

## The Challenges Facing Public Housing Authorities in a Brave New World

Roberto G. Quercia  
*University of North Carolina at Chapel Hill*

George C. Galster  
*Wayne State University*

### *Abstract*

Public housing authorities (PHAs) are entering a brave new world. Major proposed changes to the public housing program will force PHAs to compete with private sector providers for tenants. To succeed, they will have to act more like entrepreneurial market participants: to change their management practices, the types of tenants they house, and the kinds of developments they operate, and to attract private capital for the development and operation of public-private public housing ventures.

PHAs must confront the challenges of transformation while pursuing four mutually conflicting goals: housing the neediest, achieving diversity of tenantry, cross-subsidizing by attracting unsubsidized tenants, and attracting private capital. Success, or even survival, may require sacrificing one or more of these goals. Whether PHAs can increase housing production to such an extent that they can provide sufficient housing for the neediest while fulfilling the other goals as well remains unclear.

**Keywords:** Low-income housing; Policy; Markets

### **Introduction**

This article focuses on the challenges and constraints facing public housing authorities (PHAs) in light of the new realities of U.S. federal housing policy. In an environment of increasing government fiscal restraint, proposals have been made to expose PHAs to the discipline of the market. For instance, tenant-based assistance proposed for current PHA tenants is expected to force PHAs to compete for these tenants with more efficient private sector providers. At the extreme, it is not unrealistic to imagine a future in which PHAs will receive little support through direct subsidies, public housing units will be built through public-private ventures, and subsidies will be mostly tenant based.

The ability of PHAs to transform themselves, however, must be viewed in the larger context of PHAs' goals. PHAs were never meant to be like private sector providers. In fact, they were created so as not to compete with private sector developers. They were to house families who were temporarily out of work until they got back on their feet. For complex reasons, this purpose has changed over time to providing housing for the elderly, the frail and handicapped, and families with very low incomes, no employment, and little prospect for improvement. If anything, these changes have highlighted PHAs' nonmarket, social purpose. Whether such a purpose can be maintained in the emerging policy regime is a key theme we explore below.

With this reality in mind, we reflect on the extent to which public housing developments can be transformed to operate with the efficiency of private sector projects and to attract private capital. Although thus far most of the policy debate has focused on the matter of constraints that impede PHAs in achieving various goals, the challenges are more serious and fundamental. We identify four PHA goals, typically in conflict and subject to independent constraints, which we refer to as PHAs' "constrained quadrilemma." We believe that these mutually conflicting goals will inherently hamstring PHAs' ability to transform themselves successfully, even if policies succeed in removing other constraints. Instead, PHAs must rethink and reform some of their most fundamental goals.<sup>1</sup>

The remainder of the article is divided into six sections. The first presents a brief history of public housing, and the second describes private sector involvement in the provision of affordable housing. Both sections emphasize contrasting the traditional motives, financial structures, characteristics of housing stock and tenants, and management approaches of both PHA and private developments. The third section describes the proposed legislative and regulatory changes. The fourth describes what PHAs are doing to adapt to the emerging public policy reality. The fifth identifies goals that PHAs are being challenged to pursue during the transformation and discusses constraints on attainment of those goals. Even though innovative policy changes might potentially ease the constraints, because the goals are in conflict, PHAs' ability to transform themselves to achieve these goals while retaining their traditional social purpose will be

---

<sup>1</sup> In our discussion, we take the public housing system as given. We do not question whether there is a need for government intervention in housing in general, or whether we need public housing in particular. These are important questions, but an in-depth treatment of these questions would require a different paper.

severely limited. The sixth section examines ways in which conflicting goals could be addressed. In the long run, it may be possible for some PHAs to outgrow the problem of conflicting goals, but to date, we find little indication that PHAs could develop the number of units that would be needed to do so. In the last section, we summarize the material presented and derive implications for reformulation of goals for PHAs.

## **Brief history of public housing in the United States**

The American public housing program was created by the Housing Act of 1937. Consistent with its New Deal roots, public housing was never intended to be a low-income housing program per se, but focused on the creation of employment opportunities and the elimination of blighted urban and rural areas. The 1937 act saw public housing as one more element in the fight against the nation's macroeconomic ills.

After World War II, the public housing program was reconsidered as part of the deliberations culminating in the Housing Act of 1949. Although the act focused attention on the problem of housing shortages, the public housing program was included, again, under the urban redevelopment provisions of the act. PHAs were required to provide public housing units for households displaced by urban renewal efforts. Overall, however, the scale of public housing programs remained modest under the 1949 act. The program was expanded in the 1960s and early 1970s. Today, 3,400 PHAs operate 1.3 million public housing units (Cisneros 1996). The public housing legislation has been amended many times during the past 50 years, but the mixed set of goals and objectives remains (U.S. Department of Housing and Urban Development [HUD] 1979).

The demographics of public housing tenants have changed dramatically over time. Unlike the original program, which was aimed at the working poor, the 1949 act limited public housing to very low income families. (The families lost their right to public housing if their incomes rose above an established limit.) Today, as a result of numerous factors, most family developments are occupied by African Americans, and most African Americans live in predominantly black developments (Goering and Coulibaly 1989). Data for 1977 show that the overall level of black-white segregation in PHAs in the 60 largest metropolitan statistical areas was high, with dissimilarity indices of 0.60 or greater in most cases (Bickford and Massey 1991). The suboptimal location of these projects was due in large part to suburban

municipalities' refusal to allow PHAs to be constituted in their jurisdictions.

The demographics of public housing tenants changed with the passage of the Brooke amendments of 1969, 1970, and 1971. The amendments limited the amount of rent residents were required to pay by restricting the definition of income and setting maximum rents at one-quarter of a household's income. This requirement was raised to 30 percent of household income in the early 1980s. Around that time, the federal government established preferences for housing assistance among those meeting the basic income qualifications. Preference was given to those with housing costs above 50 percent of income, those living in severely substandard housing, and those involuntarily displaced from housing (Nelson and Khadduri 1992). Typically, households likely to meet these conditions have incomes below 35 percent of the area median income (AMI) (HUD 1991). The effects of these eligibility and preference changes have been a decrease in socioeconomic diversity in PHA developments and a decrease in the amount of rent PHAs can collect from their tenants.

The dramatic spatial transformation of America's urban landscape during the past four decades has also had an impact on PHAs. The movement of middle-class households and employment opportunities to the metropolitan periphery and beyond left many public housing tenants in inner-city areas with few opportunities for socioeconomic advancement. Moreover, public housing developments found themselves in neighborhoods with ever greater concentrations of poverty and the attendant social consequences (Massey and Denton 1993; Wilson 1987). Thus, to a large extent, the ability to transform many PHA developments into competitive developments is tied to the broader fortunes of the inner-city areas where they are located—fortunes that are beyond PHAs' control.

Since its inception, the financing of public housing has been a complex process.<sup>2</sup> Originally, the federal government was committed to pay the capital costs (buying land and building the units), and PHAs were expected to cover operating costs from their tenants' rental payments on a pay-as-you-go basis. Rents were expected to remain affordable through contributions from local governments in the form of reduced payments in lieu of property taxes (Aaron 1972). Typically, a PHA acts as a developer. It buys the site, employs its own design team or contracts

---

<sup>2</sup> Aaron (1972) discusses this and other topics related to the public housing system.

out the function, and takes competitive bids for construction. Immediately before unit construction is completed, the short-term loans used to meet planning and construction costs are paid off by the sale of short-term (or long-term) PHA serial bonds. The federal government commits itself to repay these bonds in equal annual installments until the debt is retired (HUD 1979).

The original financing scheme for public housing has been complicated by changes in the program over time. First, operating subsidies were formally and fully established in 1970 to make up the difference between PHAs' rental income and operating expenses.<sup>3</sup> In 1975, HUD established a formula approach (the Performance Funding System) to estimate operating subsidies to a given PHA on a PHA-wide average basis, not a project-by-project basis. Thus, the estimates do not reflect the operating subsidy needs of any given development. Second, the federal government has expanded its original role to assume responsibility for paying for modernization (the Comprehensive Grant Program) and other PHA costs (e.g., Urban Revitalization Demonstration program costs).<sup>4</sup> Overall, these changes have made PHAs increasingly dependent on federal support for their survival.

Management problems have also been a source of concern for PHAs. HUD classifies PHAs as troubled if they score less than 60 out of a possible 100 in its management evaluation system (Public Housing Management Assessment Program [PHMAP] scores) (Cisneros 1996). The scoring is based on the PHAs' ability to (1) perform modernization, maintenance, inspections, and other tasks to maintain the overall physical conditions of buildings; (2) collect rents; (3) turn over vacant units for occupancy; and (4) work with residents to provide programs, opportunities, and safe and drug-free environments. Of the 40 largest PHAs in the nation, 20 percent are considered troubled (Cisneros 1996).

---

<sup>3</sup> Since the mid-1960s, this gap has escalated significantly because of rising operating costs, lagging tenant incomes, and weak management in many PHAs.

<sup>4</sup> In 1992, ICF estimated that modernization needs in public housing totaled \$29 billion. Annual funding for modernization improvements under the Comprehensive Improvement Assistance Program and the Comprehensive Grant Program is between \$2 and \$3 billion. In addition, more than \$2 billion has been appropriated for the Home Ownership for People Everywhere (HOPE) VI—Urban Revitalization Demonstration program since fiscal year 1993. At least 80 percent of the HOPE VI funds must be used for capital costs for physical improvements (including modernization), certificates for replacement housing, and management improvements for the reconstructed housing (Epp 1996).

One of HUD's latest responses to the problems of troubled PHAs has been the Home Ownership for People Everywhere (HOPE) VI program. HOPE VI is a large-scale initiative that provides a number of competitively selected PHAs with the funding and flexibility to address the needs of public housing developments as well as to control where they are located. Activities in the program include funding for the capital costs of major reconstruction, rehabilitation, and other physical improvements; replacements for demolished public housing units; management improvements; planning and technical assistance; implementation of community service programs and supportive services; and the planning of such activities. Overall, the program has been designed to allow the greatest degree of flexibility to PHAs and to encourage creative solutions to PHAs' problems (HUD 1996a).

To summarize the above discussion, it is helpful to characterize PHAs today according to five key elements:

1. *Motives.* PHAs' central goal is to maximize the provision of affordable, decent-quality housing for the very poor and most desperate households (Spence 1993).
2. *Financial structure.* PHAs face large current financial demands for maintenance and modernization because their buildings are often old and obsolete. Moreover, concentrations of extremely poor tenants in PHA developments in concentrated-poverty neighborhoods may create destructive behavior that increases maintenance expenses. PHAs do not have the ability to adjust rents or control the quality of units in response to tenant demands or market pressures. If rents are not sufficient to cover costs, HUD provides more subsidy. Operating subsidies are accrued whether a unit is occupied or not, because the subsidy per unit is based on the average operating cost per unit across a PHA's entire stock, minus an individual tenant's rent due. The subsidy to PHAs is estimated as a function of the PHMAP score, which is an aggregate score calculated from ordinal and nominal categorical scores. Cost-effectiveness is not considered a criterion in estimating this score.
3. *Characteristics of the stock.* Units in large, big-city PHAs are likely to be in high-density, high-rise apartment complexes that were designed primarily on the basis of construction cost considerations and not livability (Epp and Lane 1992). The typical big-city PHA developments have locations that are inferior in terms of safety and opportunity. These areas also tend to have high concentrations of poor and minority

residents (National Commission on Severely Distressed Public Housing 1992). In smaller communities, in contrast, PHA units are likely to be in low-rise apartments or single-family developments. In most cases, these units provide safe housing in viable locations (HUD 1996a).

4. *Characteristics of the tenants.* PHAs serve very poor households. The average public housing tenant has an annual income of \$6,000, about 15 percent of AMI. Households in big-city public housing are likely to consist of unemployed single parents with children and to report incomes below 20 percent of AMI (Vale 1996). These, along with the elderly and the handicapped, are the households likely to meet the federal preferences for housing programs. As household income increases, tenants are required to pay higher rents according to the 30-percent-of-income rule.
5. *Management approach.* Current PHA management practices are defined mostly by federal regulations. These rules require evaluation of PHAs on the basis of their cost accounting, form processing, and adherence to procedures, not on their abilities as asset managers or their cost-effectiveness. For instance, rents are fixed at 30 percent of each individual tenant's income, without relation to quality of unit or location. Similarly, subsidies are not allocated on a unit-by-unit basis (or a project-by-project basis) but estimated as an average over the entire PHA stock. PHAs are not required to employ the concept of asset management for individual developments as part of a comprehensive strategic plan for overall PHA stock.

## **Provision of affordable housing through the private sector**

Most affordable housing in the United States, unlike that in many other industrialized countries, is provided by the private sector. Only about 1.3 million units out of an overall stock of 97 million are directly publicly owned (Sternlieb and Hughes 1991). Even in large metropolitan areas such as New York City and Boston, which have large numbers of state-assisted and federally assisted public housing units, PHAs operate only 6 to 7 percent of the housing stock. Moreover, most federally assisted housing is provided by the private sector (Sternlieb and Hughes 1991). This includes the housing provided to Section 8 certificate and voucher holders, the housing built with below-market-rate loans that restrict occupancy to low- and moderate-income

families, and the housing built through the low-income housing tax credit (LIHTC), among others. In the United Kingdom, by contrast, about a third of all units are owned and operated by local housing authorities (Whitehead 1994).

Historically, the main source of affordable housing in the United States has been the private sector process of supplying older housing known as “filtering.” As the private sector develops new units for higher-income households, the units previously occupied by these households are expected to become available to households with lower incomes—to filter down. In turn, the units vacated by this second group are expected to become available for households with still lower incomes, and so on. Eventually, these movements are expected to provide housing affordable to those with even the lowest incomes—albeit the older, less desirable stock. Whether units filter down and the rate at which that occurs depend on demand and supply considerations in various housing quality submarkets (Galster and Rothenberg 1991). In fact, there is some recent evidence that units are as likely to filter up as they are to filter down over time (HUD 1996b). This trend signals a decrease, not an increase, in the affordable housing stock as a result of filtering. Indeed, doubts as to the reliability and fairness of filtering as a mechanism of supplying affordable housing to the poor have motivated the creation of various programs to subsidize the construction of units targeted to the poor.

In the past, private sector developers of new rental housing could adjust two housing characteristics to make units affordable in the absence of public subsidies: Shelter density was maximized, and amenities were minimized (Listokin 1991). Unfortunately, this adjustment process often did not take into account considerations of health or livability, and newly built tenement slums resulted. This situation changed with the passage of minimum standard laws such as New York City’s tenement housing act in the 1870s. Despite these minimum standard requirements, pre-Depression private developers were still able to provide affordable housing at a profit, albeit in insufficient numbers, by adjusting density and amenities within legal limits.

After the 1920s, the private sector provision of affordable housing was affected by the nation’s economic ills. Housing construction and operating costs grew relative to the incomes of poor tenants. At the same time, health codes and other housing-related standards were being tightened, restricting the ability of the private sector to adjust density and amenities. The combination of these two factors curtailed the capacity of unsubsidized

low-income housing to meet investors' required rates of return. Since then, there has been a continuing need to subsidize the provision of affordable housing by private developers.

In the past four decades, the federal subsidies needed to attract private market participants to the provision of affordable housing have taken several forms. They have included the availability of financing at below-market interest rates (e.g., Section 236 and Section 221(d)(3) programs and Section 515 rural rental housing), funding for construction or substantial rehabilitation of units targeted to low-income households (e.g., Section 8), and tenant-based subsidies (e.g., Section 8 vouchers and certificates). There have also been a number of programs that offer great flexibility in the form the subsidy may take, depending on locally assessed needs and remedies, including the HOME program (Listokin 1991). Note that regardless of the form of subsidy, the households served by these initiatives have had higher incomes than the average public housing tenant, between 50 and 80 percent of AMI (HUD 1996b).

Subsidies for affordable rental housing can also be indirect. Two are worth noting. First, the insurance program of the Federal Housing Administration (FHA) was created to reduce lending risks during the Depression years. Over time, FHA has proved to be instrumental in developing affordable rental housing by itself or in combination with other government initiatives (e.g., the Section 236 rental program). FHA's multifamily program was terminated in the early 1990s because of financial difficulties, some resulting from poor management practices by private sector landlords. Second, tax incentives have also been used to attract private capital for affordable housing. For instance, tax rules have allowed developers to depreciate the value of their property in a period much shorter than its actual economic life. Similarly, under the "passive losses" rule, investors have been able to reduce their tax liability by deducting the losses incurred in their affordable housing investment from income from other sources.

Since the 1986 Tax Reform Act, however, the only tax incentive for the development of affordable housing has been the LIHTC program. This program provides a generous recapture of capital in the form of 10 years of tax credits (direct deductions from tax liabilities). To be eligible for LIHTC, a project must provide at least 20 percent of units to households with incomes at or below 50 percent of AMI, or 40 percent of units to households with incomes at or below 60 percent of AMI. LIHTC units must be reserved for the target group for 15 years. The typical LIHTC

project provides most units to households with incomes between 50 and 60 percent of median income (Wallace 1995). (As in the case of other subsidy forms, LIHTC projects serve households with incomes much higher than the average public housing tenant's.<sup>5</sup>) Because of the need to meet the rate of return required by investors, LIHTC units may be located in viable neighborhoods and managed with the efficiency common to other private sector rental units. It is also possible, however, that investors who are interested only in the tax credit benefits may assign little residual value to the property. In this case, both the quality of the location and the management may be marginal instead. Unfortunately, to our knowledge, no research-based evidence on this issue is available.

Typically, large private sector providers pursue an asset management approach to their stock. Because private sector tenants who receive Section 8 vouchers or certificates can take their business elsewhere, management practices are often responsive to these tenants' needs. This does not mean, of course, that there have not been problems with private sector management practices, especially when project-based subsidies were used. For instance, some small-scale, typically unprofessional, operators of affordable housing have had serious management problems (Stegman 1972; Sternlieb 1966).

In sum, the same five categories employed above can be used to characterize private sector provision of affordable housing:

1. *Motives.* Obviously, the central goal of private sector providers is to maximize profits or the rate of return on investment.
2. *Financial structure.* New developments cannot be constructed profitably and priced appropriately for low-income tenants without deep subsidies. The extent to which the for-profit sector can profitably provide affordable housing through filtering is also limited by operating costs relative to tenants' ability to pay. Subsidies have been needed to increase the private sector's rates of return to the point where it will participate in the provision of affordable housing. Private sector providers of affordable housing adapt their operations to the form of subsidy offered. The LIHTC is the mechanism most commonly used by the private sector to produce affordable housing. More than half the rental

---

<sup>5</sup> Wallace (1995) notes that only 28 percent of all LIHTC units, about one in four, serve households with incomes below 50 percent of AMI.

projects built in the United States in 1994 used the LIHTC program (Wallace 1995).

3. *Characteristics of the stock.* To our knowledge, there is no publicly available information about the characteristics of the affordable housing stock provided by private sector participants. In all likelihood, many older projects that have filtered down may today be in inferior locations, in terms of safety and economic opportunity for tenants. Some projects built with the use of below-market-rate financing, such as Section 236 and Section 221 projects, may also be in inferior locations. Unfortunately, the quality of the location of LIHTC projects is not known.
4. *Characteristics of the tenants.* The private sector seems to be adding affordable rental units for households with incomes between 50 and 80 percent of AMI. The typical household in a project developed under LIHTC—the most common subsidy mechanism used by developers—has an income between 50 and 60 percent of AMI, the threshold for tax credit eligibility. Unsubsidized affordable units are not necessarily occupied by low-income renters. For instance, in 1993, less than half of all extremely low rent units were either occupied by extremely low income renters or vacant (HUD 1996b).
5. *Management approach.* The for-profit sector has the economic incentive to adopt the most effective management practice, an asset management approach. To stay competitive, for-profit managers must be responsive to the needs of their tenants, who can take their business elsewhere, and to supply and demand considerations.

### **A brave new world: Applying private sector perspective to PHAs**

The exact characteristics of the new policy environment in which PHAs will operate in the future will depend on which of the proposed changes to the public housing program ultimately become law.

As of this writing, Congress is considering two pieces of legislation to overhaul the public housing system: HR 2 in the House and S 462 in the Senate. The House has passed HR 2, the Housing Opportunity and Responsibility Act of 1997, with support from both Republicans and Democrats. HR 2 would decontrol the

public housing system, repeal the 1937 law that established the program, and require greater community involvement by public housing residents. The Senate Banking, Housing, and Urban Affairs Committee approved its version of the bill (S 462), and the full Senate was expected to consider the legislation in the fall of 1997 (Cassata 1997).

HR 2 and S 462 call for the most ambitious overhaul of the public housing system to date. As passed by the House and summarized in Wells (1997), HR 2 would make these changes:

1. Repeal the 1937 United States Housing Act that created the public housing system.
2. Require able-bodied, unemployed adult residents of public housing (or of subsidized housing) to contribute at least eight hours per month of unspecified work within their communities.
3. Mandate that unemployed adult residents enter into a binding agreement with their PHAs to set a target date to move out of public housing.
4. Exempt from these requirements employed tenants as well as the elderly, the disabled, and those enrolled in education or job training programs.
5. Require each PHA to submit a five-year management plan, which would include information such as the locality's housing needs, the population served, methods of setting rents, efforts to encourage ownership, and capital improvement projects.
6. Require housing authorities to submit annual performance reports.
7. Require HUD to establish two funds to provide block grants to housing agencies to cover operation and capital expenditures.
8. Limit to 35 percent the number of new tenants whose earnings are 30 percent or less of AMI (50 percent of new tenants in the Senate bill).
9. Authorize PHAs to establish admission preferences based on local housing needs and priorities.

10. Give residents an annual choice of paying either 30 percent of their income or a (presumably lower) flat rent negotiated by the tenant and the housing officials.
11. Mandate a minimum monthly rent between \$25 and \$40, regardless of income.
12. Designate all or parts of a development for exclusive use of the elderly (age 65 or older), the disabled, or both. Allow the near-elderly (age 55 or older) to live in senior citizen developments.
13. Authorize the formation of resident counseling programs and the creation of resident management corporations that could assume control of housing authorities.
14. Require PHAs to design homeownership programs for the sale of public housing units to tenants.
15. Eliminate the requirement of one-for-one replacement of demolished units.
16. Allow termination of a lease if the tenant is convicted of a crime.
17. Establish a flexible block grant program that would allow jurisdictions such as cities and towns to apply to HUD for funds that would have otherwise gone to PHAs and to use the money to establish complementary or competing housing services.
18. Establish a board to set performance standards and accreditation for PHAs.
19. Require HUD to take over “chronically troubled” housing authorities within six months after the bill becomes law.

The Clinton administration has expressed support for many of these objectives and provisions and has proposed many similar regulatory changes. With regard to HR 2, however, the administration opposes the income eligibility changes proposed. It backs instead the existing law, which requires that 75 percent of public housing residents have earnings of 30 percent or less of AMI. The administration also opposes any minimum rent greater than \$25 and the creation of the evaluation and accreditation board. In addition, public housing officials have expressed reservations about two aspects of the bill: They oppose the rent reform (flat

rent option) and the provision that allows local governments to propose alternative programs for delivery of housing using funds that would have otherwise been provided to PHAs (among others). Thus, it is possible that many aspects of HR 2 will be enacted into law, although not precisely as passed by the House.

Aside from these likely legislative changes, approved and proposed HUD regulatory changes also include a shift to a tenant-based subsidy approach to public housing (HUD 1995). Under these changes, PHAs would be evaluated on their ability to attract and retain voucher holders or market-rate tenants. As part of this transformation, PHAs are asked to adopt a market-driven, development-based approach to asset management. In assessing the strengths and weaknesses of each property, PHAs will be required to assess the property on the basis of income, expense statements, capital, and operating reserves. For weak properties, PHAs will be asked to develop a market plan to justify any additional infusion of time, talent, and funds. Properties that cannot justify these additional resources are expected to be removed from the portfolio (Nutt-Powell 1995).

The need for PHAs to be more entrepreneurial is also at the heart of legislative reform proposed by the National Association of Housing and Redevelopment Officials (NAHRO). In collaboration with the Housing and Development Law Institute (HDLI), NAHRO has drafted model legislation for states to use in updating and revising their local housing agency enabling legislation. NAHRO wants PHAs to be able to undertake mixed-income developments, mixed-used developments, mixed financing, and mixed ownership of developments through partnerships and other entities held in part by others. NAHRO envisions PHAs undertaking a number of commercial activities such as encumbering of all agency properties, guarantee of third-party debt, lending activities, various management activities, delivery of mortgage assistance, and supplying of services of various kinds. Overall, NAHRO envisions future entrepreneurial local housing agencies possessing comprehensive powers that permit them to act in creative ways that respond effectively to local opportunities and needs (HDLI 1997).

## **Reinventing PHAs**

An examination of what PHAs are doing under the HOPE VI—Urban Revitalization Demonstration program and other new regulatory and legislative mandates may suggest the manner in which PHAs are likely to reinvent themselves in the future in

response to the aforementioned policy changes. This examination is presented in the five areas delineated earlier:

1. *Motives.* Increasingly, in addition to providing affordable housing for households with extremely low incomes, PHAs are trying to improve these households' opportunities for socioeconomic advancement.
2. *Financial structure.* The demolition of a significant number of units in the worst PHA developments has terminated the operating subsidies PHAs were receiving for their vacant units, which in turn has reduced the amount of subsidy available for the remaining occupied units.

The HOPE VI redevelopment initiatives of PHAs evince a variety of innovative financing structures, involving amalgams of LIHTC, private lender, and federal (HUD) funds, often with local infrastructure contributions from municipalities (Epp 1996). A fuller description of one such development, Techwood in Atlanta, is provided below.

3. *Characteristics of the stock.* The transition of public housing to the newly emerging policy environment is also changing the characteristics of the public housing stock (Epp 1996; Schill 1997). There has been a massive demolition and reconstruction effort by HUD. HUD plans to demolish up to 100,000 of the worst public housing units and to spend nearly \$1 billion fixing up existing projects and building some 4,000 new units (Husock 1997).<sup>6</sup> The shift is to smaller, more human-scale communities that should offer a starting point for public housing tenants to achieve self-sufficiency (HUD 1996a).

Appropriate site selection is also a key element of the emerging PHA stock. New units are being located to eliminate the physical and socioeconomic isolation that is typical among today's public housing tenants. The use of scattered-site developments and tenant-based approaches gives tenants the opportunity to live in nonimpacted areas. New research indicates that vouchers and certificates are leading to a greater scattering of subsidized tenants into the suburbs than conventional public housing did, but that these

---

<sup>6</sup> In principle, all tenants living in demolished units that are not replaced will receive housing certificates, which are to replace the Section 8 vouchers and certificates. HUD (1995) is not explicit about the number of these tenant-based housing certificates that will be made available.

suburbanized tenants nonetheless tend to concentrate in areas whose socioeconomic status and proportions of white residents are below average (Hartung and Henig 1997). Ideally, HUD envisions that all public housing units will be garden-style or small town-house public housing apartments, with proper landscaping and security features, indistinguishable from privately owned housing in the neighborhood (HUD 1996a).

4. *Characteristics of the tenants.* A reinvented public housing program has also started to serve a greater variety of tenants. Already, several PHAs (e.g., those in Chicago, St. Louis, and Seattle) are experimenting with mixed-income developments that include both public housing and market-rate units.

To assist in the transition, the HOPE VI program provides funding for education, skills training, job placement and development, and other supportive services for both tenants and neighborhood residents where public housing developments are located (e.g., the PHA in Charlotte, NC).

5. *Management approach.* The shift to a tenant-based subsidy approach to public housing is forcing PHAs to rethink the way they do business. Until now, PHAs have been isolated from the competitive pressures that influence private property managers. “Residents, who are in the best position to identify management deficiencies and demand changes, lack the consumer’s most powerful tool—the ability to take their business elsewhere” (HUD 1996a). Under the reinvention requirements, by giving tenants choices via portable Section 8 certificates, PHAs will be required to compete with their private sector counterparts for tenants.

A key element in this transformation of PHAs is expected to be the widespread adoption of a new asset management approach. This approach requires PHAs to do a site-by-site needs analysis, portfolio-wide planning for allocation of resources, and site-based budgets. In addition, PHAs are expected to use site-based decision-making, information, and financial systems for quick response and cost-effectiveness and to implement market-sensitive leasing and management on a site-by-site basis (Nutt-Powell 1995). Although the extent to which PHAs have adopted all the aspects of the asset management approach is unclear, many PHAs have instituted changes in that direction. For instance, the PHA in Kansas City, MO, has undertaken the

decentralization of management by establishing on-site management at several developments.

## **Challenges to transforming and attracting private capital to PHAs**

The ability of PHAs to transform themselves and to become attractive to private capital (both market-rate tenants and investors) must be placed in the larger context of PHAs' overall goals. In their current context of reinvention, we see PHAs as being asked to pursue four mutually antagonistic goals. Moreover, we believe that each goal has an independent set of constraints that limit its achievement, even if it were not inherently in conflict with another goal. We refer to this challenging situation as PHAs' "constrained quadrilemma," depicted graphically in figure 1. Its elements are explained below.

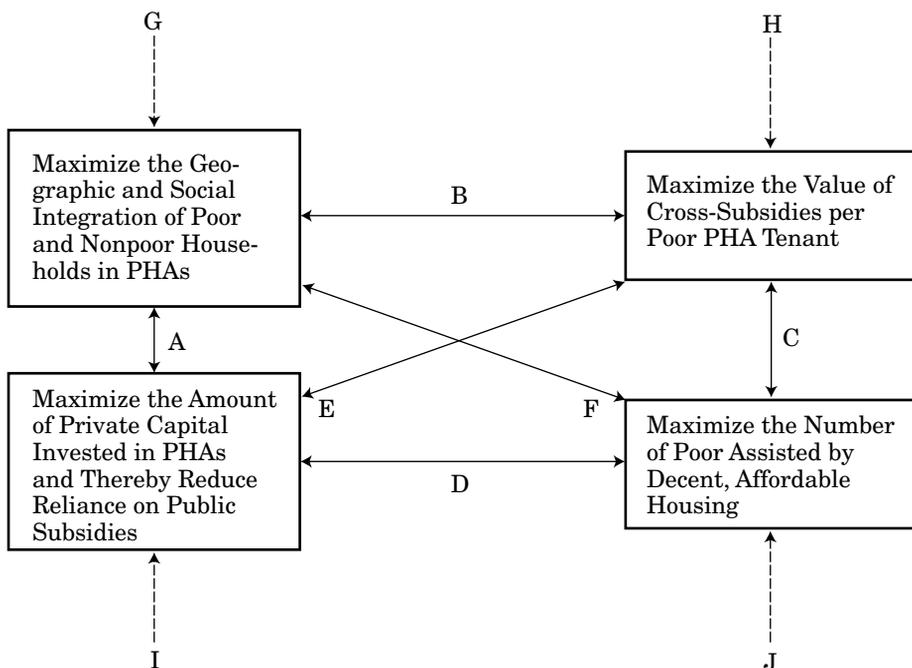
### *PHAs' goals*

It is our belief that the move toward tenant-based assistance in public housing implicitly requires PHAs to pursue four goals, which are listed below. (In the discussion that follows, "poor" refers to traditional public housing tenants who cannot afford to pay market rents, and "nonpoor" refers to potential market-rate tenants in public housing.<sup>7</sup>)

---

<sup>7</sup> Under current rules, public housing built before October 1981 can have up to 25 percent of households earning between 50 and 80 percent of AMI. The remainder, 75 percent, must have earnings at or below 50 percent of AMI. For units built after October 1981, no more than 5 percent of households can earn between 50 and 80 percent of AMI (Epp 1996). Households with incomes above 80 percent of AMI are not permitted in public housing. Under the proposed legislative changes, a maximum of 35 percent (HR 2) or 50 percent (S 462) of tenants need to have earnings at or below 30 percent of AMI. Presumably, the rest of the tenants can have incomes as high as PHAs can attract. According to Epp (1996), "income mixing" in public housing today refers to mixing families with various incomes below 80 percent of median income, which includes both working and nonworking families. In contrast, in the discussion that follows, "income mixing" refers to mixing households with incomes above as well as below 80 percent of AMI. "Poor" refers to the traditional public housing tenants under current rules—those making 80 percent of AMI or less. "Nonpoor" market-rate tenants are those making more than 80 percent of AMI—those who are ineligible for public housing today but who may be potential public housing tenants under the proposed legislative changes. We recognize that the use of these terms is somewhat arbitrary. We propose them because a commonly agreed-upon definition of "mixed-income housing" is lacking.

Figure 1. The Constrained Quadrilemma Facing PHAs



1. *Maximize the geographic and social integration of poor and nonpoor households in PHAs.* This means having both the poor and the nonpoor distributed as evenly as possible among all PHA developments. This also implies the location of new scattered-site units for poor tenants in areas with low poverty or minority population concentrations or the encouragement of nonpoor households to occupy neighborhoods near public housing developments.
2. *Maximize the value of cross-subsidies per poor PHA tenant.* This implies that PHAs need to have the highest aggregate amount of rental income coming from nonpoor (market-rate) tenants in a PHA development, per poor tenant. This ratio can be achieved by raising rents to nonpoor tenants, increasing the proportion of such tenants residing in the PHA's housing stock, or both.
3. *Maximize the number of poor assisted by decent, affordable housing.* This implies that PHAs need to have the highest possible number of poor residents in PHA developments, where units would be offered to them at the lowest feasible rent (such as the current 30 percent of tenant income), while maintaining acceptable unit quality.

4. *Maximize the amount of private capital invested in PHAs and thereby reduce reliance on public subsidies.* This implies that PHAs need to offer the highest possible rates of risk-adjusted return to investors.

We see two sets of barriers inhibiting the achievement of these goals: intergoal conflicts and external constraints on individual goals. The first set is more fundamental, so it will be discussed first.

### *Intergoal conflicts*

Six intergoal conflicts can be identified: one for every possible pair of the four goals noted above. These conflicts are identified by arrows A through F in figure 1:

- A. The goal of maximizing tenants' geographic and social integration acts as a disincentive to private investors. As a rule, low-income households are considered to be riskier tenants. They are believed to be erratic in paying rent and unreliable in maintaining units. They are also widely assumed to engage in undesirable social behaviors, such as criminal activity and vandalism. Trying to build PHA developments in nonimpacted areas involves additional elements of risk, mainly the possibility of protracted delays due to obstructionist permit acquisition processes and other forms of local political opposition.<sup>8</sup> As a result of these perceptions, investors will require an unusually high rate of return for their participation in new public housing ventures—high enough to make most such ventures infeasible, we suspect.
- B. The goal of maximizing the rental income from nonpoor tenants for use as cross-subsidies conflicts with the goal of integration. In all likelihood, nonpoor tenants will want to occupy *exclusively* those buildings they rent. This is because, in the presence of class prejudices and expectations regarding the behavior of the poor alluded to above, they will be willing to pay more (i.e., bid more per unit) in a property with no poor tenants (a homogeneous building) than in a mixed poor and nonpoor development. Moreover, nonpoor market-rate tenants are also likely to want and to occupy

---

<sup>8</sup> We are not aware of any research showing that there are protracted delays involving LIHTC and other mixed-income projects due to NIMBY ("not in my backyard") and other such factors. However, we contend that this may happen, as it often happens with low-income projects (Downs 1991).

those buildings that have the best condition, design, and neighborhood, because these attributes are income elastic and the nonpoor will bid more than the poor will. As a result, PHAs trying to enhance cross-subsidy revenues should allocate the poor so that they represent a small fraction of tenants in mixed-income developments or concentrate them in less desirable units of the PHA stock.

- C. The goal of maximizing cross-subsidies throughout the PHA system conflicts with the goal of serving the maximum number of poor tenants with decent, affordable housing. To attract nonpoor tenants, PHAs may need to offer them an unusually high-quality environment for the rent, which implies that limited renovation funding will have to be diverted from renovating units occupied by poor tenants. Conversely, PHAs may need to lower the rent of “market-rate” units to make them attractive to nonpoor tenants, given the units’ associated structural and neighborhood quality. As a result, cross-subsidies produced thereby may be minimal. Moreover, for any fixed number of PHA units, there is an inherent conflict between allocating a unit to a nonpoor household (thus enhancing cross-subsidies per remaining poor tenant) and allocating it to a poor one.
- D. The goal of maximizing the number of poor tenants in any potential development conflicts with the goal of attracting private capital. The higher the proportion of poor tenants, the lower the rental income per unit and the higher the subsidy per unit needed to meet conventional rates of return. Given that subsidy streams are subject to change over time because of political vagaries and other considerations, investors likely would be unwilling to consider the future existence of any such subsidy as guaranteed in their long-run projections. If this were the case, such a project would be considered riskier, and a higher rate of return would thus be demanded.
- E. The goal of maximizing cross-subsidies conflicts with the goal of attracting private capital. If cross-subsidies are used to subsidize the units of poor tenants (either in this development or elsewhere in the PHA’s portfolio), they cannot be used to pay returns to private investors.
- F. The goal of social integration (income diversity) within a development conflicts with the goal of serving the maximum number of poor tenants. For any given number of PHA units, the greater the number occupied by poor tenants once

maximum diversity (say 50-50) has been surpassed, the less the opportunity for class diversity, by definition.

*External constraints on individual goals*

We identify four sets of external constraints on individual goals, identified by arrows G through J in figure 1:

- G. There may be three obstacles to maximizing geographic and social integration in PHA developments. First, until very recently, there were strict federal preferences that in effect limited tenantry to the very poor. As explained above, these restrictions have been relaxed with the most recent appropriations bill (HUD 1996b), but some restrictions still remain. Second, for decades no federal funds have been available for the construction of new public housing units, with the exception of replacements for demolished units. Given that these replacement units typically represent only a small fraction of the original stock, the opportunities for dramatically altering the locations of the public housing stock are limited. More realistically, some integration may be achieved through the use of tenant-based subsidies, such as Section 8 certificates, which have been used to replace public housing units. It is clear, however, that substantial geographic integration can be achieved with certificates only if home counseling and information services are provided in conjunction (Finkel and Kennedy 1992). Finally, even if sufficient funds for substantial amounts of new construction were raised, PHAs would still have to deal with local opposition to subsidized housing—the NIMBY (“not in my backyard”) factor.
- H. There is likely an inherent market limit on the value of the cross-subsidies possible in the long run. This is because nonpoor market-rate tenants have no incentive to cross-subsidize the poor perpetually. In the short run, PHA-private ventures may be able to exploit tight submarket niches and extract cross-subsidies from nonpoor tenants in them. Such tenants are likely to search intently for private market alternatives, however. Eventually, the supply side of the market is likely to respond to reduce submarket tightness (Rothenberg et al. 1991). In this case, the PHA would increasingly be forced to compete with the private sector for these nonpoor tenants by offering lower rents or higher-quality developments; either would reduce the monetary pool available for cross-subsidies.

- I. At least three factors may limit private investor interest in PHA-private ventures. First, given the well-publicized problems in several large PHAs, investors are likely to have an image of PHAs as inept managers and undesirable partners for a joint venture. Second, many existing PHA developments are in poor condition and in inferior locations. Potential investors may see these conditions as confirmation of not only their negative perceptions of PHAs but also the tenuous viability of existing developments as sources of potential profits through renovation schemes. Third, affordable housing financing packages typically necessitate the complex bundling of multiple sources of private and public funds. The higher administrative costs and time delays associated with such financing schemes can deter private partners.
  
- J. There may be one major obstacle to the goal of maximizing the number of poor obtaining decent, affordable housing. Under the asset management approach, PHAs will be required to decide which buildings are salvageable and which are not, given limited public subsidies. For instance, some developments may have extremely high renovation needs or operating costs. Others may be located in nonviable neighborhoods so as to make any attempts at enhancing the overall residential environment extremely difficult, even given PHA building renovation. If substantial resources were spent to salvage such developments, a PHA would be left with attenuated resources to subsidize the rents of the poor. Alternatively, if a PHA decided to remove these inefficient developments from the stock—as a rational private landlord may do—a direct loss of units available to the poor would result.

The difficulties inherent in the constrained quadrilemma may be compounded by the issue of race. In the presence of racial or ethnic prejudices and discrimination, the likelihood of successfully attracting white market-rate tenants and investors is diminished. At the extreme, public housing developments and locations characterized by minority concentrations may be avoided by private capital, regardless of other considerations.

The constrained quadrilemma model has several implications. The successful transformation of PHAs will be fundamentally limited by their four conflicting goals. Individual PHAs will be forced to compromise among goals, possibly entirely sacrificing one or more, on the basis of local conditions and their expertise in management and entrepreneurial ventures. Many, we suspect,

may have to give up substantially their goal of maximizing the provision of affordable housing for the very poor.

The difficulties raised by the external constraints, by comparison, seem easier to address. Innovations evinced by HOPE VI sites and the legislative proposals now being considered represent positive moves in this direction. Yet such successes cannot overshadow the sobering implications of the basic quadrilemma that confronts PHAs in the emerging policy regime.

### **Is there a way out of the constrained quadrilemma?**

The prospect for escaping the constrained quadrilemma may not be as bleak as it initially might seem. In this section we speculate about ways in which PHAs might minimize intergoal conflicts. These include attacking the weaker links in the quadrilemma, maximizing help for the poor with a long-run strategy of producing enough mixed-income developments, and assessing the potential of PHAs to behave more like developers.

#### *Attacking the weaker links in the quadrilemma*

We believe that it may be possible to reach some workable operational compromise among three goals—integration of the poor, value of cross-subsidies, and private capital investments—by beginning with the model of a mixed-income development. The evidence does not permit us to suggest precisely what comprises the optimal mix, or whether market-rate housing is part of the mix; the particulars must depend on the development-specific context. Nevertheless, it is clear that substantial project diversity between tenants earning less than 50 percent of AMI and those earning between 50 and 80 percent is feasible and that it can attract private capital, assuming that it is well designed, well managed, and well located (Vale 1996).<sup>9</sup> Lake Parc Place in Chicago (Schill 1997) and Parkside in Detroit (Capital Needs Unlimited 1995) offer two examples. Even wider ranges of income mixes might be attracted if the redevelopment activity spreads beyond the PHA site to the surrounding neighborhood, as in the Near Westside development in Indianapolis (Epp 1996) or the Carver and Randolph areas in Richmond, VA (Richmond Redevelopment and Housing Authority 1993), or if the site has exceptional accessibility to employment or amenities, as Cabrini-

<sup>9</sup> We recognize, however, that units funded through the LIHTC are restricted to serve tenants earning below 60 percent of AMI.

Green in Chicago does. If a PHA development were to offer a range of housing qualities and tenures, it might encourage still more diversity from within by retaining residents whose incomes had risen; this idea is part of the plans in Seattle's Holly Park and Atlanta's Techwood (Epp 1996).

The redevelopment activities of the Housing Authority of the City of Atlanta (HACA) related to its HOPE VI-sponsored Village at Techwood provide a fine illustration of the foregoing.<sup>10</sup> The Village of Techwood Redevelopment Area originally contained 1,702 units of public housing, located in two prewar complexes and two postwar high-rises. The redevelopment foresees the demolition of 1,067 of these units and the construction of a 900-unit, mixed-income complex in their place.

The plan has three components. The physical component calls for 40 percent of the units to serve as public housing replacements, funded through HOPE VI and LIHTC, available for families at or below 60 percent of AMI. Twenty percent of the units will be LIHTC-eligible rental units, and another 40 percent will be market-rate rental units. In addition, 14 units will be renovated for use in the provision of community services and economic development programs. The site will include a new elementary school and recreational amenities. The economic development component involves a training and employment center and a cultural enrichment center on site. The community services component aims to create a network of interlocking social service delivery systems, based on a needs assessment by the residents.

The Village at Techwood is structured as a development partnership separate from HACA. The limited partners are created through the sale of LIHTC, and they own a 97 percent share. One general partner, a joint venture between the Integral Group and McCormick Baron and Associates, Inc., owns 2.9 percent. HACA owns 0.1 percent and has entered into a 55-year ground lease with the development partnership that imposes certain conditions on the number of public housing units contained in the development. When the lease expires, the land and all improvements revert to HACA.

The project is financed through a unique mix of public and private resources. LIHTC equity funds, an FHA-insured first mortgage from a private lender, and a second mortgage of HOPE VI funds from HACA form the funding nucleus. The city of Atlanta

---

<sup>10</sup> This section on Techwood is based on oral and written information provided by Renee Glover, executive director, HACA.

contributed funds for a variety of site improvements. Because the land was not owned by the partnership, the collateral for the first mortgage could not be foreclosed on; moreover, it was subject to the condition that 40 percent of the units continue as public housing. To offset this added risk, HACA agreed to buy the balance of the mortgage if it went into default. Additional, off-site public housing replacement units were funded through a HUD grant and by an incremental allocation of Section 8 certificates.

Two unusual financial elements of Techwood are especially noteworthy. One is a model agreement negotiated with HUD that allows the use of public housing operating subsidies for units not operated by HACA. These subsidies are allowed to “float” for eligible units instead of being attached to particular units, thereby encouraging the dispersal of public housing residents among market-rate tenants. The other element is that HACA receives a portion of the developer fee and a share of net operating income. Some of these proceeds are used to establish an operating reserve.

Finally, HACA has demonstrated a facility to take advantage of idiosyncratic opportunities for financially supporting Techwood. First, because the area was designated as part of Atlanta’s empowerment zone, market-rate and LIHTC units will be exempted from property taxes for 5 years, with the exemption gradually eroding thereafter and phasing out entirely after 11 years. Second, a \$250,000 financing shortfall for the first phase of the development was filled by leasing parcels of the development site to the Coca-Cola Company during the 1996 Olympic Games.

*Maximizing help for the poor with a mixed-income development strategy: Long-run perspectives*

However a PHA might succeed in making relatively painless compromises among the three aforementioned goals, as occurred in the Techwood case, pursuing the goal of maximizing the number of poor assisted by decent, affordable housing remains problematic unless one takes a longer-run viewpoint. This goal could be met if, in the longer run, a PHA were to succeed in (1) moving more PHA tenants out of poverty or (2) expanding the total stock of affordable units available to the poor (even while allocating a sizable fraction of the stock to the nonpoor).

The first component refers to a host of programs that fall under the rubric “family self-sufficiency” (Epp 1996). Of course, a central goal of mixed-income developments is to provide role models and job information networks that presumably improve the economic prospects for poor residents, although skepticism abounds about the degree to which this has occurred (Schill 1997). The initial evaluations of attempts to deliver comprehensive job training and social services on PHA sites have not turned up dramatic successes (Rohe 1995; Shlay 1993). Nevertheless, in principle, if more PHA poor residents can be helped into economic independence and choose market-rate housing, PHA units will be opened up for other needy households.

The second component presumes that PHAs can assume a “development” perspective and can significantly expand the stock of housing within their purview. Were they to successfully develop many new mixed-income projects, the net change in units available for the neediest might be an increase relative to the current stock, even if some of the current stock were shifted from occupancy by the poor to the nonpoor.

### *Assessing the potential for PHAs to behave more like developers*

The potential for PHAs to implement a long-run development perspective may be determined by their ability to behave more like entrepreneurial developers. There are several reasons to conjecture that at least some PHAs could reasonably be expected to succeed in expanding the stock of affordable housing through their development initiatives, as either nonprofit or for-profit developers.

*Can PHAs behave more like nonprofit developers?* There are early indications that at least some PHAs may be able to adopt a nonprofit development model or to team up with nonprofit entities in development activities. For example, PHAs have teamed with community development corporations in Seattle to develop affordable homeownership units and in Indianapolis to construct off-site replacement units for PHA demolitions (Epp 1996). Other PHAs may already be structured as joint PHA-development entities, as the Richmond Redevelopment and Housing Authority is.<sup>11</sup> These hybrid PHA entities might be able to offer a range of potentially attractive assets to financiers of the development deal,

---

<sup>11</sup> At this writing, NAHRO is surveying its members to assess the proportion that are constituted in this fashion.

such as land, bonding finance capabilities, and federal operating subsidies that may be transferable across sites (Epp 1996).<sup>12</sup>

These examples suggest two approaches for PHAs: They can adopt a nonprofit model, or they can team up with a nonprofit entity.<sup>13</sup> In considering the adoption of a nonprofit model, PHAs may be forced to adopt the same compromises in response to challenges as those adopted by the nonprofit sector.<sup>14</sup> Two are particularly relevant. First, the nonprofit sector has been forced to tap a number of funding streams to make a project feasible. These include federal, state, local, and private market resources and philanthropic moneys.<sup>15</sup> Although this strategy may imply a deeper subsidy, often it implies higher costs because significant expertise and time are needed to work out the intricacies of a project's financing. As a result, the nonprofit sector cannot target its efforts to the most needy. For instance, as mentioned above, only 28 percent of LIHTC units serve households with incomes below 50 percent of AMI.<sup>16</sup> The second challenge, just as

---

<sup>12</sup> We recognize that PHA land that has been purchased for use as public housing developments cannot be sold or used as collateral, according to the Housing Act of 1937 and Annual Contributions Contract regulations.

<sup>13</sup> It should be noted that the nonprofit sector comprises a wide variety of entities. These include community development corporations (CDCs), nonprofit development organizations, housing development organizations, and others. Organizations differ in a number of important ways, such as geographic region where they operate, size of organization, resources available, type of services provided, level of housing production, and membership of the board of directors. There may be more than 2,000 nonprofit housing organizations nationwide (Walker 1993). This diversity makes it difficult to identify a nonprofit model applicable to the challenges depicted in the constrained quadrilemma.

<sup>14</sup> Over the past 10 years, the nonprofit sector has emerged as a central player in the provision of affordable housing. Largely, this is a result of the emergence of intermediary organizations, such as the Enterprise Foundation and the Local Initiatives Support Corporation, which are able to channel capital and technical expertise to local nonprofit developers and providers. Between 1960 and 1990, Walker (1993) estimates, about 14 percent of all federally supported housing units (excluding public housing) were sponsored by nonprofit developers (736,000 units). He believes that this share has remained relatively stable into the 1990s. Excluding the Section 202 elderly housing, the sources of federal funding most commonly tapped by the nonprofit sector are the LIHTC, HOME, and Community Development Block Grant programs (Wallace 1995).

<sup>15</sup> As a rule, none of these sources of funding by itself is enough to make a project viable. In a recent study, Abt Associates (1992) estimates that a nonprofit project needs about eight sources of funding to be viable.

<sup>16</sup> Walker (1993) finds that because single-source financing is rare, developments that use multiple funding sources tend to be poorly capitalized (i.e., to have barely sufficient operating revenues).

important, is that low-income projects in low-income neighborhoods are perceived as riskier than other projects. Moreover, when these risks are added to the use of complex financial packages, it is not surprising that the nonprofit sector has had difficulty attracting public and private partners to get involved with projects serving worst-case needs.<sup>17</sup> If PHAs were to adopt the nonprofit model, they might be forced to adopt the same types of compromises, abandoning the targeting of projects primarily to those most in need.

In contrast to adopting the nonprofit model, PHAs may choose to cooperate with nonprofits to address their quadrilemma by increasing production significantly. Despite a traditionally slightly antagonistic relationship,<sup>18</sup> it is possible to identify a number of potential benefits to be derived from such cooperation. First, PHAs may profit from working with large community development corporations (CDCs) (those with most production), CDCs with experience in “patchwork” financing, and CDCs with experience working with a number of public, private, and philanthropic partners. Second, PHAs may profit from working with CDCs that have experience in the provision of services, such as job training, that PHAs need to move their tenants to self-sufficiency.<sup>19</sup>

Unfortunately, we believe that none of these potential benefits, promising though they are, is likely to offer a solution to the quadrilemma. Instead, the future relationship between CDCs and PHAs may be one of confrontation and competition rather

---

<sup>17</sup> Walker (1993) identifies two other traditional challenges to nonprofit production: limited technical capacity and the difficulty of measuring efficacy of operations. These two challenges have declined in importance as a result of recent developments. First, the national intermediary organizations now provide technical assistance to local nonprofit organizations that was unavailable until recently. Second, some comprehensive research initiatives have been put in place to measure efficacy. The National Community Development Initiative funded by philanthropic entities and HUD is an example of this interest. It is our belief that if PHAs were to adopt the nonprofit model, these two challenges could be similarly addressed.

<sup>18</sup> Traditionally, CDCs have seen PHAs as bureaucratic and lacking in innovation, and PHAs have considered CDCs unwilling (or unable) to house the poorest of the poor.

<sup>19</sup> On the other hand, CDCs can also benefit from working with PHAs. PHAs have a large stock of housing already built that could be made available to households targeted by CDCs. Moreover, under proposed changes, PHAs will have resources such as the proposed capital and operating block grants that could be used to address the financing and capitalization needs of CDC projects.

than collaboration. If proposed legislative changes are enacted, local jurisdictions will be able to apply for newly created block grants that otherwise would have gone to PHAs. It is likely that many local jurisdictions will use these new block grants to fund CDCs and other local nonprofit groups to provide housing. Even if the new block grant provision is not enacted, the need for PHAs to create partnerships with private (e.g., LIHTC) and philanthropic entities to develop new projects is likely to result in competition rather than collaboration with nonprofit providers for funding.

*Can PHAs behave more like for-profit developers?* In contrast, some PHAs may opt to adopt some variation of the for-profit development model to increase production and outgrow the quadrilemma. A way to accomplish this may be for PHAs to develop profit-making centers that can be used to finance expanded development activity.<sup>20</sup> As illustration, several PHAs have experimented with converting their maintenance shops into small-scale producers of building components. The Richmond Redevelopment and Housing Authority purchased and renovated a facility, which it rents to a nonprofit agency providing apprenticeship training to PHA residents in apartment maintenance and entrepreneurial skills. Other profit-making activities might be distinctly nontraditional. PHAs might, for example, establish retail franchises for a variety of consumer goods and services provided within the developments, such as phone or cable TV service, convenience stores, or restaurants.

Our noting these potentials should not imply that we are certain about the prospects for many PHAs to succeed as entrepreneurs. On the contrary, there are at least two major obstacles: human and regulatory. The main human obstacle is the traditional form of doing business at most PHAs: a focus on following regulations and maximizing flows of federal funds.<sup>21</sup> The main regulatory constraints relate to state enabling legislation for PHAs, most of which prohibits a wide range of entrepreneurial activities and raising of capital.<sup>22</sup> At this writing, as noted above, NAHRO is embarking on a project to provide states with model enabling

---

<sup>20</sup> We recognize that federal regulations currently prohibit the use of federal moneys in such profit-making subsidiaries.

<sup>21</sup> Without exception, the PHA executive directors, NAHRO officials, HUD staff, and private developers with whom we spoke in the course of preparing this article stressed the significance of this factor.

<sup>22</sup> We speculate that ongoing fervor at the federal level will continue to reduce binding regulatory constraints from that source.

legislation that will eliminate the most binding limitations on PHAs' abilities to become more entrepreneurial. Unfortunately, the impacts that the enactment of such enabling legislation may have on the ability of many PHAs to behave more entrepreneurially cannot be determined in advance.

Even if PHAs are successful in transforming themselves into entrepreneurial nonprofit or for-profit developers, they may still have difficulty developing the number of units necessary to outgrow the quadrilemma in the long run. On the basis of the information on LIHTC mixed-income developments discussed above, we estimate that PHAs may be able to target about one of every four units to households with incomes at or below 50 percent of AMI. At the extreme, this projection suggests that they would need to expand the stock from 1.3 million units today to about 4.6 million units to accommodate all existing public housing tenants in mixed-income developments.<sup>23</sup> Although this estimate is very rough, it gives an indication of the magnitude of development activity needed.

## **Conclusions: Back to the future?**

PHAs are about to enter a brave new world. If all the proposed changes to the public housing program are approved, PHAs will be asked to reinvent themselves in the most drastic way since the program began. The shift toward a tenant-based subsidy approach to public housing can be expected to force PHAs to compete with private sector providers for tenants. To be successful in such competition, PHAs are expected to act more like entrepreneurial market participants: to change their management practices, the type of tenants they house, and the type of developments they operate. They likely will be called on by necessity to attract private capital for the development and operation of public-private housing ventures.

This article describes and contrasts the characteristics of both PHA and private sector provision of affordable housing in terms of motives, financial structures, characteristics of stock and of tenants, and management approaches. We have shown how there are challenges and constraints facing PHAs as they try to modify the last four characteristics to better match those of their private sector counterparts, but most of these challenges are soluble in principle. Such is not the case when it comes to motives. Housing

---

<sup>23</sup> This assumes that every household in public housing today has an income at or below 50 percent of AMI, which of course is not the case.

the very poor in decent, affordable units that are not socially and geographically isolated is fundamentally distinct from maximizing return on investment. In their process of transformation, PHAs are being asked to pursue four conflicting goals: housing the neediest, achieving diversity, maximizing cross-subsidization, and attracting private capital. Overall, we believe that all these goals are mutually conflicting, and therefore PHAs will not be successful without sacrificing one or more of them.

For instance, PHAs might well reinvent themselves to become quasi-public providers if they give up their current goal of housing the neediest. LIHTC projects may provide an example of what a PHA development in this brave new world would look like. In LIHTC projects there is integration of subsidized and market-rate tenants. Typically, projects may be located in viable, nonimpacted neighborhoods. There is private sector participation in the form of capital and managerial expertise. The catch is that LIHTC projects serve households with incomes close to 60 percent of AMI, which is more than three times the average income of today's public housing tenant. Other PHAs may redefine their mission as seeking to house (and perhaps provide ancillary forms of training and assistance to) those low-income households that show promise of being only temporarily poor. Under such a strategy, public housing would be seen as a means to economic independence, not as an end in itself. Still other PHAs may strategically opt for a "portfolio" of housing assets, running the gamut of income mixes, private partnerships, and tenures. In that case, the goal could be articulated as a way to best manage the risk of the public's assets through diversification, while simultaneously meeting the particular needs of a range of needy households.

But even if a PHA were to jettison maximizing service to the neediest as a goal, conflicts would remain among the other three goals. In conjunction with the remaining external constraints, these conflicts suggest to us that it will require exceptional entrepreneurial and managerial skills for PHAs to survive as competitive suppliers of housing for *any* clientele, assuming that continued large federal subsidies are not possible. We expect that different PHAs will make different compromises among conflicting goals and adopt different strategies. In concert with differing skills and characteristics of their current stock and tenantry, these will yield a variety of models with various degrees of success. Ultimately, the strategy to be adopted will be a balance among the four goals in light of local political and market realities to achieve a PHA that is viable in the long run.

Regardless of the transformation scheme adopted, however, we do not believe that PHAs will serve the same clientele they do now. Our analysis and investigations offer little prospect that private money can come close to substituting for federal subsidies. Therefore, PHAs are likely to serve higher-income tenants in their public-private ventures of the future. If so, questions would need to be answered: Who will house the neediest? Will tenant-based assistance be earmarked for them? Will they successfully operate in the private or reinvented public sector, even with their subsidy? How will PHAs be distinguished from current nonprofit housing suppliers? Will PHAs have any unique public role to fill at all?

Perhaps the likely answer to some of these questions may be glimpsed from the workings of the PHAs in the 1960s. In his seminal work, Aaron (1972) describes the dilemma then facing PHAs: to stay financially solvent or to help only the neediest families. At that time, PHAs could determine the number of tenants that could be admitted from each income bracket, and they could refuse admission to, and evict, families with undesirable characteristics. Using this discretion, PHAs chose solvency. In 1970, Aaron found that public housing tenants constituted a very small fraction of each low-income bracket. For instance, the number of public housing tenants with 1970 incomes below \$2,000 was about the same as the number of tenants with incomes above \$3,000.<sup>24</sup> In fact, there were more tenants making \$6,000 or more a year than tenants making less than \$1,000. The public housing tenants of the future may not be very different from the tenants Aaron encountered.

In the brave new world, PHAs appear to confront the same dilemma they confronted in the 1960s. This time, however, it is the legislative and regulatory changes that implicitly seem to require them to choose solvency over helping only the neediest.

### *Authors*

Roberto G. Quercia is an Assistant Professor of City and Regional Planning at the University of North Carolina at Chapel Hill. George C. Galster is Clarence Hillberry Professor of Urban Affairs at the College of Urban, Labor, and Metropolitan Affairs at Wayne State University.

The authors would like to acknowledge a number of individuals and institutions who shared their knowledge and expertise with them. These include

---

<sup>24</sup> All the figures in the paragraph are in 1970 dollars. The median family income in 1970 was \$9,867 (HUD 1994).

Kurt Creager of the Vancouver (WA) Housing Authority; Rick Gentry of the Richmond (VA) Redevelopment and Housing Authority; Jack Goodman of the Multi Housing Council; Chris Horning of the Office of Public Housing Investments at HUD; Jack Kerry of Kerry Company; Hershel Lipow of the Center for Housing Policy; Bill Maher of the Housing and Development Law Institute; Tom Nutt-Powell of Capital Needs Unlimited; Mary Ann Russ of the Office of Public and Indian Housing at HUD; Harrison Shannon of the Charlotte (NC) PHA; John Sidor of the Council for State Community Development Agencies; Marcia Sigal of NAHRO; Martin Wexler of the Service de l'habitation in Montreal; and the participants in the Tri-Country Housing Conference held in Montreal and Ottawa, August 27–30, 1996. The analysis presented here, however, represents the views of the authors and not necessarily those of the individuals and institutions cited.

## References

- Aaron, Henry J. 1972. *Shelter and Subsidies: Who Benefits from Federal Housing Policies?* Washington, DC: Brookings Institution.
- Abt Associates. 1992. *Nonprofit Housing: Costs and Funding* (draft). Prepared by Abt Associates with Aspen Systems, Inc., for the U.S. Department of Housing and Urban Development.
- Bickford, Adam, and Douglas S. Massey. 1991. Segregation and the Second Ghetto. *Social Forces* 69(4):1011–36.
- Capital Needs Unlimited. 1995. *Capital Program: Context, Needs, Status and Recommendations to the Detroit Housing Department*. Boston.
- Cassata, Donna. 1997. Democrats' Support Boosts Hope for Success of Overhaul Effort. *Congressional Quarterly Weekly Report* 55(20):1139–41.
- Cisneros, Henry G. 1996. *The Transformation of America's Public Housing: A 1996 Status Report*. Washington, DC: U.S. Department of Housing and Urban Development.
- Downs, Anthony. 1991. The Advisory Commission on Regulatory Barriers to Affordable Housing: Its Behavior and Accomplishments. *Housing Policy Debate* 2(4):1095–1137.
- Epp, Gayle. 1996. Emerging Strategies for Revitalizing Public Housing Communities. *Housing Policy Debate* 7(3):563–88.
- Epp, Gayle, and Jonathan Lane. 1992. Capital Improvement Programs and the Physical Condition of Public Housing. In *Working Papers on Identifying and Addressing Severely Distressed Public Housing*, National Commission on Severely Distressed Public Housing, 5-1–55. Washington, DC: U.S. Department of Housing and Urban Development.
- Finkel, Meryl, and Stephen D. Kennedy. 1992. Racial/Ethnic Differences in Utilization of Section 8 Existing Rental Vouchers and Certificates. *Housing Policy Debate* 3(2):463–508.

- Galster, George C., and Jerome Rothenberg. 1991. Filtering in a Segmented Model of Urban Housing Markets. *Journal of Planning Education and Research* 11:37–50.
- Goering, John M., and Modibo Coulibaly. 1989. Investigating Public Housing Segregation: Conceptual and Methodological Issues. *Urban Affairs Quarterly* 25(2):265–97.
- Hartung, John M., and Jeffrey R. Henig. 1997. Housing Vouchers and Certificates as a Vehicle for Deconcentrating the Poor. *Urban Affairs Review* 32(3):403–19.
- Housing and Development Law Institute. 1997. *Model Housing Act* (October 3, 1996; revised November 25, 1996, and May 14, 1997). Washington, DC.
- Husock, Howard. 1997. Back to Private Housing. *Wall Street Journal*, July 31.
- ICF, Inc. 1992. The Modernization Needs of Severely Distressed Public Housing. In *Working Papers on Identifying and Addressing Severely Distressed Public Housing*, National Commission on Severely Distressed Public Housing, B-1–24. Washington, DC: U.S. Department of Housing and Urban Development.
- Listokin, David. 1991. Federal Housing Policy and Preservation: Historic Evolution, Patterns, and Implications. *Housing Policy Debate* 2(2):157–85.
- Massey, Douglas S., and Nancy A. Denton. 1993. *American Apartheid: Segregation and the Making of the Underclass*. Cambridge, MA: Harvard University Press.
- National Commission on Severely Distressed Public Housing. 1992. *The Final Report of the National Commission on Severely Distressed Public Housing*. Washington, DC: U.S. Government Printing Office.
- Nelson, Kathryn P., and Jill Khadduri. 1992. To Whom Should Limited Housing Resources Be Directed? *Housing Policy Debate* 3(1):1–55.
- Nutt-Powell, Thomas E. 1995. Public Housing: Dissed and Stressed in a Brave New World. *Cityscape* 1(3):122–23.
- Richmond Redevelopment and Housing Authority. 1993. *Briefing Book: Tour of Housing and Redevelopment Activities*. Richmond, VA.
- Rohe, William M. 1995. Assisting Residents of Public Housing Achieve Self-Sufficiency: An Evaluation of Charlotte's Gateway Families Program. *Journal of Architectural and Planning Research* 12(3):259–77.
- Rothenberg, Jerome, George C. Galster, Richard V. Butler, and John R. Pitkin. 1991. *The Maze of Urban Housing Markets: Theory, Evidence, and Policy*. Chicago: University of Chicago Press.
- Schill, Michael. 1997. Chicago's Mixed-Income New Communities Strategy. In *Affordable Housing and Urban Redevelopment in the United States*, ed. Willem van Vliet, 135–57. Thousand Oaks, CA: Sage.

- Shlay, Anne B. 1993. Family Self-Sufficiency and Housing. *Housing Policy Debate* 4(3):457–95.
- Spence, Lewis H. 1993. Rethinking the Social Role of Public Housing. *Housing Policy Debate* 4(3):355–68.
- Stegman, Michael. 1972. *Housing Investment in the Inner City: The Dynamics of Decay*. Cambridge, MA: MIT Press.
- Sternlieb, George. 1966. *The Tenement Landlord*. New Brunswick, NJ: Rutgers University Press.
- Sternlieb, George, and James W. Hughes. 1991. Private Market Provision of Low-Income Housing: Historical Perspective and Future Prospects. *Housing Policy Debate* 2(2):123–56.
- U.S. Department of Housing and Urban Development. 1979. *Exploring New Strategies for Improving Public Housing Management*. Washington, DC.
- U.S. Department of Housing and Urban Development. 1991. *Priority Housing Problems and “Worst Case” Needs in 1989: A Report to Congress*. Washington, DC.
- U.S. Department of Housing and Urban Development. 1994. *U.S. Housing Market Conditions 1st Quarter*. Washington, DC.
- U.S. Department of Housing and Urban Development. 1995. *HUD’s Reinvention: From Blueprint to Action*. Washington, DC.
- U.S. Department of Housing and Urban Development. 1996a. *Public Housing That Works*. Washington, DC.
- U.S. Department of Housing and Urban Development. 1996b. *Rental Housing Assistance at a Crossroads: A Report to Congress on Worst Case Housing Needs*. Washington, DC.
- Vale, Lawrence J. 1996. Public Housing Redevelopment: Seven Kinds of Success. *Housing Policy Debate* 7(3):491–534.
- Walker, Christopher. 1993. Nonprofit Housing Development: Status, Trends, and Prospects. *Housing Policy Debate* 4(3):369–414.
- Wallace, James E. 1995. Financing Affordable Housing in the United States. *Housing Policy Debate* 6(4):785–814.
- Wells, Robert Marshall. 1997. Overhaul Bill Shifts More Authority to Local Public Housing Officials. *Congressional Quarterly Weekly Report* 55(20): 1140–41.
- Whitehead, Christine M. E. 1994. Introduction and Update. *Housing Policy Debate* 5(3):231–40.
- Wilson, William Julius. 1987. *The Truly Disadvantaged*. Chicago: University of Chicago Press.

