nor any associated debt payments.

[4]A fair market rent set at the 40th percentile of an area's rental housing would reflect the fact that about 40 percent of the market area's rental housing can be obtained at this rent level.

estimated by HUD to cost about $700 per unit per month, compared to $240 for public housing.

Just as calculating aggregate averages for the two housing options obscures wide variations among public housing authorities, computing an average per unit cost across an entire stock of developments within a public housing authority does not recognize significant variations in costs among individual developments. To identify these variations and the issues they raise, we reviewed financial data on operating and rehabilitation costs for 40 developments located in nine public housing authorities across the country. From these 40, we chose 5 to illustrate the range of conditions we found in our review.[5] These five examples are discussed in detail in appendix I, along with the cost implications of using housing certificates and related issues.

These examples disclose a broad range in the cost of operating public housing and providing housing certificates. At one extreme, certain developments located in New York City, New York; Los Angeles, California; and Alexandria, Virginia, cost about half as much to operate currently as public housing as what they could be rented for in the private market.[6] Moreover, the operating costs for these developments are below the fair market rent in the area. If the public housing program is converted to use certificates, developments with these characteristics raise such questions as (1) whether the federal government should use the capital fund to pay for any needed modernization (which can run into the millions of dollars per development), as is contemplated in the proposed legislation, or whether these costs should be paid for out of revenues generated by the developments; (2) what, if any, restrictions should be placed on the use of the additional revenues such developments could generate for the public housing authorities, particularly as units become vacant and rents may no longer be restricted to the fair market rent; and (3) how the federal government will pay for the additional expenses caused by increasing rents from a level necessary to cover operating costs to the fair market rent. (See example 2 in app. I.)

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[5]The 40 developments were identified by nine urban housing authorities nationwide in response to our request that they identify their more marketable and least marketable developments. We categorized these developments into five groups based on common characteristics. From these five groups, we chose five developments to present as examples.

[6]We defined operating costs to include current operating expenses and amortized costs for the rehabilitation of the property and funding of a reserve account for nonroutine expenditures.

At the other extreme are public housing developments whose operating costs after rehabilitation would be several times higher than the cost of housing certificates. These developments generally need extensive renovation, and while they can be found in housing authorities across the country, they are frequently associated with the large troubled urban authorities. Also, the market values of some of these developments is well below their operating costs. A critical question related to these developments is under what circumstances, if any, the federal government should use the capital fund to subsidize their rehabilitation. Another question is whether to target these developments in a conversion to housing certiciates, since these developments represent the greatest opportunity for cost savings. (See example 5 in app. I.)

Between these extremes are developments with various relationships between their operating costs, market values, and fair market rents. These developments raise other issues. Among the more significant are (1) how the added cost of the proposed "shopping incentive" will be financed; (2) how the objective of the "shopping incentive," which in part is to make public housing developments more competitive with private rental properties, can be reconciled with one of the overall goals of HUD's proposal–reducing the concentration of very poor people in very poor neighborhoods; (3) whether the federal government should pay the additional costs of subsidizing families in public housing developments when the market values of these developments exceeds the fair market rents; and, (4) if current public housing residents move to higher-quality housing through the use of housing certificates, whether the additional costs will be paid for through increased federal subsidies or will be offset by housing fewer families. (See examples 1, 3, and 4 in app. I.)

The issues arising from our review of selected housing developments are largely unanswered by HUD's proposal. The answers will, of course, determine the actual costs of converting from the current public housing program to a program that uses certificates. But HUD has not done a detailed cost analysis, for individual housing developments, that takes into account their rehabilitation needs, operating costs, and market values and therefore would clarify the prospective costs for individual developments–critical information in deciding the issues on which overall costs depend.

PROMOTING GREATER CHOICE IN HOUSING

A key element of HUD's plan is to give the residents of public housing greater choice in deciding where they will live. Under the plan, public housing residents who are not satisfied with their housing will be able to use their housing certificate to rent another public housing unit or a privately owned apartment.

To the extent that current residents exercise their choice by moving out of very poor neighborhoods, a basic goal of the plan will be achieved. However, the outcome depends on several issues, including (1) the extent to which tenants desire to move, (2) the availability of affordable apartments in the neighborhoods that tenants choose, (3) the willingness of landlords to accept tenants with housing certificates, and (4) the extent to which laws intended to prevent discrimination are followed and enforced. Since these factors tend to be locally determined, the degree of choice and the related issue of the extent to which very poor people are concentrated in very poor neighborhoods will probably vary from one housing authority to another.

Tenants' Desire to Move Will Vary

The decision to move is often a very personal one, motivated not only by the quality of a person's present housing but also by the proximity to work, the availability of shopping and medical care, the location of family and friends, and the level of security. Officials of housing authorities we visited in New York, New Jersey, Virginia, and California stated that it is unlikely that many elderly tenants will move, because they are satisfied with their current housing. In addition, we observed a variety of housing developments, serving families with children, that were in good condition and in desirable locations, where tenants' choice to move would not likely be based on their dissatisfaction with their current housing.

The elderly population represents a significant percentage of the people in public housing. HUD estimates that more than a third of the 1.4 million units of public housing are occupied by the elderly. It is generally recognized by public housing officials nationwide that this housing tends to be in reasonably good condition. Also, while public housing developments serving families have frequently been depicted as distressed, crime-ridden, and poorly located, in fact, many provide decent, safe, and sanitary housing.

Availability of Affordable Units Affects Choice

A key factor in any plan to bring the forces of the market to bear on public housing is the availability of alternative housing that is affordable to public housing residents. Recent data show that the national vacancy rate for rental apartments has exceeded 7 percent. However, this average figure does not reflect significant variations among housing markets throughout the country. Generally, the lower the vacancy rate in an area, the more difficult it will be for assisted households to find alternative housing. In the New York City housing market, for example, where about 11 percent of the nation's public housing stock is located, the vacancy rate is less than half the national average, making alternative housing more difficult to find.

Landlords' Acceptance of Housing Certificates Impacts Choice

The ability of public housing tenants to exercise choice in their housing decisions depends not only on the availability of affordable housing but also on the willingness of private landlords to accept their housing certificates. Landlords electing to accept tenants with housing certificates do so voluntarily and, in so doing, also agree to the program's requirements. Identifying ways to improve landlords' willingness to accept housing certificates was the subject of a study commissioned by the National Multifamily Housing Council.[7] To achieve this objective, the study recommended that housing certificates operate as much like the regular market as possible, though it was recognized that in some areas, eliminating all government involvement would be unwise.

Under the American Community Partnerships Act, HUD has proposed provisions that would make housing certificates more consistent with the operation of the regular market. These provisions are aimed at attracting additional owners of private-market rental housing to rent to families using housing certificates. HUD has proposed changing requirements that have discouraged landlords' broader participation in the current housing certificate and voucher programs. Key provisions that would facilitate private landlords' acceptance of housing certificates include

- eliminating the "take one, take all" requirement, and replacing it with the requirement that owners must lease a "reasonable" number of units to certificate holders;

- making it easier for owners to terminate the lease of a certificate holder, in accordance with state and local law (e.g., for not paying rent; for repeated, serious violations of the lease; for any criminal or drug-related activities, etc.); and

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[7]Abt Associates, Inc., Final Report on Recommendations on Ways to Make the Section 8 Program More Acceptable in the Private Rental Market, (Cambridge, Mass.: Mar. 1994).

- clarifying that owners can screen and select families for admission according to the owners' standards (but following the Fair Housing Act's requirements).

Housing Choice Affected by Discrimination

Discrimination in the rental market is an issue that is difficult to quantify. However, to the extent that it exists, whether it be against female heads of households, families with children, or members of particular races, it would negatively affect residents' choice in housing. Conversely, of course, to the extent that housing discrimination laws are followed and enforced, residents' choice would be encouraged.

CONCLUSIONS

HUD's recommendation to transform public housing to a tenant-based housing certificate program is a fundamental shift in federal housing policy that has significant implications for public housing authorities, their residents, and the federal government. To date, HUD's cost analysis, used in part to support the recommendation, has relied on average costs and does not reveal the wide differences in the costs of the two approaches for individual housing developments. For some public housing developments, the cost of operating is about half of what the government would have to pay once it provided tenants with housing certificates. For other developments in the worst condition, rehabilitation expenses plus operating costs are several times higher than what certificates would cost. With such divergent cost implications, a transformation from the public housing program to one using housing certificates raises issues that are largely unanswered in HUD's proposal. Therefore, the ultimate cost of converting to housing certificates is not known.

HUD has not required that public housing authorities do a detailed cost analysis of individual housing developments, which would provide critical information in deciding these issues, though the Department is planning to require that housing authorities collect some of this information during stage one of the transformation. If such an analysis took into account individual developments' rehabilitation needs, operating costs, and market values, it would reveal the cost implications for individual developments and public housing authorities. It would also provide the data necessary to assess the other issues raised in this report. In doing so, it would clarify the choices available to the Congress in allocating housing funds.

AGENCY COMMENTS

We discussed the contents of this report with HUD's Assistant Secretary for Policy Development and Research and with other senior Department officials. These officials neither agreed nor disagreed with the manner in which we characterized the cost implications and other implications of converting to housing certificates. However, they acknowledged that converting to housing certificates would have different cost implications for various housing developments. They also stated that HUD's proposal to transform public housing was never intended to focus on individual developments or public housing authorities. Rather, HUD's intention was to present a major shift in housing policy that was revenue neutral and focused on the benefits of individual choice.

SCOPE AND METHODOLOGY

In addition to discussing with HUD officials the proposal to transform the public housing program and reviewing the agency's documents and reports on the costs of public housing and the estimated costs of the housing certificate program, we judgmentally selected and contacted nine public housing authorities throughout the country. We asked that they identify their more marketable and least marketable developments. We obtained both general and detailed information about the individual housing developments–for both elderly people and families–that these authorities manage, their actual costs of providing public housing, and their costs related to the proposed certificate program. Specifically, we obtained detailed data on 40 developments managed by the nine authorities in the following locations: Alexandria, Virginia; Baltimore, Maryland; Chicago, Illinois; Cleveland, Ohio; Jersey City, New Jersey; Los Angeles County, California; City of Los Angeles, California; New York, New York; and Seattle, Washington. These data included developments' operating incomes and expenses, the costs to rehabilitate these developments to market standards, estimates of rents that could be charged for the rehabilitated units, and other pertinent information. We then categorized developments with similar characteristics into five groups, from which we then chose five examples to highlight the kinds of issues HUD's proposal raises. HUD officials agreed that our grouping of projects was reasonable for the purpose of illustrating these issues. Our sample size and selection criteria were not intended to allow for projections of how many public housing developments fall within each group, nor were our five examples intended to be all-inclusive. These examples are presented in appendix I.

We also visited four of the housing authorities to discuss the implications of the data we collected in greater detail and to obtain their input on key factors affecting housing choice for the residents of public housing. We also reviewed recent reports pertaining to national vacancy rates and factors affecting the mobility of assisted renters.

We conducted our work between March and May 1995 in accordance with generally accepted government auditing standards. We did not independently verify the financial data on operating costs nor the estimates of rehabilitation needs of the public housing developments used as examples in this report.

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We are sending copies of this report to the appropriate congressional committees, the Secretary of Housing and Urban Development, and the Director of the Office and Management and Budget. Copies are available to others on request. If you or your staff have any questions, please call me on (202) 512-7631.

Sincerely yours,

Judy England-Joseph

Judy A. England-Joseph
Director, Housing and Community
Development Issues

COST IMPLICATIONS OF TRANSFORMING PUBLIC HOUSING

The Department of Housing and Urban Development's (HUD) plan to transform public housing to a market-driven, certificate-based system will present different and wide-ranging cost implications for the nation's 3,300 public housing authorities. For some, but currently unknown, number of these authorities' 13,200 developments, the cost comparisons will show the real housing value that public housing units deliver. For other developments, the cost comparisons will highlight the questionable value–from a cost perspective only–of continuing to overpay for public housing when viable, less costly private rental apartments are available.

The following examples illustrate the range of cost implications that HUD's plan could have for housing developments. These examples are for illustration only and should not be used to project overall costs of the plan. To control for tenants' income and for purposes of consistency, each example assumes that assisted households would make no contribution toward their rent.

Four costs are presented in each example. The first is the property's current per unit operating cost. These can vary widely depending on such variables as the property's location and amenities and the extent to which maintenance and modernization expenses have been deferred. Also, according to HUD's Director, Office of Assisted Housing, current operating costs are somewhat understated because they do not adequately account for the costs of employee benefits, solid waste disposal, services such as child care and tenant counseling, and security. The second cost–the revised operating cost–presented in each example, is the sum of current operating costs; the rehabilitation and modernization expenses necessary to put the unit in a market-ready condition, as estimated by the housing authority; and a reserve for future nonroutine expenses. The third cost is the market value of the unit. This is the approximate monthly rent that the unit could bring in the private market, according to the opinions of and surveys made by housing authority officials and local real estate agents. The fourth cost–the fair market rent–is the maximum monthly rent that HUD would pay for households using housing certificates.

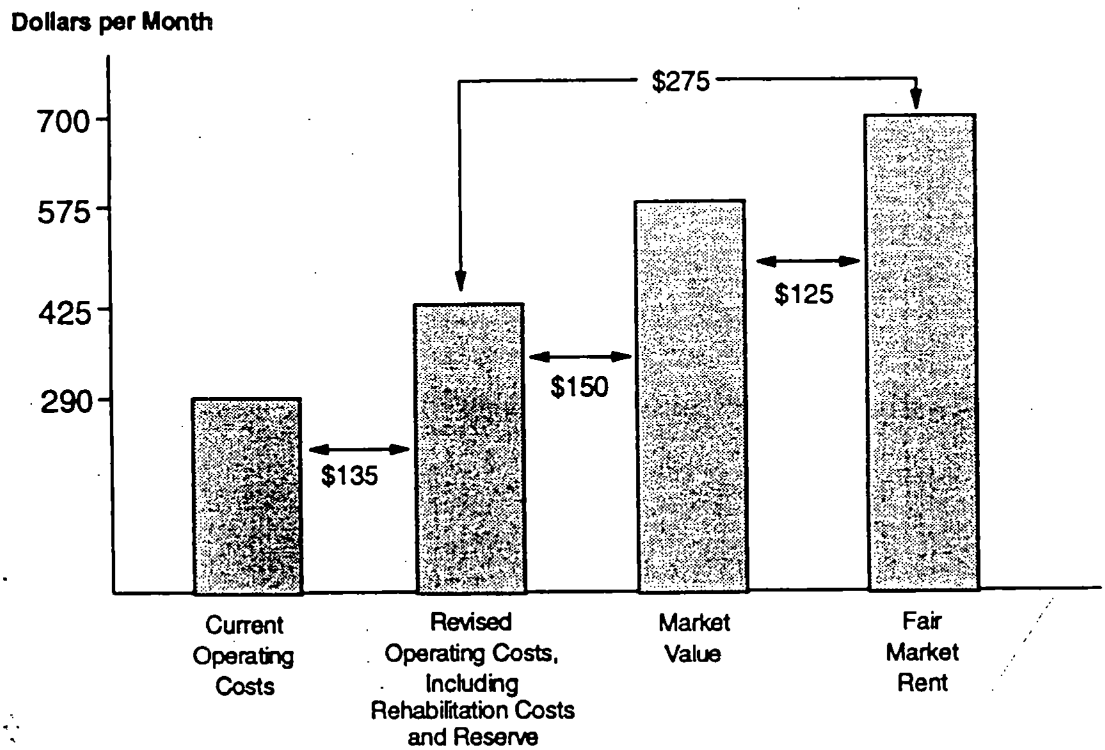
EXAMPLE 1

As shown in figure I.1, this development has the following monthly per unit costs: current operating costs of $290, revised operating costs of $425, a market rental value of $575, and a fair market rent of $700.

In this example, the federal government is currently subsidizing that portion of the public housing authority's current operating costs ($290) not covered by the tenant's rent contribution. If the federal government pays for the modernization of this 100-unit property out of grant funds, it will cost about $850,000, or about $8,500 per unit. Conversely, if the federal government either makes a direct loan or insures a private loan for the modernization costs and requires a reserve for nonroutine expenses, the revised operating costs will be about $425 per month. Once this modernization is completed, as called for under HUD's proposal, the public housing authority would be able to charge a market rent of $575, or $150 more than the revised operating costs. Last, if a household chose to use its housing certificate to move to private rental housing, it could receive a subsidy up to the fair market rent of $700. This is $125 more than the market rent of the public housing unit.

For this example, the federal government minimizes its cost by retaining the development as public housing. If the housing is rehabilitated and maintained as public housing, it has a monthly per unit cost of $425. This can be considered a good value for the federal government, since the unit's market value of $575 exceeds the monthly revised operating costs by $150.

Figure I.1: Example in Which Unit's Market Value and Fair Market Rent Exceed Operating Expenses



HUD's plan raises the following issues concerning the costs of this development.

- Should the federal government pay to rehabilitate public housing properties when these properties could generate sufficient revenues to pay for these expenses? In this example, under the proposal the federal government would pay the $850,000 in rehabilitation costs. Alternatively, these costs could be financed by a loan that could be paid back through the additional revenues generated at the property's market rent. If the federal government pays for the rehabilitation costs, the public housing authority would still have operating costs of about $290, plus an amount set aside for reserve, yet be able to rent the unit for $575, thus generating about $285 in additional revenues for the public housing authority. Conversely, if the federal government required that the rehabilitation be finance through a loan, the public housing authority's revised operating costs, including funding for a reserve, would be $425. This would generate $150 in additional revenues for the public housing authority.

- Should the federal government subsidize public housing units at market rents, as proposed in stages two and three of HUD's proposal, when these rents exceed the public housing authorities' operating expenses? If yes, should any federal restrictions be placed on public housing authorities' use of the additional revenues that would be generated?

- How, under the proposal, will increases in federal subsidies resulting from converting to housing certificates be paid for? In this example, these increases could result from (1) subsidizing the public housing authority at the market value of its units, versus its operating costs; (2) providing public housing residents with a "shopping incentive," since the market value of the unit is less than the fair market rent; and (3) providing tenants with housing certificates enabling them to move to a unit with a monthly rent at or near the $700 fair market rent. Possible alternatives for paying for these costs include increased spending by the federal government or a reduction in the number of families assisted.

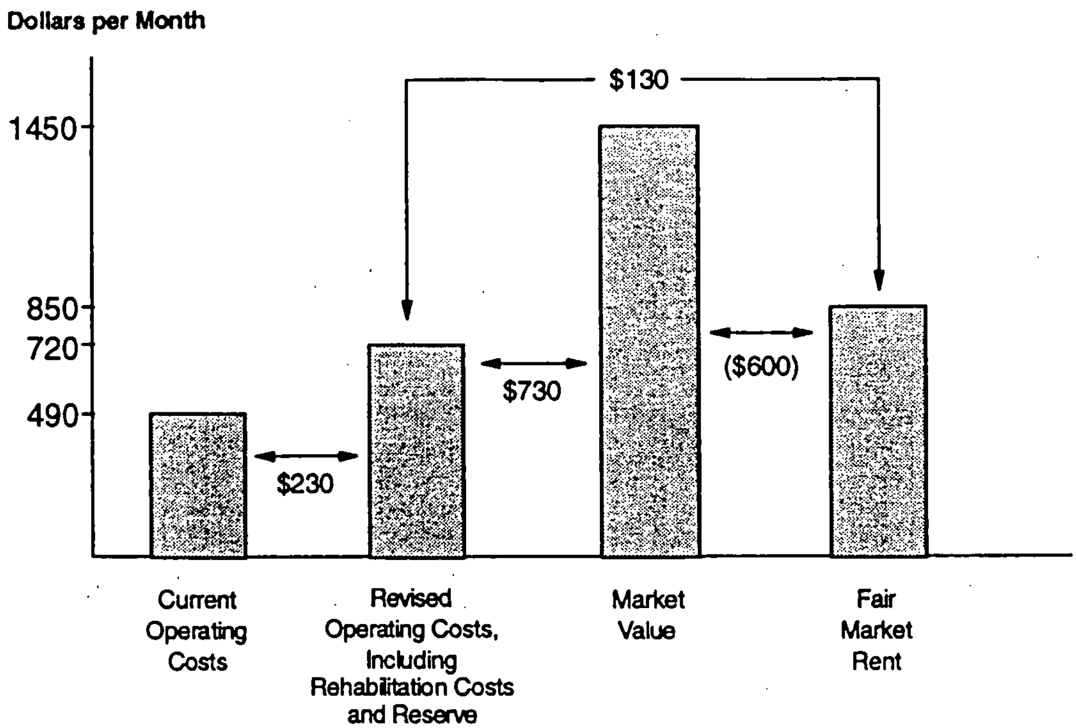
EXAMPLE 2

Figure I.2, highlights the characteristics of our second example. As shown in the figure, this development has the following monthly per unit costs: current operating costs of $490, revised operating costs of $720, a market rental value of $1,450, and a fair market rent of $850.

Again in this example, the federal government is currently subsidizing that portion of the current operating costs ($490) not covered by the tenants' rent contribution. Modernization costs for this almost 1,100-unit project are estimated at over $17 million, or about $15,500 per unit. The federal government, as in the first example, could either pay the $17 million in the form of a grant, or it could make a direct loan or insure a private loan. If modernization costs are financed through a loan and this cost together with a reserve for nonroutine expenses is added to the current operating costs, the revised operating costs are about $720 per month. This is still well below the fair market rent ($850), which the housing authority would be permitted to charge current residents under HUD's proposal. Moreover, the revised operating expenses are less than half of the unit's market value, which the housing authority conceivably could charge new tenants as units become vacant unless the rents are capped to ensure that lower- income households continue to be served by the property.

For this example, as was the case in the first example, the federal government minimizes its cost by retaining the development as public housing. This unit provides a good value for the federal government, since the unit's revised operating costs of $720 are $130 below the $850 fair market rent permitted under HUD's proposal. Moreover, the unit offers the residents an excellent value since the unit's market value of $1,450 is double the revised operating costs ($720) and $600 above the fair market rent.

Figure I.2: Example in Which Unit's Market Value Exceeds Both Operating Costs and Fair Market Rent



HUD's plan raises the following issues concerning the costs of this development.

- As with example 1, a question is raised over whether it is prudent to adopt housing certificates for properties where the federal government is getting substantially more housing value than it is currently paying for.

- Second, as with example 1, should the federal government pay to rehabilitate public housing properties when these properties could generate sufficient rental revenues to pay for the rehabilitation? In this example, these costs are estimated at over $17 million.

- Third, and again as with example 1, a question is raised over whether any federal restrictions should be placed on the increased revenues that the public housing authority could generate when the revised operating costs are below both the fair market rent and the market value of the property. In this example, the public housing authority could theoretically receive an additional $130 per unit per month ($850 minus $720) for current residents and an additional $730 per unit per month ($1,450 minus $720) if vacant units were rerented at their market value.

- Finally, like our first example, this example raises the question of how additional federal subsidies would be paid for if the public housing authority is permitted to charge the fair market rent and tenants would receive that amount.

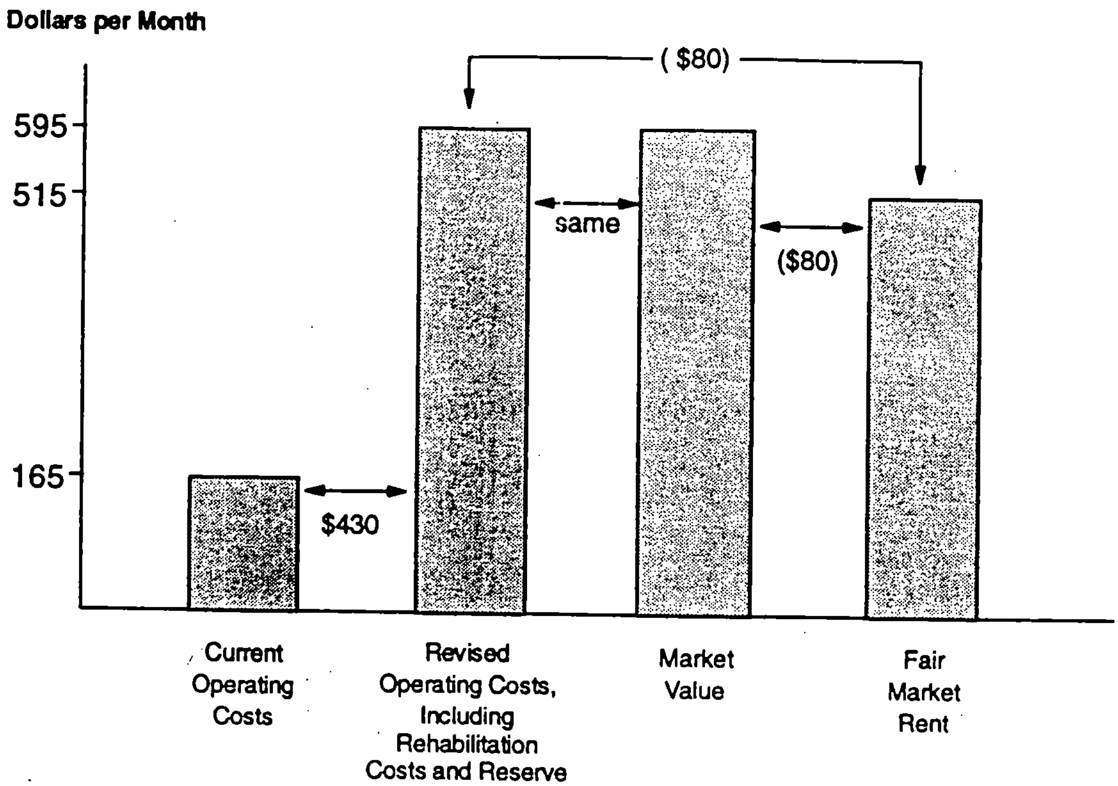
EXAMPLE 3

As shown in figure I.3, this development has the following monthly per unit costs: current operating costs of $165, revised operating costs of $595, a market rental value of $595, and a fair market rent of $515.

In this example, the federal government is currently subsidizing that portion of the current operating costs ($165) not paid by the tenants. If the federal government pays for the modernization of the 59-unit property out of grant funds, it will cost about $2.3

million, or about $39,000 per unit. Conversely, if the federal government either makes a direct loan or insures a private loan for the modernization costs and requires a reserve for nonroutine expenses, the revised operating costs will be about $595. Once this modernization is complete, the property would also have a market value of about $595. The fair market rent for the area in which this property is located is $515 per month, which is $80 below the property's projected revised operating costs. However, the property houses elderly people, who may have difficulty paying the additional rent and who generally are less likely to be able or willing to use housing certificates to move to alternative housing. If the property is rehabilitated, its market value of $595 would be a good value for its residents, since this is $80 more than the fair market rent. The federal government, on the other hand, is getting a market value equivalent to its housing subsidy cost. However, again, because this unit's value is above the fair market rent, the federal subsidy costs are greater than if the project's residents were provided housing certificates.

Figure I.3: Example in Which Unit's Market Value and Operating Costs Are Equal and Both Exceed the Fair Market Rent



HUD's plan raises the following issues concerning the cost implications for this development.

- As with the prior two examples, should the federal government pay for the cost of modernization through a grant when the property could finance the rehabilitation through rental income?

- As long as the current residents remain in this project, should the federal government continue to subsidize their rents above that which would be allowed with housing certificates?

– Finally, how will the added costs of subsidizing current residents in this property be paid for?

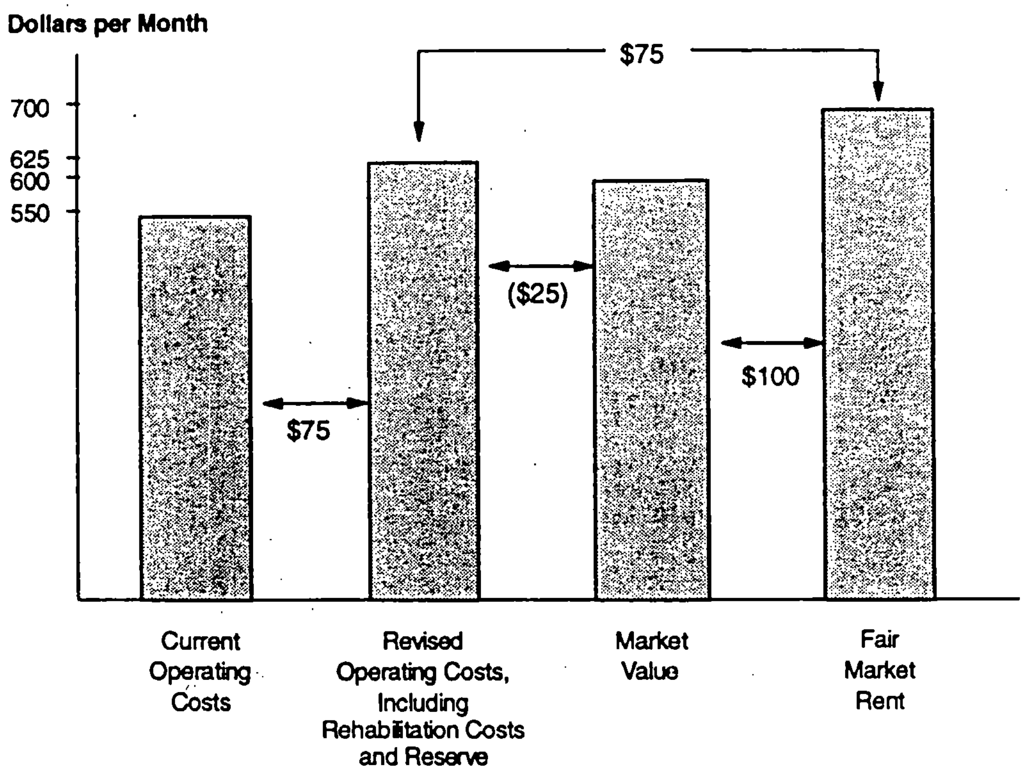
EXAMPLE 4

Figure I.4 illustrates our fourth example. In this example, the development has the following monthly per unit costs: current operating costs of $550, revised operating costs of $625, a market rental value of $600, and a fair market rent of $700.

In this example, the federal government is currently subsidizing that portion of the public housing authority's current operating costs ($550) not covered by the tenants' rent contribution. If the federal government pays for the modernization of this 150-unit property out of grant funds, the cost will be about $340,000, or about $2,300 per unit. Conversely, if the federal government either makes a direct loan or insures a private loan for the modernization costs and requires a reserve for nonroutine expenses, the revised operating costs will be about $625 per month. Once this modernization is completed, the property would have a market value of $600 per month, or about $25 less than the cost to operate the property. Last, if a household chose to use a housing certificate to move to private rental housing, it could receive a subsidy up to the fair market rent of $700.

For this example, the federal government would have to subsidize the rent on the property at a level $25 per unit per month above its market value. However, the revised operating costs of $625 would still be $75 per month below the fair market rent.

Figure I.4: Example in Which Unit's Market Value Is Less Than Both Operating Costs and Fair Market Rent



HUD's plan raises the following issues concerning the costs of this development.

- First, what criteria or parameters should be used for deciding when to rehabilitate a public housing unit when the revised operating costs exceed the unit's market value?

- Second, how should the rehabilitation expenses be paid for? For example, should the portion of the rehabilitation costs that cannot be financed through rental income be financed by the federal government through a grant? Such an approach might allow part of the rehabilitation costs to be financed at the property's market rent of $600 and the remainder to be paid for through a grant.

- Finally, as in the case of our other examples, a question is raised concerning how to pay for increases in federal subsidies resulting from converting to housing certificates. In this example, these increases could result from (1) subsidizing the rehabilitation of the property at least partly through a grant, since the property's revised operating costs are above its market value; (2) providing public housing residents with a "shopping incentive," since the market value of the unit is less than the fair market rent; and (3) providing tenants with housing certificates enabling them to move to a unit with a monthly rent at or near the $700 fair market rent.

EXAMPLE 5

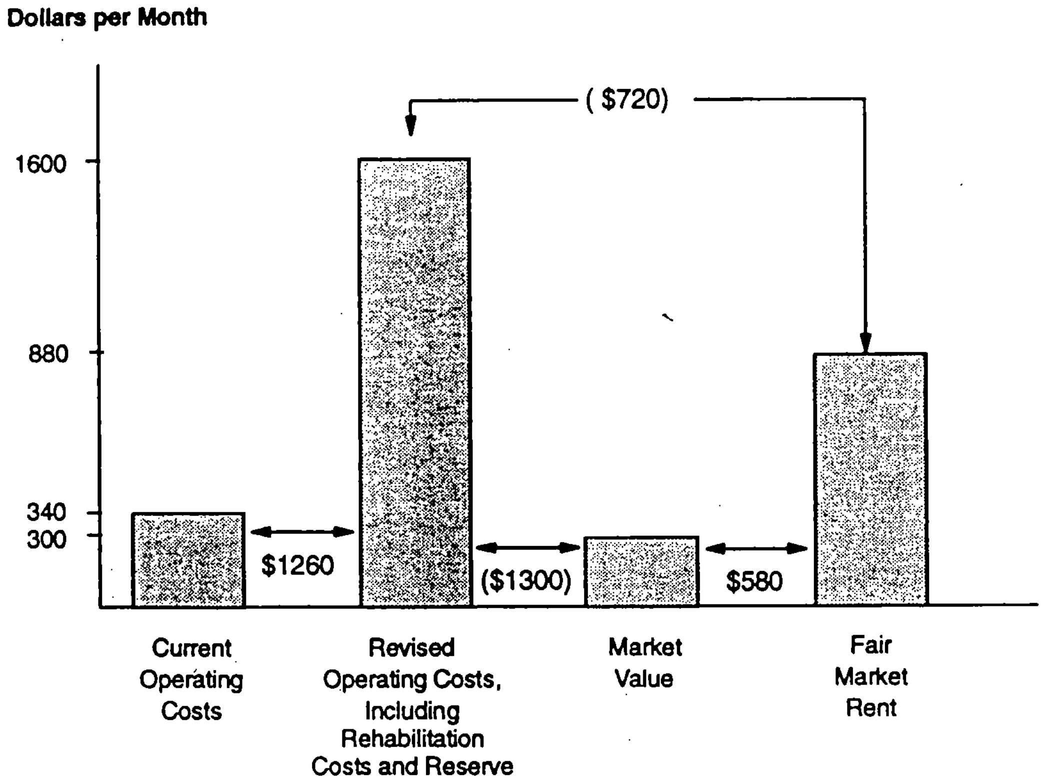
As shown in figure I.5, this development has the following monthly per unit costs: current operating costs of $340, revised operating costs of $1,600, a market value of $300, and a fair market rent of $880.

This example typifies properties that have fallen into very serious disrepair, for which the costs of extensive renovation cannot be justified on the basis of the market rents that the rehabilitated units could generate. In this example, the federal government is currently subsidizing that portion of the public housing authority's current operating costs ($340) not covered by the tenants' rent contribution. If the federal government pays for the modernization of this property with over 4,000 units out of grant funds, the cost could be over $500 million, or more than $125,000 per unit. Alternatively, if this rehabilitation is financed by a direct loan and a reserve is established for nonroutine expenses, the revised operating costs would be about $1,600. Once the rehabilitation is completed, the property's market value is about $300 per month. Last, if current residents were issued housing certificates and chose to move to private rental housing, they could receive a subsidy up to the fair market rent of $880.

From a cost perspective, rehabilitating the property in this example makes no economic sense. Specifically, the federal government would incur an inordinately high cost to rehabilitate the unit, after which its market value of $300 per month would be less than one-fifth the cost of operating the unit. Moreover, if the property is rehabilitated, tenants would be left in a unit whose market value is far less than the value of the housing they could obtain with housing certificates at the fair market rent of $880.

This example highlights the type of property that, because of its high rehabilitation costs, inflates the cost of public housing when compared to the cost of housing certificates. Assuming this property is located in an area where there is an adequate supply of rental housing to accommodate housing certificate holders, then the rational economic decision would be to provide residents with the certificates.

Figure I.5: Example in Which Operating Costs for Rehabilitated Housing Exceed Both Fair Market Rent and Market Value



HUD's plan indicates that upwards of 100,000 units of public housing would likely be demolished. Properties such as the one illustrated by example 5 would be likely candidates. However, this example still raises certain issues, including how rehabilitation should be paid for if the local government wants to retain all or a portion of this housing? For example, should the federal government be willing to subsidize the rehabilitation only up to the property's market value and require the local government to finance the remainder of the cost?

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TESTIMONY BEFORE THE HOUSING AND COMMUNITY OPPORTUNITY SUBCOMMITTEE OF THE HOUSE BANKING & FINANCIAL SERVICES COMMITTEE

WASHINGTON, DC
OCTOBER 13, 1995

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

REMARKS PREPARED FOR
SECRETARY HENRY G. CISNEROS

Mr. Chairman, thank you for inviting me here this morning. I appreciate the opportunity you and the members of your subcommittee have given me to discuss the proposed "United States Housing Act of 1995."

I think it is fitting that the Subcommittee's first major legislative vehicle focuses on public housing -- because the transformation of public housing remains our biggest mutual challenge and responsibility. At the outset, however, I want to note that the views I am expressing today reflect only the views of the Department and not necessarily those of the Administration.

Since 1937, the Federal government has invested some $90 billion in the Federal housing inventory. The legacy of that investment is mixed.

On one hand, public housing provides a stable supply of rental housing that is affordable to families with very low incomes. Approximately 1.3 million households live in public housing developments operated by some 3400 public housing agencies. Approximately 45 percent of these households are families with children, 35 percent are elderly, and another 10 percent are people with disabilities.

For these people, public housing provides a real, tangible response to the failure of the private market to provide sufficient housing at affordable rents. Nationally, the supply of affordable housing units falls well short of the demand -- by about 4.7 million units. That gap would be far greater without public housing or other forms of federal housing assistance.

But despite serving this critical function, the current public housing system is plagued by a series of deeply-rooted and systemic problems. Concrete high rises have become vacant shells, scarring the urban landscape. Other projects are beset by crime and gang activity. The very names of some places -- Cabrini Green, Robert Taylor Homes, Desire -- haunt the American imagination. Other problems exist in the 100-odd public housing agencies that are classified as troubled entities.

Change is needed. Far reaching reform is warranted. But long-lasting reform must respond to the full scope of the problem. I think it is helpful if I review briefly our perception of the problem as well as the key components of our reinvention initiative, before we focus on the committee's proposed solutions.

Key structural problems afflict the current public housing system.

First, public housing concentrates the very poor. The average income of families living in public housing is currently around 17 percent of area median income, or $6300. This is a relatively recent phenomenon. In 1980, for example, the average income of families living in public housing was about 33 percent of area median income. Congressional decisions during the past decade and a half -- particularly federal laws governing admissions and rents -- compelled public housing agencies to serve those low-income families experiencing the greatest distress.

Second, public housing is itself concentrated in high poverty neighborhoods. Due to deliberate local siting decisions, public housing tends to be located in areas lacking jobs, economic opportunities and basic amenities. This experience contrasts sharply with that of section 8 certificates and vouchers. A recent General Accounting Office (GAO) study of four metropolitan areas indicated that fewer than 10 percent of Section 8 recipients live in high poverty neighborhoods (i.e. neighborhoods that are more than 30 percent poor). In contrast, 23 percent of public housing residents live in such high poverty neighborhoods.

Third, federal laws penalize public housing tenants who work. They discourage employed families from working ... and working families from staying. Public housing rents, set at 30 percent of a family's adjusted income, penalize families who want to work -- by taking away 30 cents of every additional dollar they earn and a higher portion of their after-tax income. In addition, rents charged for families who are already working are often far higher than that which the unit would command in the private market, since rents are based purely on income. As a result, residents who would provide the best role models -- people who work and who could help others find jobs -- are often the first to leave.

Fourth, the discipline of the real estate market does not apply to public housing. The current system empowers a distant, federal bureaucracy to ensure that public housing agencies perform well in maintaining and administering their housing stock. Residents who are in the best position to identify management deficiencies and compel changes are denied the ultimate tool available to consumers -- the ability to take their business elsewhere. No matter how poor the physical condition of the apartment, no matter how crime-ridden or economically depressed the neighborhood in which the housing is located -- subsidies are tied to housing units and cannot be transferred.

Finally, the federal method of overseeing the public housing industry aggravates all these problems. Federal statutes and rules regulate every aspect of public housing, including admissions, rents, evictions, resident rights and relations, modernization, development and procurement. The system is awash in process and paperwork, in adhering to guidelines, and filling out forms. For the past two and a half years, HUD has attempted to end federal mircomanagement by streamlining and simplifying the rules governing nearly every aspect of public housing management, eliminating dozens of handbooks and guidelines in the process. Yet the underlying public housing statute -- the 1937 Housing Act -- remains an impediment in many areas.

These are the root problems that real reform must address.

This March, I submitted the President's Reinvention Plan for HUD to Congress. Perhaps the most far-reaching component of HUD's Reinvention is a simple, yet profound, plan to transform public housing. Where the current system gives public housing agencies capital and operating subsidies to maintain projects, we will give families rental vouchers -- that could be used in public housing or a private apartment of their own choice. Where the current system relies on a complex, complicated array of rules and regulations to oversee the performance of agencies, we will rely on families to decide whether management has performed well.

The reinvention proposal envisions an orderly and prudent transition to prepare agencies and residents for the shift to a market environment. We had three stages in our proposal:

During the first transition stage, beginning in fiscal 1996, HUD would consolidate dozens of disparate public housing programs into two accounts, one for capital and management improvements, and one for operations. The nation's 3,300 well-performing public housing agencies will be able to modernize units which are worth improving and to tear down units that are not worth saving. Many of the basic laws governing public housing -- one-for-one replacement, federal preference rules, restrictions on the modernization program -- would be either repealed or dramatically altered.

During this time, HUD would focus its full attention on the 100 agencies that continue to exhibit severe management deficiencies. To this end, we seek new, enhanced powers, and intend to intervene aggressively to turn these agencies around.

In the second transition phase, existing capital and operating subsidies would be converted to project-based assistance, and agencies would learn to operate under market discipline. Rental income -- instead of arbitrary capital and operating budgets -- would drive their property-management decisions.

In the final phase, all subsidies would be converted to tenant-based assistance.

Those are the three stages of our plan to transform public housing, and that Reinvention proposal is the prism through which I have evaluated the Lazio bill.

I have had some opportunity to read the legislation and discuss it with staff. The Subcommittee appears to have adopted the first stage of our proposal, which is profound in itself.

It adopts program consolidation and merges tenant-based vouchers and certificates.

It eliminates the one-for-one replacement rule which requires public housing authorities to replace every unit they tear down with a new housing unit.

It encourages income-mixing.

It streamlines the modernization program.

It provides the Department enhanced powers when assuming control of troubled public housing agencies.

And it continues and accelerates the deregulatory track that has been pursued by the Department for the past two and a half years.

But the bill stops short of empowering the people who live in public housing and eliminating the worst public housing projects because it continues to wed federal funding to buildings and bureaucracies, rather than to people.

Even more problematic, the bill gives public housing agencies unfettered discretion in the areas of income targeting, preference rules and rent restrictions. Local agencies will be compelled to exercise this discretion, given the dramatic reduction in public housing subsidies, in a way that disproportionately harms the poorest households, including the elderly.

In essence, what you have proposed is a federal block grant that devolves responsibility to 3,400 public housing agencies across America. As with all block grants, the key to success is the balance struck between local-flexibility and program accountability.

I think in its current form the legislation swings the pendulum way too far -- towards unfettered control by local bureaucracies and away from prudent national standards and appropriate federal oversight. Let me illustrate this point by discussing a few points of contention which I hope we can resolve together.

The first is income targeting.

The issue of income targeting exposes a central tension in public housing today: a tension between targeting government resources to those who most need help, and the need to mix working families with those on welfare.

We need to reconcile this tension.

Our policies should promote economic integration. We should encourage income-mixing and give dependent families role models: families that are living links to the working world. For two and a half years, I have crisscrossed America, speaking about the pathologies we create when we concentrate poor people in dense, dangerous housing projects, cut off from the economic and social mainstream.

Residents need income-mixing. So do public housing authorities. They need working families to help pay higher rents to make up for some of the operating subsidies which Congress is cutting.

Nevertheless, this bill tips the balance too far. The bill would allow all public housing units to be filled by households earning up to 80 percent of the area's median income. By contrast, 85 percent of current public housing residents have incomes below 35 percent of their area median.

The bill would also remove existing statutory provisions which require that at least 75 percent of newly admitted residents in particular developments have incomes below 50 percent of area median.

The bill would couple this dramatic relaxation in current income targeting rules with a repeal of all federal preferences for admission. Currently, public housing agencies are required to target 50 percent of their vacancies or new admissions to people with worst case housing needs. With a return to local preferences, PHA's will be free to reach down their waiting lists and skip over poorer families to attract higher income people.

I strongly fear that the combination of proposed changes in federal preference and income targeting rules alone will, overtime, alter the fundamental mission of public housing: to serve poor and low-income Americans unable to find decent and safe shelter in the private housing market.

But this bill goes even further by ending the current practice of linking public housing operating subsidies to the rents actually charged residents. By severing this link, the new block grant would actually penalize public housing agencies that serve poorer residents -- further supporting the likely trend towards serving tenants with relatively high incomes.

We need to be clear what 80 percent of area median income means.

In St. Louis, 80 percent of area median income for a family of four is $35,700 -- 236 percent above the poverty line.

In Baltimore, 80 percent of area median income is $39,500 -- 261 percent above the poverty line.

In Newark and Boston, it's more than $40,000.

Is this the purpose of public housing? Should we use scarce federal dollars to subsidize families making enough money to afford an average private rental in their markets?

We also need to be clearer about what public housing means in a lot of American communities. Given recent capital expenditures, in some communities the best, if not the only, affordable, low-income housing is public housing.

If we, in effect, remove income limits, we could quickly move out of a public program designed to help lower-income and poor people, and be left, five years down the line, with a much more severe affordable housing shortage and even more homelessness.

In addition, by giving public housing agencies carte blanche to determine when and where to income mix, we could create situations where very low-income families continue to be concentrated in distressed developments while higher income families are permitted to reside in better located and maintained housing.

Think what these income targets would do in tight housing markets where public housing has relatively high market value -- in places like Cambridge, Massachusetts, or New York City.

Who would be served and who would be pushed into the streets?

I ask that the Subcommittee reconsider its income targeting provisions and work with the Administration to reach some acceptable middle ground.

I would offer two suggestions. First, the Senate public housing reform bill requires 40% of all public housing units to be filled by households earning less than 30 percent of the area's median income. That's a start in the right direction. But I would go even further and use the low income housing tax credit targeting of 60% of area median as the upper limitation

Require 40% => ppl w/ <30% of median inc
+ Upper limit => 60% of area median

for the public housing program. That will give public housing agencies the ability to mix incomes in affordable housing developments without serving families who do not require government assistance.

The second major point of contention is over the virtual termination of any meaningful rent protections in the public housing program.

The Subcommittee bill essentially repeals the Brooke amendment in public housing, which has capped tenant rent contributions since 1969. The bill would replace Brooke with (1) a minimum rent of $50 a month; and (2) a Federally mandated ceiling rent based on market value or operating costs. Public housing agencies would be given total discretion to set rents between these minimum and maximum levels.

I have grave problems with the Subcommittee's action in this area. The bill will lead to rent increases for the most vulnerable households with the lowest incomes, particularly those living in low-wage and low-benefit states.

The median income for public housing residents is approximately $6,300. A minimum rent of $50 would increase the rents paid by approximately 132,000 public households by an average of $346 per year.

But it is highly likely, given the reduction in operating subsidies and the repeal of the Brooke amendment, that public housing agencies will raise rents more substantially for a larger number of households.

I believe the Subcommittee action is simply unfair, inequitable and unwarranted.

The Subcommittee's action would compound severe reductions in other Federal programs serving many of the same poor families. The Congressional budget resolution, for example, already assumes $100 billion in savings from means-tested entitlement programs, including the Earned Income Tax Credit, AFDC, food stamps, child care and child nutrition programs. The budget resolution assumes another $182 billion in savings from Medicaid. There are many families in public housing who now are barely juggling the costs of basic necessities like shelter, food, clothing, transportation and child care. How they will cope given increases in their rents is difficult to contemplate.

I believe that public housing agencies should be asked first and foremost to take other actions necessary to compensate for reductions in operating subsidies before raising tenant rents; for example, weeding out inefficiencies in their operations or demolishing troubled inventory. I note that the Senate public housing reform bill is more judicious in its approach to rent-setting, retaining the Brooke protections for families below 30% of area median and permitting public housing agencies to set minimum rents not to exceed $30.

I think the best approach is contained in the Senate appropriations bill: retain Brooke, set a minimum rent of up to $25, and permit public housing agencies to set ceiling rents and disregard earned income from families who make the transition to work. The Senate appropriations bill correctly focuses on the need to mix incomes in public housing and raise revenues without unduly harming the most vulnerable families and elderly persons. I strongly urge the Subcommittee to consider this approach.

The third major point of contention is over the extent to which public housing agencies will continue to be accountable to residents, taxpayers and the public trust.

The quid pro quo of giving local entities greater flexibility and latitude in the operation of federally-funded programs must be the insistence on accountability.

Financial safeguards must be put in place to ensure that federal funds serve intended beneficiaries and are not subject to fraud, waste and abuse. Performance measures must be developed and monitored to ensure that local agencies carry out their public trust pursuant to national goals and objectives.

The Committee bill would establish a two-tier system of program accountability and federal oversight. On the front-end, the bill would require public housing agencies to develop strategic plans for their operation of public housing in this new, deregulated environment. Such plans must be developed in consultation with relevant constituencies and can be submitted to HUD only after public hearing. The Secretary would be given limited review powers.

On the back end, the bill would establish a new Accreditation Board composed principally of representatives from the public housing and real estate industries. The Board would be given the responsibility to establish performance benchmarks and perform oversight and auditing functions. The Board would have jurisdiction over both public housing and "deep subsidy" project-based assisted programs and would be funded through fees imposed on the public housing agencies. HUD would retain certain enforcement powers to remedy management deficiencies in agencies that are inferior performers and are deemed troubled or dysfunctional by the Board.

I think there are two areas that deserve close attention and scrutiny. First, a bureaucratic system only goes so far in ensuring good, sound, consistent management practices. The core motivation of HUD's reinvention plan was to give residents the market power to influence the adequacy of local management. HUD's reinvention subjected local agencies to the market test of consumer choice, not to the less reliable indicator of performance measurement systems.

I think performance measurement can work if it measures the right things and if the federal government is given appropriate and meaningful oversight. I think the notion of an Accreditation Board -- to instill greater professionalism in the public housing industry and to perform several oversight functions -- is an intriguing one. Such a Board could bring together individuals with real-life management skills and expertise and provide a level of practicality that all too often was missing from HUD guidance and actions in the past.

Yet an independent Accreditation Board also raises, as you will appreciate, many difficult questions. Ensuring performance accountability among federal grantees clearly involves a spectrum of functions and tasks -- technical assistance and support, the establishment of performance measures, the oversight of performance, enforcement where performance is inferior and so forth. What roles are uniquely the federal government's and what functions can be assigned or delegated to an independent entity need to be explored with great care.

There are other questions as well.

How large will this new entity need to be? Who will staff it?

What should the entity's relationship be to HUD? Will HUD retain independent audit powers, to protect public housing residents and taxpayers when it sees the need? Will HUD retain the ultimate right to approve the performance standards?

To whom is the Accreditation Board accountable? How can we best assure that the entity is independent, objective, apolitical and will make the tough evaluation decisions needed?

What should be the entity's scope? Is it wise to have the entity cover all the deep subsidy housing programs, as the bill proposes?

Clearly, there are many questions which need to be explored before we proceed with a change of this magnitude. I am committed to work closely with you and your staff to ensure that this idea receives a meaningful, substantive hearing.

The second area of attention -- whatever is decided on the Accreditation Board -- must be on the qualities and the talents of public housing professionals. I believe that both local agency staff and HUD personnel are not adequately prepared for the transition to this new framework -- where local agencies are expected to be more entrepreneurial, where HUD staff are expected to be more supportive and less intrusive. If we are going to have responsible devolution, we need to significantly expand the quality and quantity of the training that is available to this industry. Existing funding is not sufficient for the current program; it is even less so when we contemplate the major changes that are about to be made.

The fourth major point of contention is over the treatment of our most troubled housing stock, some 100,000 units nationwide, which we call severely distressed public housing.

These are the projects that trap people. They are the most dangerous and the most costly. They also represent the strongest possible case for conversion of project-based subsidies to vouchers and certificates, as envisioned by HUD's reinvention plan.

The Subcommittee bill acknowledges this by requiring such conversion when a building is distressed or substantially vacant, the conversion would be cost-effective and there is a sufficient supply of affordable and available housing. These determinations would need to be outlined in the community improvement plan submitted by the public housing agencies.

I believe the bill is far too cautious about dealing with this portion of the public housing inventory. Any objective observer would conclude that these distressed developments have long outlived their usefulness and are now more harmful to tenants and neighborhoods than beneficial.

My fear is that, in many communities, local politics and pressures won't allow public housing agencies to move expeditiously to demolish projects that should come down. Right now, many public housing agencies are continuing to commit substantial federal resources to rehabilitate projects that should be demolished. This bill will not alter that reality; instead, the rehabilitation of badly sited projects will continue apace -- wasting scarce federal resources and establishing the next generation of failed projects.

Some sites should not be rehabilitated. If HUD does not have the power to say that, we risk allowing public housing agencies to invest new funds in projects that may, ultimately, have to come down at a future date. If HUD does not have the power to expand the eligible uses of existing funds -- from modernization to tenant-based assistance -- federal funds will continue to be invested inefficiently.

The Subcommittee bill recognizes elsewhere that HUD needs enhanced powers when it takes over troubled public housing agencies. I would strongly argue that the same logic should apply to the distressed inventory. As a former Mayor, I fully accept the notion that there are times when the threat of federal intervention is the key catalyst for "doing the right thing". I would strongly suggest that dealing with the distressed inventory is one of those times.

The final major point of contention concerns the bill's treatment of section 8 rental assistance.

As with the bill's public housing title, there are several proposals for revising section 8 which would generally improve the administration and effectiveness of this critical program. The separate voucher and certificate programs would be merged. Various rules which have impeded the participation of good landlords in the program -- onerous notice requirements, the "take one, take all" provision -- would be eliminated.

But the bill makes a number of reforms to the section 8 program that I think are ill-advised and counterproductive. As with public housing, the bill would set the income eligibility level for section 8 at 80 percent of area median and would permit public housing agencies to establish their own preference system for allocating this scarce assistance. The bill would also track the proposed public housing rent provisions by repealing the Brooke amendment and giving public housing agencies total discretion in the setting of rents (except that a minimum rent of $50 would be mandated). Finally, the bill would prohibit portability.

As with public housing, these changes could result in converting a housing program that is carefully targeted on serving very low-income families with worst case housing needs into one that serves moderate income families with minimal need for such assistance. Whereas the public housing changes are fueled by a desire for greater economic integration -- a laudatory goal -- it is not clear what is driving applying these changes to the section 8 program.

The history of section 8 is radically different than that of public housing. In most communities, the Section 8 tenant-based program naturally achieves economic integration because it allows poor families to live in mixed-income residences and neighborhoods. Thus, recipients of rental aid tend to be more widely dispersed throughout the rental market than residents of public housing. With program reforms, greater outreach by the public housing agencies and counseling to recipients, that record should improve.

Lifting the income limits and severing any link between housing needs and preferences will not cure any serious deficiency in the existing program. It will, however, mean that a scarce federal resource could be distributed in ways that are difficult to defend in times of severe fiscal constraints. We are getting maximum "bang for the buck" with the existing section 8 program; radical change is simply not called for.

There are obviously many issues of lesser importance as well as technical comments which the Department would like to share with the Subcommittee. I will transmit a full analysis and evaluation of your bill as quickly as possible.

I hope, in the coming weeks, we can do more to bridge some of the goals of this legislation to the details within.

I look forward to working with you towards that end.

Thank you. I welcome your questions.