Putting Housing Program Delivery into High Gear

By Toby Halliday and Bill Kelly
Stewards for Affordable Housing of the Future

In recent years the United States has seen a sharp increase in demand for rental housing affordable to the lowest income households. Much of the increase has been driven by households that experienced loss of income or foreclosure in the wake of the financial crisis. But while demand for affordable rental apartments will continue to expand, resources are increasingly limited.

Stewards of Affordable Housing for the Future (SAHF) is a collaboration of 12 not-for-profit housing social enterprises that together own and operate nearly 100,000 affordable apartments nationally serving low-income persons, including families with children, seniors, persons with disabilities, and the formerly homeless. We have responded to this crisis in a number of ways, launching several initiatives focused on making sure that affordable housing resources are used effectively and efficiently for assisted properties and their residents. We have also developed recommendations for administrative reform to reduce operating and transaction costs and to elevate performance and impact as the key criteria for participation in HUD programs. Key portions of that agenda are outlined in this article.

We believe program outcomes and performance in privately owned, HUD-assisted housing can be improved by removing barriers to efficiency, loosening the knot that ties project-based assistance to current properties,

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and improving service delivery through greater reliance on strong housing providers. Examples of some of these strategies have already been successful on a limited scale and should help build momentum for larger-scale implementation.

Background

HUD's project-based rental assistance (PBRA) programs provide critical support to over 1.2 million of the nation's most vulnerable households. These programs, which include HUD's project-based Section 8 program for all types of residents, its elderly housing program (Section 202), and its program of housing for persons with disabilities (Section 811), engage private owners of rental properties to provide housing to low-income residents in exchange for long-term contracts providing rental assistance for eligible households. While initially designed to serve households with incomes as high as 80 percent of area median, PRBA programs now usually serve households with incomes below 50 percent of median and often far lower – the average annual household income is $12,800.

The ongoing quest for budget savings has placed great pressure on these rental assistance programs. In reviewing the cost, results, and efficiency of program administration, we see opportunities to reform outdated practices and misaligned incentives. We find that program rules focus too heavily on restraining bad practices instead of promoting good outcomes, discourage efficiency, and impose high compliance costs instead of effectively identifying and mitigating risk.

The regulatory regime also treats all housing providers the same regardless of mission orientation or demonstrated performance and rewards those who can successfully navigate arcane program rules. Meanwhile, over the past several decades, rental housing and the real estate industry more generally have evolved in dramatic ways beyond the old model in which each property was owned by a separate legal entity and financed on a free-standing basis. Whereas decades ago, most nonprofit owners were neighborhood-based organizations with small portfolios, many are now national or regional and own hundreds of properties. Many public housing authorities and for-profit developers have also evolved into mission-driven and creative affordable rental housing enterprises. Purchasing and financing approaches have evolved to achieve efficiencies of scale. Whereas energy and insurance were once bought on a property-by-property basis, sophisticated owners now control these costs on a portfolio basis. Whereas single property financing was the norm in the real estate industry, now real estate investment trusts and other forms of combined ownership have increased the availability and reduced the cost of capital with corporate and portfolio financing. We believe the regulatory framework should be updated to reflect these changes in the industry, and that these changes will promote better program performance and efficiency.

Remove barriers to efficiency

There are many examples of how competing program priorities and restrictive rules have led to a focus on compliance rather than performance and constrained innovation and efficiency. HUD scrutiny of property budgets is just one example. Operating procedures initially designed to produce decent, safe housing in places where it was previously scarce or unavailable has led to a cost reimbursement structure that relies on detailed budget review and approval and discourages efficiency. Because many markets had no comparable housing, in some cases contract rents were allowed to exceed local market rents, a concession that had a good initial rationale but that created perverse incentives. "Exception rents," as they are now called, encourage the perpetuation of inefficient management practices, obscure and compensate for ever-increasing compliance costs, and encourage a "use it or lose it" approach to budgeting.

Similar problems arising from conflicting priorities can be found in the way projects are developed and financed. Declining funding for new development projects has encouraged maximum geographic distribution of small properties, many of which are operated by an owner with only one such property. While this approach is popular with Congress and limits neighborhood opposition, small properties suffer from higher per-unit costs for administrative, operating, and service expenses. In addition, small properties experience relatively high development financing costs and in some cases may not be competitive or feasible candidates for tax credit financing, further raising the cost of property acquisition and major repair.

In the HUD portfolio every development financing deal requires multiple layers of capital, each with its own rules for owner and resident participation, its own documents, its own timetable, and its own reporting and compliance obligations. Experienced owners must endure dozens of largely redundant reviews for grant and financing programs. As a result, cost-effective portfolio-level financing is nearly impossible to secure. While property-level financing was originally developed as a way to isolate risks, modern portfolio financing agreements spread risk among properties and reduce default risk for lenders, and could do the same for HUD. Existing rules not only discourage sharing of property resources, but actively prevent owners from achieving economies of scale and lowering costs.

There are a few instances where developers have been successful in securing financing that can be used across their portfolios. Mercy Housing, for example, was able to carry out a combined refinancing of 27 rural properties in the Northwest through a portfolio purchase in 2003, which saved considerable transaction costs. There have also been several successful efforts to provide bulk refinancing and rehabilitation of bundles of elderly senior housing properties over the last 10 years. Yet these examples have not been easily replicated, and none has gone beyond bulk financing to facilitate reduced administrative or operational costs or improved sharing of resources among properties under common ownership. SAHF has recommended new approaches, and the Administration's budget proposal for FY 2014 calls for a potentially game-changing "Flexible Portfolio Demonstration" for high-capacity owners who could save money under more flexible program rules for portfolio-level management and financing.

Loosen the links between project-based assistance and existing properties

Currently, a number of PBRA policies result in perverse outcomes – sometimes serving to exacerbate concentrations of poverty or requiring expensive renovations of high-density or obsolete buildings. These circumstances stem from a shift in policy in the mid-1980s, when it was decided that existing PBRA contracts could only be extended or terminated upon expiration, but not moved or re-allocated among two or more properties. This froze the existing geographic allocation and income mix in place – which is significant because many PBRA buildings house high concentrations of households with extremely low incomes. Because of the current inability to transfer assisted units to other locations, the historical link between the rental subsidy and the existing building creates a barrier to mixed-income communities and encourages the preservation of obsolete or poorly designed buildings and properties just to preserve the underlying subsidy.

While many Section 8 buildings operate well in their current form and many are the sole source of affordable housing within gentrifying neighborhoods, some policy changes are needed to better serve residents. Policies should shift to facilitate mixed-income communities, preserve and expand affordability in high-opportunity neighborhoods and prevent displacement of existing tenants.

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Additionally, clear rules to allow transfer of affordable units to alternate locations are long overdue.

SAHF members have already demonstrated positive results by putting these ideas in practice in several properties. At the 504-unit Grove Parc Plaza in Chicago's South Woodlawn neighborhood, for example, Preservation of Affordable Housing, Inc. (POAH) is undertaking a significant community revitalization effort. Long an emblem of the community's distress and a magnet for crime, Grove Parc is being transformed to a positive influence for community improvement. This is being enabled by a HUD Choice Neighborhoods grant and willingness by HUD to grant unusual flexibility to move a portion of project-based assistance to new locations. This allows POAH to replace obsolete apartments and reduce both the housing density and the concentration of extremely low-income families with the goal of reducing crime and attracting more businesses to the neighborhood. In another case of rare HUD flexibility to solve a high-profile challenge, the Community Builders is preserving needed rental subsidies by relocating Charlesview Apartments in Allston, Massachusetts, which otherwise faced termination of the assistance contract triggered by the conversion of the property to a non-housing use. Based on the clear benefits of these and other uses of flexibility by strong, mission-oriented owners, we have urged HUD to experiment with broadening the criteria for using this strategy and easing the approval process.

Improve service delivery through greater reliance on high-performing partners

Of the approximately 23,000 privately owned, HUD-assisted properties, many are currently held by owners with very limited capacity. Many owners — large and small, for-profit and not-for-profit — are stellar performers, but too many cannot cope with the complexity of modern property management, much less recapitalization, of older properties. Many properties are poorly managed or deteriorating, and affordability is at risk of loss either through conversion to non-affordable uses in strong markets or blight in weaker markets. Better results for residents can be achieved by facilitating transfer of such properties over time to experienced owners with a commitment to high quality and long-term affordability.

A delivery system with a greater emphasis on strong performers could shift administrative focus away from avoiding failure and toward rewarding high performance. Owners with strong and consistent performance should be empowered to achieve greater efficiency and impact and held accountable for results. Their capacity and performance should be assessed periodically, not for each transaction in which they engage but at the enterprise level. By relying more on strong partners for reliable execution, market-based rents for economic discipline, long-term affordability restrictions to avoid speculation in the underlying real estate, and resident outcome evaluations, the government could reduce its reliance on regulation to overcome flaws in the delivery system.

HUD can take other steps to encourage strong performers. For example, HUD's current process for screening out owners with a history of noncompliance imposes an unproductive paperwork burden on both HUD staff and other program participants, who must undergo detailed review of each transaction affecting each property, even when they have recently completed reviews for other properties. Less frequent review of consistently strong owners and properties and greater scrutiny of higher risk projects and transfers would reduce cost and improve effectiveness.

Additionally, HUD field offices should focus on areas of expertise rather than attempting to use reduced staff to respond to all types of issues within a defined geography. Specialization would improve capacity and consistency and reduce administrative costs. HUD should also assign program staff to coordinate all HUD-related issues with large multi-jurisdictional owners, rather than leaving the owner to try to resolve issues based on the varying views of staff in local offices.

Finally, HUD should build on its successful efforts to adopt common applications, uniform inspections, and other program simplifications in cooperation with state and local governments. Over-reliance on inspections and audits is not only burdensome for HUD and its partners, but it is also outdated as an asset management tool. HUD has already begun working on identifying reliable early indicators of whether a property is at risk of distress or delinquency using standard industry indicators such as contributions to reserves and vacancy levels. As HUD identifies more reliable indicators it should reduce duplicative compliance reviews. It also needs to expand early interventions on troubled properties so that existing owners have an opportunity to reverse negative trends, and to allow HUD to take steps to replace underperforming owners and managers before properties slide into irreparable disrepair.

Next Steps

Current budget constraints provide significant pressure to improve program efficiencies and effectiveness and create an opportunity to make changes in program structures that have proven too difficult in normal circumstances. This environment has led to many recommendations for change in HUD programs—including several similar to ours offered by the Housing Commission sponsored by the Bipartisan Policy Center.

Over the last four years HUD has taken major strides in improving policy guidance and program execution. Now, with much of the policy work done and a seasoned leadership team at headquarters, it is time to pivot to ensuring consistent application of new policies while confronting some of the harder challenges of bureaucratic barnacles and misdirected incentives. With a greater focus on program outcomes, including better housing and improved residents' lives, HUD can harness the improved capacity of its best partners—and potentially generate some much-sought cost savings in the process. We are encouraged by the proposed Flexible Portfolio Demonstration in the FY 2014 budget and are hopeful that we can move to more efficient business practices in the next year. CI

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