

Privatization of Public Housing Projects Using Section 123 of the Housing and Community Development Act of 1987

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Recent legislation allows public housing projects to be sold to the tenants. This article describes the requirements of this process, and factors which must be taken into consideration in assessing the feasibility of a sale. The author presents two case studies of privatization of existing public housing projects. He describes how their purchase and rehabilitation are being financed, and points out that educational and social issues must also be addressed in order to ensure long-term economic viability for such conversions.

Introduction

A significant portion of the nation's public housing is now over forty years old. A great many of these older projects have deteriorated to the point where renovation will not suffice to restore the buildings to decent, safe, and sanitary housing. Apathy, neglect, drugs, unemployment, and other factors are so much a part of the public housing problem that radical new approaches are necessary.

Recognizing this, Congress and the Department of Housing and Urban Development (HUD) enacted legislation in 1987 which would permit public housing residents to purchase their projects from the government. Residents would take complete control over the renovations and financial management of the property. They would have total responsibility for setting and maintaining self-sufficiency goals, determining their own destiny, and ultimately making the project a vibrant community.

The process of "privatization" was recently given substantial support through the establishment of an Office of Resident Initiatives within HUD's Office of Public Housing. The Office of Resident Initiatives is encouraging tenant groups in scores of projects nationwide to participate in this movement.

As of fall 1989, applications for purchase have been filed by tenant groups in two large public housing projects in Washington, DC and St. Louis, Missouri. Because public housing projects are administered locally, no nationwide statistics are available as to the number of projects currently under resident management. Nevertheless, it is anticipated that as many as a dozen large projects, in addition to numerous smaller ones, will apply for privatization each year as the program gains momentum.

In order to qualify for purchasing projects under Section 123, residents must be organized as a not-for-profit Resident Management Corporation (RMC). As the RMC, residents must have served as the management agent for

the project under contract with the Public Housing Authority (PHA) for at least three years.

As part of the overall requirements of sale, the PHA must certify that it will replace all units sold to an RMC within thirty months, either through development of new units or modernization of vacant units by the PHA; or, through acquisition of existing privately owned units by the RMC to be operated as rental housing using tenant income and rent limitations comparable to those for public housing.

Before a sale can be effected, there are numerous conditions that Section 123 imposes on the property and parties involved. These include replacement and resale rules; and livability, affordability and eligibility considerations. This article focuses on the difficult question of how to finance such sales.

Although HUD administers the overall public housing program, individual public housing projects are actually supervised by local PHAs. Section 123 specifies that the PHA must negotiate with any qualified RMC that wishes to purchase a project. Once the local PHA and the RMC have tentatively agreed on a purchase price, HUD must approve the deal. HUD must take into account the property's fair market value, and the ability of the residents to purchase and maintain it. If a project meets these review criteria, HUD must approve the sale.

Once an agreement is finalized, the RMC may freely sell individual units to project residents or other qualified low-income families residing in or waiting for public housing. However, the proceeds from sales are to be retained by the PHA for the express purpose of increasing the number of public housing units available for occupancy.

The initial privatization of such projects is but the first step in a conversion process whose goal is to provide homeownership opportunity to public housing residents. Section 123 permits ownership to be of any form or arrangement, including limited dividend cooperative, condominium, fee simple, or shared appreciation. In a limited

dividend cooperative the project is jointly owned by the residents, analogous to the way a corporation is jointly owned by shareholders. Residents own a share of the project and pay rent to the RMC. Residents may freely sell their share in the project and move out; however, part of the proceeds from the sale will revert to the co-op organization. In condominium ownership, each unit is individually owned by the resident. Residents pay dues to an owners' association for general maintenance of commonly owned areas and exterior building maintenance. Neither fee simple ownership nor shared appreciation have yet been tried in public housing projects.

Regardless of which form of ownership is adopted, planners and other technical assistance providers must ensure that the RMC will have sufficient resources at its disposal to operate the project.

Case Studies

In the fall of 1988, technical assistance contracts were provided by HUD to the National Center for Neighborhood Enterprise (NCNE) in Washington, DC to help with the privatization of two public housing projects: the 464-unit Kenilworth-Parkside Apartments in Washington, DC and the 485-unit Carr Square Village Apartments in St. Louis, Missouri.

The technical considerations of privatizing the first two public housing projects were so great that three subcontractors were engaged to augment NCNE staff. The real estate consulting firm of Dennis Eisen & Associates conducted a detailed feasibility analysis and prepared the economic projections. A second real estate consultant, MPC & Associates, drafted the disposition application and numerous other forms. Paul Pryde, an economic development consultant, assisted with each project's self-sufficiency plans. The law firm of Arnold & Porter drafted the legal agreements and other formal documents.

It has taken years for housing advocates to sell the concept of privatization to the Administration and Congress. Once the law was finally enacted--as part of the Housing and Community Act of 1987--many more months of work were needed to bring the parties in the first actual sale to the negotiation and contract table. The purpose of this paper is to describe a few aspects of the process to date for the above-mentioned projects, namely, the setting of the purchase price, the sources of construction funding, the investigation of overall economic feasibility, and the elements of the self-sufficiency plan.

Purchase Price

In accordance with Section 123, fair market value is one of the principal factors considered in setting the purchase

price of a project. If this had been the only factor, the purchase price of the two properties would have been in the millions of dollars. At Kenilworth-Parkside, estimates of reasonable tenant contributions (at 30 percent of income) came to about \$1.35 million with current operating expenses of \$1.72 million, resulting in an anticipated shortfall of \$370,000 per year. At Carr Square Village, the estimate of tenant contributions came to just over \$1 million with operating expenses of \$1.25 million, resulting in a projected shortfall of \$250,000 per year. This meant that the residents could not afford to cover the operating expenses of the projects. The additional assumption of a mortgage was naturally out of the question. Therefore, the final negotiated price in each instance was eventually set at one dollar.

Construction Funding

Both Kenilworth-Parkside and Carr Square Village required extensive rehabilitation to bring the units up to proper condition. The funds to do this came from two vastly different sources. At Kenilworth-Parkside, \$23 million in funds for modernization were provided by HUD through a Comprehensive Improvement Assistance Program (CIAP) grant. At Carr Square Village, the \$29.5 million needed for modernization will come from a variety of sources, including borrowed funds from the private sector and the sale of tax credits to corporate investors. Only a small portion of the funds were initially provided through private foundation or government grants. Because of the private sector involvement, the Carr Square Village endeavor will most likely be organized as a joint venture between the RMC, developer, and corporate investors.

Economic Feasibility

Even though the projects are being sold at essentially zero cost, residents will not be in a position to carry them financially until their average incomes have increased. This will be facilitated through concentrated job training and other economic development activities. There will be a need for heavy ongoing post-sale subsidies to replace the annual government subsidies which were previously used to close the gap between revenue and operating expenses from when the projects were operated as public housing. Moreover, there is the additional expense of debt service payments on the mortgage(s) used to rehabilitate Carr Square Village.

The consultants used detailed information--Section 8 fair market rents, utility allowances, operating expenses, mortgage payments, overall tenant contributions--to determine the future level of subsidies needed for each site

once modernization is completed.

A computer model was developed to simulate the long-term economic operation (two or more decades from the day of sale) of a public housing project. By varying the depth and extent of Section 8 subsidies, this model made it possible to (1) determine the overall level of post-sale financial assistance necessary to provide enough net operating income to support mortgage payments on any funds borrowed, and (2) determine the necessary cash flow each

year to create operating reserves in anticipation of the expiration date of Section 8 subsidies. With this information, the key issue from an economic feasibility standpoint became whether the projected revenues from tenant contributions and investment income (from the operating reserve fund) would cover operating deficits in perpetuity.

Since mostly borrowed funds will be used to modernize Carr Square Village, the model predicted a post-sale subsidy period of fifteen years. During this time, Section 8

A Checklist for Planners

The article describes four elements of the privatization process--purchase price, construction funding, economic feasibility, and self-sufficiency plan--which are only part of the lengthy, complex path towards ultimate homeownership for housing residents.

The following checklist provides a more complete view of the steps, activities, and considerations that must be taken into account when providing technical assistance to public housing projects and their Resident Management Corporations.

I. Preliminary Qualifications for Privatization

A. Qualification of Resident Management Corporation

1. Must be incorporated
2. Must be resident controlled
3. Must have a management contract with the PHA
4. Must have managed the property for at least 3 years
5. Must have appropriate management and fiscal procedures and controls
6. Should have secured tax-exempt status to assist in securing foundation grants.

B. Required Project Financial and Descriptive Data

1. Will all or only a part of the project be purchased?
2. Does it meet livability standards?
3. What rehab or modernization is needed to meet standards?
4. What is current operating income from tenants and the ACC?
5. What are current operating costs?
6. Encumbrances and liens?

C. Description of Current Supporting Programs

1. Day care
2. Job training and placement
3. Elderly services
4. Tutorial and youth services

II. Technical Assistance Studies Needed

A. Initial Feasibility Analysis

1. Demographic Survey
2. Revenue and operating expense projections
3. Debt service considerations
4. Rental subsidy and reserve fund projections
5. Overall economic forecast

B. Preliminary Economic Development Plan

C. Self-Sufficiency Plan

D. Application to PHA and HUD

E. Development and Financing

F. Initial Legal Work

G. Marketing Plan for Rehabilitated Units

H. Coordination with HUD and other agencies

III. Factors Involved in Completing Disposition Application

A. Meet Local Public Housing Authority Requirements

1. Meet requirements of HUD Disposition Handbook
2. Prepare replacement plan
3. Prepare relocation plan
4. Determine sale price
5. Hold public hearing

B. Establish Local Government Cooperation

1. Obtain Mayor's letter of support
2. Request phase-in or abatement of real estate taxes

C. Provide Assurances of RMC Competency

1. Economic development assurance
2. Management capability assurance

D. Identify Funding Sources For Rehab or Modernization

1. Federal programs (CIAP, etc.)
2. State and local government programs
3. Private sector sources

E. Identify Funding Sources For Operations

1. Section 8 (if requirements are met)
2. Income from reserves
3. Revenue from other operations
4. Foundation and government grants

certificates will be needed for all 485 units in the first five years; for 380 units in years six through ten; and for 260 units in years eleven through fifteen. No post-sale assistance is planned or anticipated beyond the fifteenth year.

Because the funds needed for the modernization of Kenilworth-Parkside are provided by HUD through a CIAP grant, the model showed that the particular combination of Section 8 certificates and vouchers would no longer be needed after the fifth year of operation.

Establishing Self-Sufficiency

A self-sufficiency plan, one of the most important supporting documents, must accompany the application for sale. It is a comprehensive, well-coordinated document containing plans for economic development, project rehabilitation, homeownership costs, resident participation, and project management.

F. Factors Determining Economic Feasibility

1. Adequacy of financing
2. Self-sufficiency schedule
3. Long-term economic forecasts

IV. HUD Functions

- A. Provide Technical Assistance Funds*
- B. Approve Sale Price*
- C. Approve Application at All Levels*
 1. Field office
 2. Regional office
 3. Headquarters
- D. Grant Section 8 Subsidies*
 1. Allocation of certificates and vouchers
 2. Waiver/adjustment of Fair Market Rent (FMR) limits
 3. Renewability pledge

V. Approve Contract of Sale

- A. Draft Document*
- B. Negotiate Terms*
- C. Ratify Final Document*

VI. Requirements for Joint Ventures with Outside Investors (if relevant)

- A. Agreements*
 1. Memorandum of Understanding between RMC and private sector partners
 2. Approval by HUD and PHA of joint venture
- B. Descriptions*
 1. Nature and form of partnership
 2. Duties, responsibilities and ownership
 3. Identification of outside/limited partners
 4. Intended sources of equity and debt capital
 5. Use and sale of tax credits

VII. Requirements for CIAP-Funded Projects (if relevant)

- A. Include Rehab Needs in PHA's 5-year Plan*
- B. Prepare Preliminary Application*
- C. Prepare Final Application*

VIII. Requirements for HUD Section 5(h) Co-ops (if relevant -- see legislation)

IX. Closing

- A. Conditions Required Preceding Closing*
 1. Financing obtained for rehab or modernization
 2. CIAP completed (if applicable)
 3. Contingencies removed
 4. All approvals obtained
- B. Transaction Procedures.*
 1. Earmark Section 8 assistance for recapture
 2. Phase out Annual Contributions Contract
- C. Steps for Transfer of Title*
 1. Title work and preparation of papers
 2. Settlement and recording

X. Economic Development Plan

- A. Develop detailed economic development plan*
- B. Develop coordinated implementation strategy*

XI. Homeownership

- A. Select Homeownership Form*
 1. Limited dividend co-op
 2. Leasing cooperative
 3. Condominium
 4. Other arrangements
- B. Provide Training Appropriate to Ownership Form*
- C. Plan Timing of Conversion*
 1. Must be synchronized with self-sufficiency and economic development plans
 2. Must arrange timing to meet legal restrictions to qualify for tax credits
- D. Plan for Sales to Individual Residents*
 1. Establish criteria for selecting purchasers
 2. Sales price of apartments or co-op shares
 3. Associated fees for training or membership
 4. Reimbursement of proceeds to the PHA
- E. Plan for Secondary and Subsequent Sales*
 1. Establish limitation on resale prices
 2. Develop equity sharing formulas

A self-sufficiency plan must include, for example, an economic development plan stating how the RMC should identify the type of job skills in demand in the surrounding metropolitan area; how and where residents can develop these skills; methods for job placement or small business start-ups; and how additional supporting programs such as day care and transportation can be funded and operated. The components of the economic development plan must be well-coordinated so that the self-sufficiency plan is implemented in a logical sequence. For example, employers and their needs must be identified before job training programs can be initiated. Otherwise, the effort will be largely wasted and the residents discouraged.

Furthermore, the self-sufficiency plan must show how the residents can become involved and participate in the overall privatization process in order to understand limited dividend cooperatives (or other forms of ownership), and the rights and responsibilities of ownership.

The self-sufficiency plan does not need to contain a great level of detail, but must convince local and federal officials that the RMC knows what to do, how to proceed, and has a firm set of benchmarks against which to measure progress in the path towards self-sufficiency.

Next Steps

It is anticipated that the Bush Administration will provide technical assistance funds permitting the purchase of five to ten public housing projects by their respective RMC each year. A technical manual, based on the Kenilworth-Parkside and Carr Square Village experience, will be developed to help make the process of "going private" more efficient for future RMCs.

The elements of the privatization process described in this article--purchase price, construction funding, economic

feasibility, and the self-sufficiency plan--are just four of the steps in a lengthy, complex path towards ultimate homeownership for public housing residents. Consult the checklist included with this article to better understand the process for privatizing public housing projects.

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