Good Neighbors
San Diego
Housing Commission

REPORT

DATE ISSUED: November 10, 2006 REPORT NO: HCR 06-85

ATTENTION: Chair and Members of the Housing Commission
For the Agenda of November 17, 2006

SUBJECT: Re-positioning of the San Diego Housing Commission's Public Housing Portfolio

REQUESTED ACTION: Approve submission of an application to the U.S. Department of Housing & Urban Development (HUD) to opt out of the Public Housing program, replace the Public Housing operating subsidy and capital fund with Section 8 Tenant Based Rental Assistance, and expand the supply of affordable housing.

STAFF RECOMMENDATION: Authorize the Housing Commission's President/Chief Executive Officer to:

1. Apply to HUD to opt out of the Conventional Public Housing program (1,366 units) in order to re-position the housing portfolio away from dependency on federal subsidy to become self-sufficient and self-sustaining in perpetuity;
2. Apply for Section 8 Tenant Based Housing Choice Vouchers ("vouchers") for all Public Housing units approved by HUD for opt out to ensure continuing assistance for currently assisted residents,
3. Take all actions and execute all documents to implement this proposal.

SUMMARY: The federal subsidy to operate and maintain public housing is not only decreasing but becoming operationally restrictive and inefficient. As a solution, the Housing Commission is recommending opting out of the Public Housing program and re-positioning its housing portfolio, while continuing to serve all of its current Public Housing residents. Should the application to opt out of the Public Housing program be approved by HUD, current residents would be awarded Section 8 Tenant Based Housing Choice Vouchers, which they could use to remain in their current home or to move to any other rental property that accepts Section 8 vouchers. Current residents would not be required to relocate. As residents move through attrition, the Housing Commission's existing Public Housing portfolio (1,366 units) would become available at a varying range of affordable rents to low income households earning no greater than 80% Area Median Income (AMI) ($55,200 annual income for a family of four). The revenues realized from this operating model could be leveraged to build or purchase other developments thereby increasing the inventory of affordable housing throughout San Diego. Newly developed units could be rented at a range of incomes, including market rents, providing an opportunity to expand workforce housing. Any new housing provided through this leveraging program would be subject to subsequent Housing Commission and Housing Authority approval. It is estimated that this transition would take at least five years to complete.

BACKGROUND: Conventional Public Housing is a federally funded program whereby the federal government paid development costs for local public housing agencies and subsequently regulates use of the locally owned housing stock. When the Conventional Public Housing program was established in 1937, low income households paid a fixed, lower-than-market rent to housing authorities that used the rent payments to operate and maintain the housing sites. In 1969, Congress approved the Brooke Amendment to the Housing Act of 1937, which capped a household's rent liability at 25% of adjusted income (increased to 30% of adjusted income over a period of years). Each household pays an amount affordable to their circumstances. Following enactment of Brooke, housing authorities did not receive sufficient rental income to continue to maintain the public housing properties in a decent, safe manner. Congress then authorized and appropriated funding for the Operating Subsidy, and the Department of Housing & Urban Development (HUD) developed a formula that has been used to allocate the Operating Subsidy to housing authorities. In return, housing authorities were required operate public housing sites in compliance with a very specific set of regulations that governed eligibility, maintenance and financial standards, accounting methods, and day-to-day operations of the properties. Because HUD rules do not allow projects to accommodate reserve funds for future major systems repairs, Congress also appropriates a separate Capital Fund for such repairs.

The Quality Housing & Work Responsibility Act of 1998 (QHWRA) significantly amended the 1937 Act to require that HUD develop a more fair method of allocating the subsidy to housing authorities. Following a report by the Harvard Business School on the costs of operating public housing sites, HUD recommended – and Congress approved – a new subsidy calculation.

The "old" calculation was meant to pay the difference between the rent collected and the cost of services – up to a specific dollar level – called the Annual Expense Level. That number was adjusted for inflation every few years, but has been used since the early years of the program.

The "new" calculation, to be used to determine the subsidy starting with calendar year 2007, considers several drivers, co-efficients and add-ons, based on what the Harvard study indicated it <u>should</u> cost to operate a public housing site.

Finally, beginning in calendar year 2007, housing authorities are required to change the way their Public Housing programs are operated. Agencies must restructure public housing operations to meet Project Based/Asset Management requirements established by HUD. Under this model, only direct costs can be paid by funds available to public housing sites; other costs of operating the program must be paid from two fees – the property management fee and the asset management fee. Both fees are based on HUD schedules. The primary difficulty under this model is the lack of flexibility to use funds available to the Housing Commission.

<u>DISCUSSION:</u> The Housing Commission, as detailed in its FY2006-2008 Business Plan, has committed to reducing its dependency on Federal subsidy and housing programs through asset development and enhancement of alternative financial resources.

The major strategies included in the FY2006 – 2008 Business Plan approved by the Housing Commission and Housing Authority on September 16, 2005 and November 1, 2005, respectively, are:

1. Further the Agency's Mission of Creating Affordable Housing Opportunities for Low and Moderate Income Families, Seniors and Person with Disabilities
2. Increase State and Local Revenue Sources to Relieve Financial Dependency on the Federal Government for Affordable Housing
3. Establish the Housing Commission as a National Model of Efficiency
4. Provide Policy and Public Education Leadership Regarding Affordable Housing

In support of these strategies, the Housing Commission is proposing to take innovative actions to reduce reliance on HUD for funding to operate the current portfolio of Public Housing units. These actions include adopting private sector methods in the leveraging of equity and the development of mixed income communities that will result in more housing opportunities for San Diego's moderate and low income families.

LOOMING FINANCIAL CRISIS

The Housing Commission owns 1,366 Public Housing units located at 151 sites scattered throughout the City of San Diego. Currently, none of the existing properties carries any debt. A Deed of Trust granted in favor of HUD dictates the occupancy requirements and use of the properties. Occupancy is restricted to tenants who earn no greater than 80% of Area Median Income (AMI) ($55,200 annual income for a family of four) with no more than 30% of their income going towards their total housing costs. At least 40% of residents must have extremely low incomes (up to 30% AMI). Currently, the average household income of public housing residents is $17,880 and the average rent payment is $335.64.

The current Operating Subsidy provides funding to housing authorities in a series of inflexible streams: one for operating expenses, one for capital expenses and one through the competitive grant process that allows the Housing Commission to provide resident programs. Over the past several years, the amount of funding appropriated for the Operating Subsidy has decreased, and housing authorities have had to cut back on services and/or upkeep of properties to stay within the revenue available.

The Housing Commission's FY2006 Operating Subsidy of $2,349,000 is at 88% of its FY02 level. The FY06 Capital Subsidy of $1,896,000 is 79% of the FY02 level. This funding is insufficient to meet the ongoing needs of the Housing Commission's Public Housing program.

Attachment 1 depicts the decline in funding of the Operating Subsidy for Public Housing nationally for FY1999-2007. Attachment 2 depicts the diminishing Capital Subsidy for Public Housing nationally for FY1999-FY2007.

Additionally, under the new Project Based/Asset Management requirements, the Housing Commission will lose the economies of scale achieved over the years through centralization of operations (procurement, financial services, maintenance, eligibility review). The new model would not fund centralized functions or home office costs. While sufficient Operating Subsidy might be made available in the direct costs account, it could not be accessed to pay for centrally delivered services. <u>This will lead to a budget shortfall in excess of $1.5 million beginning in FY09 (July 2008).</u>

PROPOSAL

The Housing Commission is proposing to adopt a private sector methodology to achieve self sufficiency for its Public Housing portfolio. Current Public Housing residents would be provided Section 8 vouchers and could continue to stay at their current location or move to any other rental housing that accepts Section 8. Current residents would not be required to relocate. Sites currently designated for the elderly and/or disabled would retain that designation, and very low income ceilings would be no higher than the 50% AMI level ($24,150 for a family of one). This proposal offers the added benefit of providing tenants more flexibility in where they choose to live, since Public Housing units are situated in specific static locations, whereas Section 8 vouchers can be used throughout the community.

As residents move through attrition, the existing Public Housing portfolio (1,366 units) would become available at a varying range of affordable rents to low income households earning no greater than 80% Area Median Income (AMI) ($55,200 annual income for a family of four). This ultimately doubles the number of families assisted through this proposal (1,366 new voucher holders, plus 1,366 affordable former Public Housing units).

Under the proposed model, federal Operating and Capital Subsidies would be given up in favor of converting the properties into Housing Commission-owned, mixed income communities that are revenue self-sufficient. Under Public Housing, each tenant pays a different amount, which makes the Housing Commission dependent on HUD to make up the difference. Under the proposed model, the revenue stream would be fixed with affordable rents (but higher than Public Housing rents), predictable and sufficient to operate the housing responsibly. In addition, cash flow would support borrowing against the Public Housing portfolio to build or acquire additional rental housing.

By borrowing against the Public Housing portfolio, the Housing Commission can create more rental housing, depending on the rent structure ultimately chosen for the existing public housing to be converted. (Lower rents means less borrowing potential; a balance between affordability and additional housing opportunities will be sought.) Using very conservative assumptions, at least 350 new units could be created through a combination of acquisition and new construction. The tenant mix of the portfolio would be more reflective of the income diversity of the City, representing families from the very low income bracket through middle class working families.

ACTION PLAN

If approved by the Housing Commission and Housing Authority, an application to opt out of the Public Housing program would be submitted to HUD. HUD typically takes a year to evaluate such a proposal, often seeking additional information. Once the application is approved, the Housing Commission would apply for Section 8 vouchers. It may take at least five years to receive enough vouchers to transition all Public Housing residents to the Section 8 program. It is possible that vouchers cease to be available midway through the conversion, leaving the Housing Commission with some public housing and some non-public housing units.

As vouchers are awarded, selected properties would convert to the new rent structure. Proposals for new housing through acquisition or new construction would be brought through the normal project review process to the Housing Commission and Housing Authority for approval, as would any proposed borrowing secured by units released from the HUD Public Housing program. This is a long-term program, to be implemented over many years.

<u>FISCAL CONSIDERATIONS:</u> The source of funding for housing management and subsequent development would come entirely from rental income of the properties, leveraging that rental income with equity from private investors, and loans solely supported from the income generated from the rental housing stock. No City of San Diego funds will be involved.

PREVIOUS COUNCIL and/or COMMITTEE ACTION: The FY2006 – 2008 Business Plan approved by the Housing Commission and Housing Authority on September 16th and November 1, 2005, respectively.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS: Outreach efforts included presentations and discussions at Resident Advisory Board meetings and local community meetings in the north and south areas of the City. A significant majority of residents attending the meetings have been in favor of the proposal; a few persons expressed concern that they would be forced to move from their current public housing unit (staff has explained that all residents could remain in current units if they chose). Meetings have also been held with the San Diego Organizing Project and San Diego Housing Federation.

ENVIRONMENTAL REVIEW: On October 12, 2006, the City of San Diego, as the Responsible Entity, issued a Determination of Exemption for this project pursuant to the applicable provisions of the National Environmental Policy Act (NEPA), 24CFR Part 58, Section 58.34(a)(3). In addition the City, as lead agency under the California Environment Quality Act (CEQA), issued a Determination of Environmental Exemption for this activity on October 9, 2006, pursuant to section 15060(c)(3) of the CEQA guidelines.

KEY STAKEHOLDERS & PROJECTED IMPACTS: The first phase of the proposal, opting out of the Public Housing program, would not cause displacement of current Public Housing residents. Any future acquisition or development of rental housing by the Housing Commission would be a separate action and would address all required reviews and processes.

Respectfully submitted,

Signature on File
With Original Document

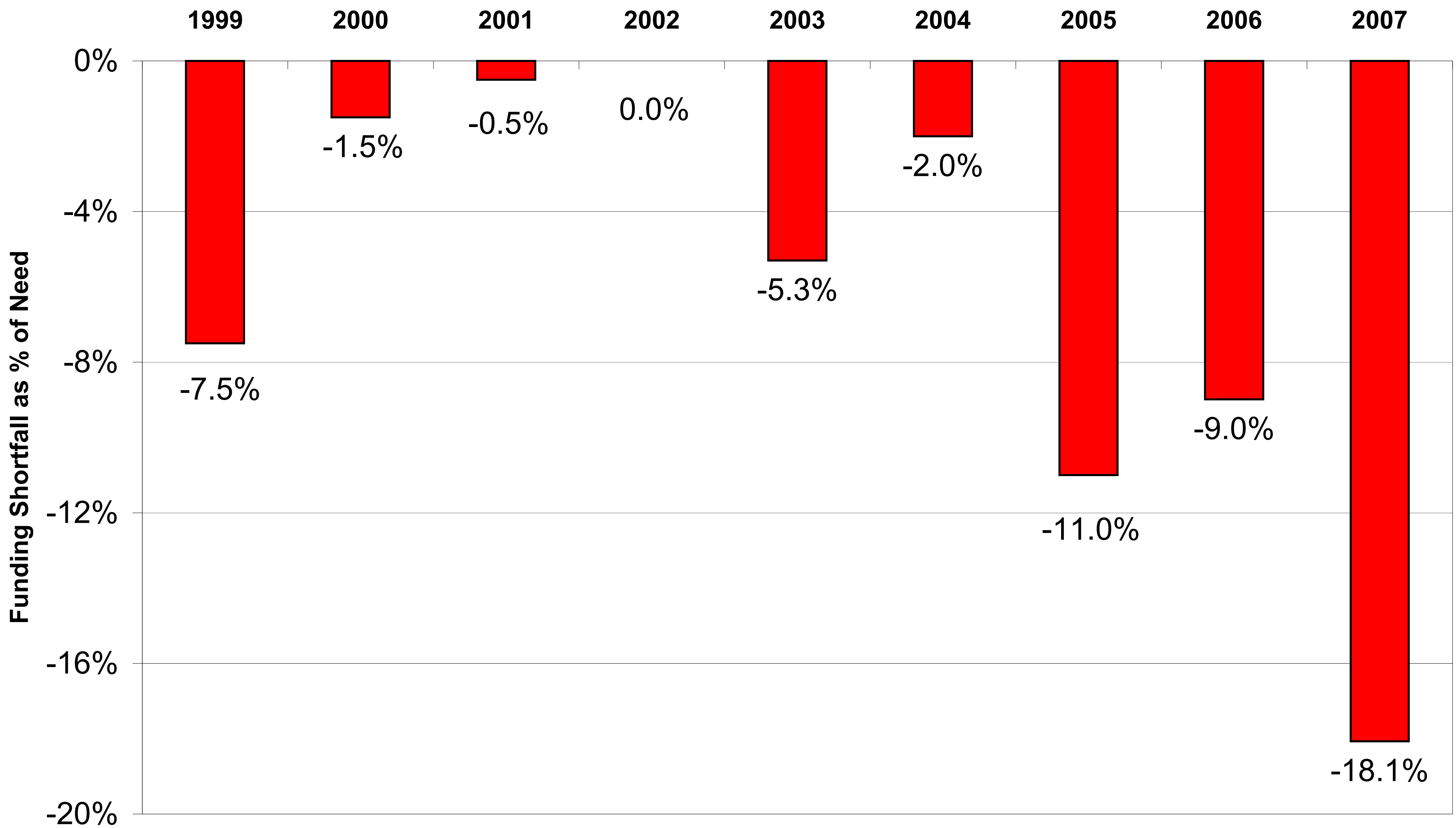
Steven Snyder
Director, Facilities

Approved by,

Elizabeth C. Morris
President & Chief Executive Officer

Attachment(s):
1) Graph Depicting the Decline Nationally in Operating Funds for PH
2) Graph Depicting the Diminishing Capital Subsidy of the National PH Stock for FY1999-FY2007

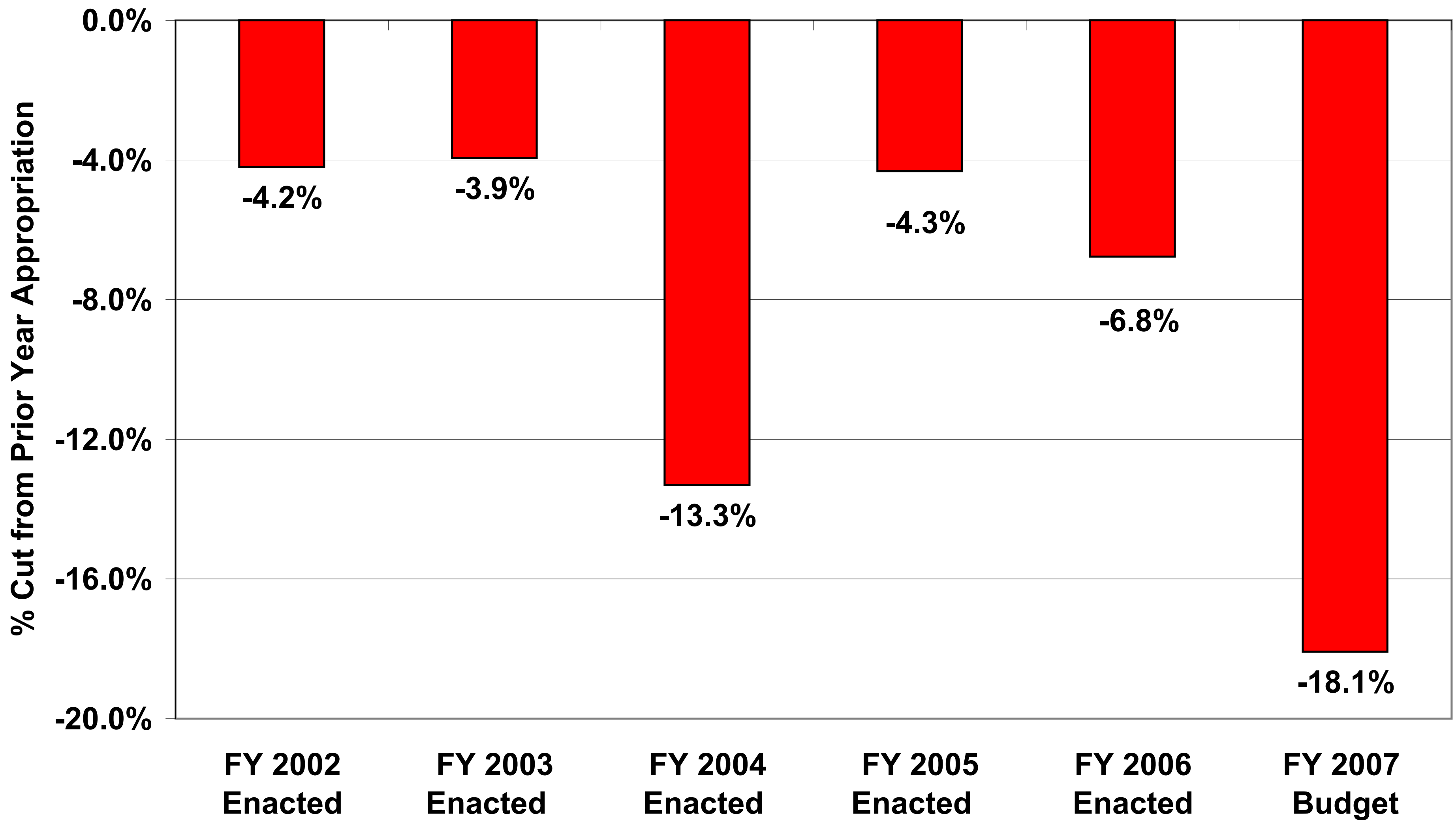
Public Housing Operating Subsidy
Funding Falling Short of Need
FY 1999 - FY 2007*



* FY 2007 = Administration Request, all other years enacted.

Public Housing Capital Investment Reduced

Change in Total Capital Funding, FY 2002 - FY 2007



Total Public Housing Capital and HOPE VI funding. FY 2007 = President's Request; all others = enacted. FY 2007 Budget includes $99 M rescission of FY 2006 HOPE VI funding.