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PUBLIC HOUSING IN THE 21ST CENTURY: HUD'S VIEW ON THE FUTURE OF PUBLIC HOUSING IN THE UNITED STATES

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERALISM AND THE CENSUS

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

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PUBLIC HOUSING IN THE 21ST CENTURY: HUD'S VIEW ON THE FUTURE OF PUBLIC HOUSING IN THE UNITED STATES

TUESDAY, JULY 18, 2006

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FEDERALISM AND THE CENSUS,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m. in room 2154, Rayburn House Office Building, Hon. Michael R. Turner (chairman of the subcommittee) presiding.

Present: Representatives Turner, Clay, and Dent.

Staff present: John Cuaderes, staff director; Jon Heroux, counsel; Juliana French, clerk; Adam Bordes, minority professional staff member; and Jean Gosa, minority assistant clerk.

Mr. TURNER. Good morning. A quorum being present, this hearing of the Subcommittee on Federalism and the Census will come to order.

Welcome to the subcommittee's hearing entitled, "Public Housing in the 21st Century: HUD's View on the Future of Public Housing in the United States." This is the fifth in a series of hearings the Federalism and the Census Subcommittee is holding on public and low-income housing.

Congress first authorized the concept of public housing in 1937 as part of President Roosevelt's public works legislative package. Congress originally intended public housing to serve working families on a temporary basis. Over the years, public housing has evolved in a program that has served poorer families who are more likely to become long-term residents.

By the 1960's and 1970's, much of the Nation's public housing had fallen into disrepair and distress. By the 1980's, the public and many in Congress were demanding that the public housing system be reformed. Congress responded and made several minor reforms throughout the late 1980's and early 1990's. By 1995, however, it was clear that these reforms had not done enough. Far too many people still lived in public housing developments that did not provide clean, safe and quality housing.

In 1998, Congress again responded to the problem by passing the Quality Housing and Work Responsibility Act. This landmark legislation was the largest overhaul of the public housing system since its creation. It was a sweeping reform of the public housing system. On many levels, it has been widely praised and has been successful.

Still, no legislation is perfect, and the Quality Housing and Work Responsibility Act is no different. It too has some shortcomings. Beginning February of this year, the subcommittee has held four hearings to examine the viability and efficiency of the Nation's assisted and public housing system. We have received testimony from a wide variety of stakeholders. These witnesses have included members of academia, public housing authority directors, non-profit housing developers, financiers and public housing tenants. These hearings have been interesting and informative.

Our inquiry, however, is not complete. That is why we have invited the Department of Housing and Urban Development to testify before us today. The purpose of this hearing is to allow the Department the opportunity to discuss its vision for the future of public and assisted housing programs. Also within the context of this subcommittee's last four hearings, we have asked the Department to respond to the views and recommendations of our previous witnesses.

[The prepared statement of Hon. Michael R. Turner follows:]

TOM DAVIS, VIRGINIA
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
RANKING MINORITY MEMBER

ONE HUNDRED NINTH CONGRESS

Congress of the United States

House of Representatives

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SUBCOMMITTEE ON FEDERALISM AND THE CENSUS
Congressman Michael R. Turner, Chairman

OVERSIGHT HEARING
STATEMENT BY MICHAEL R. TURNER, CHAIRMAN

Hearing topic: ***Public Housing in the 21st Century: HUD's View on the Future of Public Housing in the United States.***

Tuesday, July 18, 2006
10:00 AM
2154 Rayburn House Office Building

OPENING STATEMENT

Welcome to the Subcommittee's hearing entitled, *"Public Housing in the 21st Century: HUD's View on the Future of Public Housing in the United States."* This is the fifth in a series of hearings the Federalism and the Census Subcommittee is holding on public and low-income housing.

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the late 1980s and early 1990s. By 1995, however, it was clear that these reforms had not done enough – far too many people still lived in public housing developments that did not provide clean, safe, and quality housing.

In 1998, Congress again responded to the problem by passing the Quality Housing and Work Responsibility Act, also known as QHWRA. This landmark legislation was the largest overhaul of the public housing system since its creation. It was a sweeping reform of the public housing system. On many levels, it has been widely praised and has been successful. Still, no legislation is perfect and QHWRA is no different. It too has its shortcomings.

Beginning in February of this year, the Subcommittee has held four hearings to examine the viability and efficiency of the nation's assisted and public housing system. We have received testimony from a wide variety of stakeholders. These witnesses have included members of academia, public housing authority directors, non-profit housing developers, financiers, and public housing tenants. These hearings have been interesting and informative.

Our inquiry, however, is not complete. That is why we have invited the Department of Housing and Urban Development to testify before us today. The purpose of this hearing is to allow the Department the opportunity to discuss its vision for the future of public and assisted housing programs. Also, within the context of the Subcommittee's last four hearings, we have asked the Department to respond to the views and recommendations of our previous witnesses.

With that, I would like to welcome the Honorable Roy Bernardi who is Deputy Secretary of the U.S. Department of Housing and Urban Development. I would also like to welcome the Honorable Orlando Cabrera who serves as Assistant Secretary for Public and Indian Housing at HUD. Assistant Secretary Cabrera will be joining Deputy Secretary Bernardi to assist him in answering the Subcommittee's questions.

Thank you for agreeing to testify today. I welcome you both and look forward to your comments.

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Mr. TURNER. With that, I would like to welcome once again, returning to our committee, the Honorable Roy Bernardi, who is Deputy Secretary of the U.S. Department of Housing and Urban Development. I would also like to welcome the Honorable Orlando Cabrera, who serves as Assistant Secretary for Public and Indian Housing at HUD. Assistant Secretary Cabrera will be joining Deputy Secretary Bernardi to assist him in answering the subcommittee's questions.

Thank you for agreeing to testify today. I welcome you both and look forward to your comments. Secretary Bernardi has kindly prepared written testimony which will be included in the record of this hearing. You will notice that there is a timer at the witness table. The green light indicates that you should begin your prepared remarks, and the red light indicates that time has expired. The yellow light will indicate when you have 1 minute left in which to conclude your remarks.

Mr. Secretary, I will be very lenient, of course, with your time, since you have been so gracious in appearing before this committee. It is the policy of this committee that all witnesses be sworn in before they testify. Will you please rise and raise your right hands?

[Witnesses sworn.]

Mr. TURNER. Please let the record show that all witnesses have responded in the affirmative.

And with that, I will recognize Secretary Bernardi.

STATEMENTS OF ROY A. BERNARDI, DEPUTY SECRETARY, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; AND ORLANDO J. CABRERA, ASSISTANT SECRETARY FOR PUBLIC AND INDIAN HOUSING, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

STATEMENT OF ROY A. BERNARDI

Mr. BERNARDI. Good morning, Chairman Turner. It is a pleasure to be here, not only myself, but on behalf of Secretary Alphonso Jackson, for the opportunity to share our views on the current and future direction of public housing in the United States.

The need for affordable housing and structural problems of the public housing program call for reconsideration of how this asset is best used to serve the most people. The management and operation of the public housing program has evolved into a system characterized by complexity, inflexibility and centralized control. This has resulted in a program that is not easily adapted to the specific needs of a single community or a troubled development.

By the 1990's, our existing system had produced 100,000 troubled and severely distressed public housing units. It has taken the Department over a decade to address this legacy of good intentions and failed policy through the HOPE VI program, the Capital Fund program and other initiatives. The HOPE VI program alone has resulted in the demolition of 78,000 plus severely distressed units, the construction or rehabilitation of 50,400 public housing tax credit and market rate units, and the successful relocation of over 63,000 families. And the work in this program is ongoing.

While the goal of the public housing program should be to ease the burden of low income Americans by providing them with a sim-

ple and affordable housing option, the current system unfortunately makes this helping hand its own heavy burden. We need to find a better solution for transitioning people to self-sufficiency, so others can benefit from public housing. The current system discourages honesty and work by making eligible income the basis on which rent is determined. In addition, the process for calculating rent and verifying income are onerous, often inaccurate, and can result in significantly different rents for similar households.

Our current rent system has become a trap for lowered aspirations and often is viewed as a lifetime entitlement for tenants who might otherwise achieve greater independence. We at HUD propose a much different future for public housing, having evaluated the shortcomings of the current system.

I want to be very clear about the status of elderly and disabled within any proposed reforms. Nothing we intend to do will change the protected status of elderly and disabled residents within the public housing program.

Necessary changes. The statutory and regulatory environment governing public housing should be simple, flexible and progressive. Central among these policy shifts will be the transition to asset management. This approach will focus on the sustainability of each property and allow housing authorities to become true asset managers in line with the private sector. Moving a portfolio of 1.2 million units to this asset management model is essential for promoting stability and private financing options.

Housing authorities should be authorized to simplify how they charge tenant rent and set rents based on local conditions, increased expectations and efforts to promote self-sufficiency. Again, the elderly and disabled should be protected classes within this system and exempt from these increased expectations.

More housing authorities need opportunity to access flexibility, responsibility and authority that Moving to Work status provides. Housing agencies and the Moving to Work program are experimenting with term limits in concert with rent reform and employment incentives. Such bold reforms allow more families to achieve self-sufficiency, ultimately serving more Americans.

Our vision for public and rent-assisted housing includes the opportunity for home ownership. HUD has had a successful home ownership voucher program that has paved the way for low income Americans to become homeowners. Home ownership counseling, strong and committed collaborations among PHAs and assistance from local non-profits and lenders have proven to be essential in making this program work.

Mr. Chairman, over 8,000 low income families moved from the Section 8 rental program and used their Section 8 assistance to become home owners during the program's first 4 years. By the end of fiscal year 2007, the program will provide home ownership opportunities for some 10,000 families.

Another key home ownership initiative put forward by the Secretary is legislation to revitalize the Federal Housing Administration. FHA has been invaluable to helping first time and minority home buyers who are low and moderate income achieve home ownership. Legislation in the House and Senate, H.R. 5121 and S. 3535, would make valuable changes to again allow greater access

to home ownership with safe, amortizing mortgage loans for more low income families.

In closing, public housing is valuable to low income Americans, but needs reform to ensure deserving families get the affordable housing they need. I know, Mr. Chairman, you have held numerous meetings and numerous hearings on this matter. I am sure that we will be talking about improper payments, that we have a nice track record here at HUD for that. We will be talking about Moving to Work, we will be talking about asset management, and I am just very pleased to have with me Assistant Secretary for Public and Indian Housing, Orlando Cabrera. He and his staff are working very, very hard to necessitate the changes that we feel are necessary, and working in conjunction with your committee, hopefully working together, so we can utilize this asset and provide more opportunities for more people, but at the same time, moving people from public housing to Section 8 to low income to tax credit programs, and then eventually to self-sufficiency.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Bernardi follows:]

WRITTEN STATEMENT OF
DEPUTY SECRETARY ROY A. BERNARDI
U.S DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

HEARING ON

"PUBLIC HOUSING IN THE 21ST CENTURY: HUD'S VIEW ON THE FUTURE OF PUBLIC HOUSING IN THE UNITED STATES"

BEFORE THE

SUBCOMMITTEE ON FEDERALISM AND THE CENSUS

COMMITTEE ON GOVERNMENT REFORM

U.S. HOUSE OF REPRESENTATIVES

JULY 18, 2006

Chairman Turner, Ranking Member Clay, distinguished Members of the Subcommittee:

On behalf of Secretary Alphonso Jackson, thank you for the opportunity to share our views on the current and future direction of Public Housing in the United States. This is a timely opportunity, as public housing is at an important crossroads. The need for affordable housing and structural problems of the public housing program beg a reconsideration of how this precious asset is best used to serve the most people. At the same time, lessons learned from programs like HOPE VI and Moving to Work (MTW) highlight important reforms that might be applied to the entire public housing portfolio.

The statutory and regulatory environment in which public housing currently operates is characterized by complexity, inflexibility, and centralized control.

The management and operation of the public housing program has evolved into a system of centralized rules, applied uniformly across America. While on the surface this appears to be a sound approach to delivering a national asset, it has resulted in an inflexible program that is not easily adapted to the specific needs of a single community or a troubled development. In fact, these assets are not national at all, instead they are completely local and housing authorities should be given more control over the management of these resources.

In our current system, the management focus is not on the property or asset, but instead on the agency as a whole. This approach undermines effective oversight and unnecessarily results in micromanagement of PHAs. The same rules that were enacted to safeguard program quality have, in many instances, resulted in poorer quality housing. Because of this outdated oversight system, we have handcuffed the ability of local agencies to respond to the needs of each individual asset.

By the 1990s our existing system had produced 100,000 troubled and severely distressed public housing units. It has taken the Department over a decade to address this legacy of good intentions and failed policy through HOPE VI, the Capital Fund program, and other initiatives. The work is ongoing.

While the goal of the public housing program should be to ease the burden of low-income Americans by providing them with a simple and affordable housing option, the current system makes this helping hand its own heavy burden.

By making eligible income the basis on which rent is determined, the current system discourages honesty and work. In addition, the processes for calculating rent and verifying income are onerous, often inaccurate, and can result in significantly different rents for similar households. Often, resident attention is focused more on mastering the system to reduce their rent, rather than securing true self-sufficiency.

In a twist of unintended consequences, our current rent system has become a trap of lowered aspirations and often is viewed as a lifetime entitlement for tenants who might otherwise achieve greater independence. This has the unfortunate outcome of dramatically reducing the total number of individuals that can be served by the program.

Even more troubling is that our current system encourages leaseholders to deny the existence of family members so they are not listed on the lease.

These issues are particularly problematic given that we know public housing is not an entitlement and that many families are on waiting lists for this limited resource, especially in larger cities. Since HUD cannot serve every American family who would be eligible for our programs, we need to find a better solution for transitioning people to self-sufficiency so others can benefit from this resource.

Having said this about the current system, I want to be very clear about the status of elderly and disabled within any proposed reforms. Nothing we intend to do will change the protected status of elderly and disabled residents within the public housing program.

We propose a much different future for public housing.

We feel strongly that the statutory and regulatory environment governing public housing should be simple, flexible, and progressive. Public housing authorities should be given greater authority to locally manage their developments.

Central among these policy shifts will be the transition to asset management, which will likely have the most dramatic impact on the industry as it goes forward. This approach will focus on the sustainability of each property, and allow housing authorities to become true asset managers, in-line with the private sector. Today, housing authorities own and operate billions of dollars in assets, yet the value of these assets is generally unavailable for securing loans, private investment, and other forms of leverage. Moving our entire portfolio of 1.2 million units to this asset management model will create untold opportunity for greater sustainability, development of new and improved affordable housing options, and linkages to private financing that were previously unavailable.

As we move our physical portfolio toward a market model, we also need to take steps to ensure our reformed system treats the beneficiaries of public housing in a progressive and humane way. Housing authorities should be authorized to simplify how they charge tenant rent, particularly for the elderly and disabled. They should also be allowed to set rents based on local conditions, increased expectations, and efforts to promote self-sufficiency. At the same time, elderly and disabled should be protected classes within this system, and exempt from these increased expectations.

In the interest of making the most of a limited asset and in transforming public housing from a life time entitlement to a temporary resource, housing agencies in the MTW Program are already experimenting with term limits in concert with rent reform and employment incentives. The hope is these reforms will allow more families to cycle through the system, ultimately serving more Americans from our waiting lists.
For example, a housing agency could establish any number of rent reforms, including flat rents, percentage of income, tiered rents or some combination of these and other rent reforms. They could combine this with escrow accounts that accelerate the growth of resident assets and independence. Housing agencies should also increasingly couple this with incentives to move up a housing ladder within their own system. Under such a framework, a housing agency could develop a plan with each resident that moves them

from public housing, to Section 8, to a Low Income Housing Tax Credit unit in a HOPE VI development, and, finally, a private market apartment or homeownership. The idea would be to move them through the system, and assist them at each level as they take on greater responsibility for their own housing, with the ultimate goal of achieving self-sustainability by joining the record number of homeowners in the United States.

The Administration's vision for public and rent assisted housing includes the opportunity for homeownership. Some may not be aware, but HUD has a successful Homeownership Voucher program that has paved a path for low-income Americans to become homeowners. Homeownership counseling, strong and committed collaborations among PHAs, and assistance from local non-profits and lenders have proven to be an essential component in making this program work for families across the country.

Over 8,000 low-income families moved from the Section 8 rental program and became homeowners during the program's first 4 years. By the end of FY 2007, the program will provide homeownership opportunities for approximately 10,000 families.

Another key, homeownership initiative put forward by the Secretary is legislation to revitalize the Federal Housing Administration (FHA). FHA has traditionally been invaluable to helping first time and minority homebuyers who are low and moderate income achieve homeownership. Over the last several years, a failure to amend 72-year old provisions in the Housing Act has left FHA with inflexible regulatory burdens and statutory requirements that prevent it from updating products. Legislation in the House and Senate, HR 5121 and S 3535, would make valuable changes to again allow greater access to homeownership with safe, amortizing mortgage loans for more low-income families.

The President's vision for an ownership society correctly focuses on the reality that homeownership helps families create wealth they can use for so many purposes like expanded educational opportunity. The point is to keep available affordable homeownership opportunities for low-income families.

In closing, I want to stress public housing is valuable to low-income Americans, and should be improved to ensure it serves these families in a more progressive and humane way. During the last seventy years, public housing has served millions of low-income American families. Our challenge is to ensure that we can enable that program to serve millions more for another seventy years.

Thank you for the opportunity to discuss these important issues with you today, I look forward to working with you on public housing reform as we take this program into the future.

Mr. TURNER. Thank you, Mr. Bernardi. I want to congratulate you and Secretary Jackson on your diligence. I know from your background as a former mayor, you have looked to not just the issue of how to manage public housing, but how do you impact the lives of the people who are in public housing, how do they receive the assistance that they need.

Throughout your testimony, you highlight, and I know that Secretary Jackson also is committed to the issue of transition and self-sufficiency, that public housing be an opportunity, not merely just an issue of warehousing or of an opportunity for providing fixed housing for fixed populations, but an opportunity for people to receive the services and the intervention that they need, so that they can transition to economic independence.

HUD's commitment to ending what had been a period of economic segregation in our large warehousing projects to economic diversity is a very important issue. And I want to ask you a policy question first. We have been joined by Mr. Clay.

I'm sorry, does Mr. Cabrera have a statement also?

Mr. CABRERA. Only if the chairman would like to hear it.

Mr. TURNER. I would absolutely love to hear it. I am sorry, from the opening I thought perhaps you did not, Mr. Cabrera.

Mr. CABRERA. Not at all. If it is easier and you would like me to waive, I am happy to.

Mr. TURNER. No, I would be glad to hear your opening statement and also acknowledge we have been joined by Mr. Clay, our ranking member.

STATEMENT OF ORLANDO J. CABRERA

Mr. CABRERA. Thank you, Mr. Chairman.

Mr. Chairman and Ranking Member Clay, thank you for inviting us to testify today about the future of public housing in the 21st century. My name is Orlando Cabrera, and I am the Assistant Secretary for Public and Indian Housing at HUD.

After reviewing the testimony of all of the witnesses that have appeared before you, one might conclude that public housing is in a state of crisis. I would suggest that it is not, and it is in a state of much needed change.

In brief, public housing is joining the world of multi-family housing in terms of financial management and oversight. The most effective means to illustrate this change, in my experience, is using financial analysis. Yet it is the one least used when discussing public housing, which traditionally has been perceived as a social program.

First, a very brief and very general history of public housing finance might help. Public housing first came about as a way to provide decent housing for lower income workers in our cities. Nationwide, but particularly in our larger cities, most of the developments that are used as public housing today are about 70 years old and were the stock used to house those workers.

The Federal Government paid to construct the units and the rents covered the operating costs, because the units were relatively new. And because the families that were housed were mostly the working poor, the basic arithmetic worked in most cities for about 20 years.

In the early years, there was no Federal operating subsidy, and as such, there were few Federal operating requirements. By the early to mid-1960's, this simple financial model began to break down mostly because those assets aged. Operating costs, including deferred maintenance, began to rise and tenant incomes began to decline. PHAs were still free to set rents flexibly, only it required higher rent burdens on increasingly poorer tenants.

In 1968, Congress passed the Brook amendment, which fixed rents at 25 percent of tenant incomes. While Brook protected the tenant, it hastened the financial crisis for many large PHAs in many ways. It wasn't for another 6 years that Congress established a comprehensive operating subsidy program and another decade or more until it established a comprehensive program for capital improvements.

Once we began to finance public housing operations and capital improvements through appropriation, we discouraged public housing authorities from operating in accordance with sound real estate practices, charging adequate rents and creating capital reserves. For some years, that persisted until it became clear that public housing's capital stock had aged so much and was in such dire need of capital improvement that the issue had to be revisited. Capital investment occurred during the late 1970's and early 1980's, but essentially very little change when it came to improving public housing stock.

In 1994, Congress passed HOPE VI to address the most distressed public housing authorities. PHAs began to demolish the obsolete inventory and rebuild with affordable units as opposed to public housing units. Then in 1996, Congress passed the Quality Housing and Work Reform Act, creating new operating fund and capital fund programs. The Congress directed HUD to develop these programs through negotiated rulemaking.

A byproduct of QHWRA was that Congress began to reconsider the business model that public housing had used for decades. Much of this issue centers around the adequacy of the former business model and the possibility of new business models. It commissioned a study known as the Harvard Cost Study. The Harvard Cost Study examined the way that PHAs were funded. It looked at the cost of operating other HUD housing programs in similar markets. It recommended a new formula for determining operating subsidy, replacing a system that traditionally disfavored the Nation's newer population centers, in the south and southwest, from those parts of the country that were losing population.

Based on Harvard's research, Congress directed HUD to undertake asset management, and HUD did. The operating fund rule was produced after a 2-year negotiated rulemaking process and set forth the path for change. The former business model for public housing essentially paid public housing authorities an operating subsidy based on a formula that assumed a set number of units with the same cost per unit, regardless of the nature of each individual development that the public housing authority owned. No manager of real estate would use this model, because it would be impossible to know the true cost of actually operating the units under management.

The new model contemplates that public housing authorities run their units in a way that actually recognizes the economics of running each of the developments that is under a public housing authority's management. First, asset management does not apply to PHAs that have fewer than 250 units. Second, asset management requires public housing authorities to make decisions based on the economics of managing units first. Third, asset management requires public housing authorities to know the cost of running their business. Fourth, asset management encourages local flexibility by minimizing HUD involvement in operations. Finally, asset management will mean that the operating subsidy formula will change. Seventy-percent of PHAs are gainers under the new formula, while about a quarter are decliners.

As part of phasing in asset management, the negotiated rulemaking committee recommended and HUD ultimately adopted a concept called stop loss that applies only to those PHAs that are declining in subsidy and elect to apply for stop loss. Stop loss means that a PHA that declines its subsidy may elect to apply for stop loss designation, which will mean that their pre-operating subsidy rule allocation level will remain the same because they have achieved stop loss status. They have become efficient.

Stop loss is a very small component of asset management. Comparatively, few of the Nation's PHAs will apply for stop loss simply because they do not decline significantly. Moreover, the stop loss assumes that an applicant PHA has elected to accelerate their move toward asset management. Many witnesses who have testified noted that asset management was prescriptive. Some went further and alleged that asset management was micromanaging. My sense is that most of the comments relate to stop loss, not asset management.

Asset management, as previously mentioned, is a move toward greater local control and flexibility and less centralized control at HUD. Stop loss is a small subset of asset management. Effectively, it guarantees that a decliner can lock in its former subsidy level at the expense of other gainers and declining PHAs. So in order to achieve stop loss, HUD has required that stop loss applicable PHAs demonstrate that they are achieving efficiency on their own and within their budgets without external subsidy.

Another aspect of asset management that is fundamental is better financial reporting. Asset management was developed after consulting with accountants in order to achieve a model that better conforms with generally accepted accounting principles consistently applied. Achieving a better conforming financial structure means that PHAs will be better equipped to access financial markets, because the former model was not a model that most stakeholders in the financial community, namely rating agencies, investment bankers, bond insurers and others, might better assess PHAs as entities.

The transition toward asset management begins in earnest in 2007 and full conversion should be in place by 2011. It is a 4-year process. Assuming that asset management is successfully implemented, the 21st century for public housing means that PHAs will evolve using a variety of business models, not just one. It means that PHAs will be better positioned to access debt and capital mar-

kets in order to improve the condition of existing units, units where it makes sense to rehab, or more likely than not, develop new affordable housing units that serve their communities. Ultimately, the issue is change and adaption.

Thank you for your time and attention. I am ready to answer any questions that you may have. Thank you, Mr. Chairman.

[The prepared statement of Mr. Cabrera follows:]

Oral Statement Script of Orlando J. Cabrera
Assistant Secretary for Public and Indian Housing
U.S. Department of Housing and Urban Development
before the
House Government Reform Subcommittee on Federalism and the Census

July 18, 2006

Chairman Turner, Ranking Member Clay and Members of the Committee, thank you for inviting us to testify today about the future of public housing in the 21st century.

My name is Orlando Cabrera and I am the Assistant Secretary for Public and Indian Housing at HUD. After reviewing the testimony of all of the witnesses that have appeared before you, one might conclude that public housing is in a state of crisis. I would suggest that it is not in a state of crisis, but in a state of much needed change.

In brief, public housing is joining the world of multifamily housing in terms of finance, management, and oversight.

The most effective means to illustrate this change, in my experience, is using financial analysis. Yet it is the one least used when discussing public housing.

First, a brief and very general history of public housing finance might help.

Public housing first came about as a way to provide decent housing for lower-income workers in our cities. Nationwide, but particularly in our larger cities, most of the developments that are used as public housing today are about 70 years old and were the stock used to house those workers. The federal government paid to construct the units and the rents covered the operating costs. Because the units were relatively new, and, also, because the families housed were mostly the working-poor, the basic arithmetic worked in most cities for about 20 years. In the early years, there was no federal operating subsidy and, as such, there were few federal operating requirements.

By the early-to-mid 1960s, this simple financial model began to break down. Operating costs, including deferred maintenance, began to rise and tenant incomes began to decline. PHAs were still free to set rents flexibly, only it required higher rent-burdens on the increasingly poorer tenant bodies.

In 1968, Congress passed the Brooke-amendment, which fixed rents at 25% of tenant incomes. While Brooke protected tenants, it hastened the financial crisis at many large PHAs. It wasn't for another six years that the Congress established a comprehensive operating subsidy program and another decade or more until it established a comprehensive program for capital improvements. Once we began to finance public housing operations and capital improvements through appropriation, we discouraged public housing authorities from operating in accordance with sound real estate practices – that is, we disincentivized PHAs from charging adequate rents

and creating capital reserves for some years. That persisted until it became clear that public housing's capital stock had aged and was in dire need of capital improvement. Some capital investment occurred during the late 70s and early 80s, but essentially, very little changed when it came to improving public housing's capital stock.

In 1994, Congress passed HOPE VI to address the most distressed public housing properties. PHAs began to demolish this obsolete inventory and re-build with affordable units – as opposed to public housing units. Then, in 1996, Congress passed the Quality Housing and Work Responsibility Act, creating a new operating fund and capital fund programs. The Congress directed HUD to develop these programs through negotiated rulemaking.

A byproduct of QHWRA was that congress began to reconsider the business model that public housing had used for decades. It commissioned a study known as the Harvard Cost Study.

The Harvard Cost Study examined the way that PHAs were funded. It looked at the costs of operating other HUD-housing programs in similar markets. It recommended a new formula for determining operating subsidy, replacing a system that traditionally disfavored the nation's newer population centers in the south and southwest from those parts of the country that were losing population.

Based on Harvard's research, Congress directed HUD to undertake asset management and HUD did. The operating fund rule was produced after a 2-year negotiated rulemaking process and set forth the path for change.

The former business model for public housing essentially paid public housing authorities an operating subsidy based on a formula that assumed a set number of units with the same cost per unit regardless of the nature of each individual development that the public housing authority owned. No manager of real estate would use this model because it would be impossible to know the true cost of actually operating the units under management.

The new model contemplates that public housing authorities run their units in a way that actually recognizes the economics of running each of the developments that is under a public housing authority's management. First, asset management does not apply to PHAs that have fewer than 250 units. Secondly, asset management requires public housing authorities to make decisions based on the economics of managing units first. Thirdly, asset management requires public housing authorities to know the cost of running their business. Fourth, asset management encourages local flexibility by minimizing HUD involvement in operations.

Finally, asset management will mean that the operating subsidy formula will change – 75% of PHAs are gainers under the new formula while about a quarter are decliners. As part of phasing in asset management, the negotiated rulemaking committee recommended and HUD ultimately adopted a concept called stop loss that applies only to those PHAs that are declining in subsidy. Stop loss means that a PHA that declines in subsidy may elect to apply for stop loss designation, which will mean that their pre-operating subsidy rule allocation level will remain the same because they have achieved stop loss status. Stop loss is a very small component of asset management.

Comparatively few of the nation's PHAs will apply for "stop-loss" simply because they do not decline significantly. Moreover, the "stop-loss" assumes that an applicant PHA has elected to accelerate their move toward asset management.

Many witnesses that testified noted that asset management was prescriptive. Some went further and alleged that asset management was micromanaging. My sense is that most of those comments relate to "stop-loss", *not* asset management. Asset management, as previously mentioned, is a move toward greater local control and less centralized control. Stop-loss, which is a small subset of asset management, effectively guarantees that a decliner can lock in its former subsidy level at the expense of other gainer and declining PHAs. So in order to achieve "stop-loss", HUD has required that "stop-loss" applicant PHAs demonstrate that they are achieving efficiency on their own and within their budgets without external subsidy.

Another aspect of asset management is fundamental to most businesses – that is better financial reporting. Asset management was developed after consulting with accounts in order to achieve a model that better conforms with generally accepted accounting principles consistently applied. Achieving a better financial structure means that PHAs will be better equipped to access financial markets because the former model was not a model that most stakeholders in the financial

Community, namely rating agencies, investment bankers, bond insurers and others, who might better assess PHAs as entities if they were structured in a manner that was more comprehensible.

The transition toward asset management begins in earnest in 2007, with full conversion by 2011.

Assuming that asset management is successfully implemented, the 21st century for public housing means that PHAs will evolve using a variety of business models, not just one. It means that PHAs will be better positioned to access debt and capital markets in order to improve the condition of existing units. Units where it makes sense to rehab – or, more likely than not – develop new affordable housing units that serve their communities. Ultimately, the issue is change and adaptation.

Thank you for your time and attention. I am ready to answer any question that you may have.

Mr. TURNER. Thank you, Mr. Cabrera. We do not have a copy of your written testimony, so if you would please provide us with a copy of that, I would greatly appreciate it.

Mr. CABRERA. Sure.

Mr. TURNER. And I would like to recognize our ranking member, Mr. Clay, for his comments and questions.

Mr. CLAY. Thank you very much, Mr. Chairman. I thank you for holding today's hearing to receive the administration's views on public housing issues, and I certainly welcome our witnesses's testimony. I would love to submit my statement in its full text into the record.

Mr. TURNER. Without objection, so ordered.

[The prepared statement of Hon. Wm. Lacy Clay follows:]

STATEMENT OF CONGRESSMAN WM. LACY CLAY
HEARING ON PUBLIC HOUSING
JULY 18, 2006

Mr. Chairman, I thank you for holding today's hearing to receive the Administration's views on public housing issues. I welcome our witnesses and look forward to their testimony.

Our nation's public housing programs have been a bedrock of support for millions of families, elderly, and disabled individuals for decades. They are facing increasing pressures, however, due to limited federal funding options, insufficient regulations that limit the amounts of capital for long-term development projects, and growing economic disparities among our citizens who rely on housing programs for their survival. While there are no silver bullet solutions to these problems, we have to remain open minded to new ideas that may improve the lives of residents.

That being said, I have significant concerns with this administration's proposed funding for public housing. The elimination of program requirements to replace a decommissioned housing unit with a new unit on a one-to-one basis, coupled with reductions in the number of housing vouchers available, is causing significant decreases in the availability of affordable public housing units for many low-income working citizens. Furthermore, federal resources for capital improvements remain inadequate, and local agencies face daunting approval processes for proposed projects that are funded.

As in previous years, the President's budget for FY 2007 provides no funding for the HOPE VI program that is essential to the revitalization efforts of dilapidated public housing complexes. In addition, the budget calls for shrinking the

amount of funding for the Public Housing Capital Fund by nearly $250 million from FY 2006 funding levels. This is sending the wrong signal at the wrong time to our capital markets.

Inconsistent support for these programs will only lessen the commitment to public housing from the private sector. If our Public Housing Authorities cannot depend on long-term capital commitments from the federal government, it makes little business sense for the private sector to hold up their end of the bargain.

This concludes my remarks, Mr. Chairman, and I yield back.

Mr. CLAY. Thank you.

Let me start with Mr. Bernardi. How are you this morning?

Mr. BERNARDI. Fine, sir.

Mr. CLAY. It is good to see you.

You know, I believe we need to rid public housing of dilapidated developments and allow for new developments to replace them. According to the St. Louis Housing Authority, however, there are more than 700 units that need repair or are uninhabitable in their public housing program.

Can you speak on ways in which HUD can work to improve its capital development efforts for PHAs to ensure that housing can be replaced or repaired in a timely manner?

Mr. BERNARDI. Yes, Ranking Member Clay. I know you are familiar with our HOPE VI program that went into place in 1994. There were 100,000 severely distressed units throughout the country. The HOPE VI program in its infancy took applications from PHAs around the country. I am pleased to say that from an unlimited amount of dollars that could be expended with a particular PHA, changes were made. Now I believe the maximum limit is $20 million for a PHA to address that situation.

At the same time, we encountered some difficulties in the process that many PHAs, while they had the ability to manage a housing authority, were not developers and didn't really know how to go about putting into place the demolition of properties and then the reconstruction of those properties. That is a program that we have at HUD.

Unfortunately, a tremendous amount of money is still in the pipeline, money that has been appropriated has not been expended. But that program continues to exist, and that is the main program that I believe that we have that addresses the concern of severely distressed public housing to either rehabilitate that or to take it down. But what is awfully nice about HOPE VI is that in its lifetime, I believe it has leveraged like $9 billion of non-public moneys. So you can see the cooperation and the utilization of other entities to provide quality housing.

Then the housing that evolves from that, sir, is not just affordable housing, it is mixed income housing, it is housing on a voucher program. So it really lends to what I believe we all would like to see, an integration, if you will, of lower income folks into the mainstream of the community when it comes to housing.

Mr. CLAY. Tell me why the money is still stuck, for lack of a better term, why is it still stuck in the pipeline and not really in the hands of the housing authorities to do the repairs?

Mr. BERNARDI. There are some instances, and I am sure Secretary Cabrera can give you those chapter and verse, but there are some instances like Atlanta, for example, and I believe in Chicago, where they have done wonderful things. As I mentioned earlier, you really need, and now we require that when an application is submitted you have a developer online. Previously many of these, they were public housing authorities who made the application and then the process just bogged down as they looked to move it forward, trying to find the right development, the right partners.

Mr. CLAY. You know that the housing authorities will give us a different angle than that.

Mr. BERNARDI. That is true, but in some instances, sir, when that money has been in the pipeline for 3, 4 and 5 years, there has really been very little action, that gives us pause. We have always thought, I feel very strongly it is a good program. But there is still a couple of billion dollars, I believe, in the pipeline. And we need to make sure that is expended.

And then some day, I believe it was then-Secretary Martinez, now Senator Martinez, said, we need to improve on this and we need to talk about perhaps maybe a HOPE VII. We are taking a look at it. Our folks in Public and Indian Housing are studying it, and they can give you good examples of how it is working, but in other areas where we can improve.

Mr. CLAY. Let me ask Mr. Cabrera, then, Mr. Bernardi mentioned HOPE VI several times. The President's budget for fiscal year 2007 proposes once again to zero fund the HOPE VI program, a program given high marks by many housing experts. How is Congress expected to improve the operation and performance of our public housing programs if we are constantly fighting for adequate funding among these programs? And how can the private sector reliably partner with PHAs seeking HOPE VI program funds when the long term viability of the program remains in question?

Mr. CABRERA. Well, one way is to leverage the capital fund. The capital fund is a fund that is open in the marketplace, in other words, PHAs can use the capital fund to do demolition and disposition of their properties, and they have.

The second way is doing precisely what Secretary Bernardi just said. One of the things we have discovered is that PHAs, as a general rule, are on a learning curve when it comes to development. They understand how to manage public housing units pretty well, they have been doing it for a while. But development is not something that they have been doing for a very long time.

An issue with HOPE VI, and I think the real context of the conversation is this, I think Deputy Secretary Bernardi has mentioned HOPE VI favorably in many cases, as has Secretary Jackson and the President. I want to distinguish that, though, from an effective use of funds. Of the $5.5 billion that has been allocated to HOPE VI, approximately $2 billion has not been used.

Adding to that, some of those developments are 10 years old. Usually what you would see is that in those cases where the PHAs apply competitively for HOPE VI money, those PHAs applied on their own, generally not venturing with a developer with the experience in construction. So therefore, they have been hampered in their development.

On the other hand, when you look at Atlanta, and that is a great example, Renee Glover appeared before you, she understood this. So she partnered with a variety of developers and got things moving. That model, I think, is predominating now. I think what you have seen in the last 2 years is PHA moving in that direction and realizing that development is a whole different ball of wax in management.

So essentially the short answer here is it is a learning curve. It isn't simply an issue of appropriation. It is an issue of how you utilize the appropriation on the ground level as a PHA.

Mr. CLAY. I agree with that, but I am still hearing two conflicting premises coming from this administration. One, the President zeroes out in his budget HOPE VI. Then I hear you today saying that all but $2 billion of the $5 something billion has been spent because housing authorities have been created.

Mr. CABRERA. No, the $2 billion is approximately somewhere between 30 percent and 40 percent of the entire appropriation. That is a significant number. I think this is what folks are wrestling with. In other words, great, it is a nice idea, but if you can't get the money used, you wind up in a position where the program comes into question.

Mr. CLAY. Now, there has not been a misunderstanding between HUD and the PHA? Initially, the PHAs were not under the assumption that they could come up with their own development and then told in the middle of the ball game, oh, you had better find a private partner? Has that happened?

Mr. CABRERA. Mr. Ranking Member, you know, I have only been here since November, so I don't know if it has happened in the past 11 years. It might have, it might not have.

Mr. CLAY. I see.

Mr. CABRERA. But I think the real issue amongst most PHAs, and I think most PHAs would say that yes, there is a remarkable difference between development and management and yes, it is a better policy than not to work within the framework of someone who knows construction than not to work within that framework.

Mr. CLAY. I know that in St. Louis, we have been able to find a pretty good partnership between PHAs and private developers, McCormick Barron being one of them.

Mr. CABRERA. We have had other large, major cities with HOPE VI developments that have struggled mightily with this issue because they did not partner. Now they have come to the issue of the partner.

Mr. CLAY. So if other cites come forward with a partnership then the $2 billion is still on the table?

Mr. CABRERA. Yes.

Mr. CLAY. Mr. Bernardi, did you have something to add?

Mr. BERNARDI. I wanted to address the budgetary concerns that you raised, Ranking Member Clay. As you know, we have a finite number of dollars with which to run all of our programs at HUD. The fact of the matter is, since 1998, 42 percent of our budget was consumed by tenant-based and project-based vouchers. In the 2007 budget, that percentage will go from 42 to 62 to 64 percent. I make that distinction to let you know that we are being pulled in many directions with a finite number of resources.

So logic tells us that if you have $2 billion that has not been expended in a particular program, albeit it a very good program and a program that works well in most cases, at the same time, we have other programs that we need to fund, so it is a balancing act, as you know, from budget year to budget year.

Mr. CLAY. Are there any considerations on the table for some type of creative, I want to say creative financing or in some ways have public housing authorities make money? Have you seen any examples of that?

Mr. BERNARDI. We have public housing authorities that utilize their capital dollars and I believe even their operational dollars to go out into the marketplace to bond and receive resources, so that they can repair and build.

Mr. CLAY. Like the authority in Atlanta.

Mr. CABRERA. May I add to the Deputy Secretary's answer?

Mr. CLAY. Sure.

Mr. CABRERA. I would go a step further. We have public housing authorities that are running units that are not within any restriction in terms of who they serve. So we have some public housing authorities that actually make a good amount of money basically being real estate managers. And they are using that money for development wherever they can.

Mr. CLAY. That is an interesting concept. I thank you, and I thank the chairman. I am sure I will get another opportunity.

Mr. TURNER. Absolutely. I want to thank my ranking member, Mr. Clay. As this committee has undertaken the issues of urban revitalization, public housing, he has been a leader both in his community and on this committee in making certain that we flesh out the issues as to how on the Federal level we can best assist those in our local communities in addressing our public development issues.

Mr. Bernardi, I had signaled to you that I was going to ask you a policy question. As you know from the hearings we have had, we have had a broad range of topics that we have discussed. So my questions will be very diverse in the areas that I ask you. And the first one is a policy question. To ask you this policy question, I am going to tell you a story first of when I served as mayor of Dayton. In our very first hearing, when we had former Secretary Cisneros and former Representative Lazio, I told them this story and asked them their comments, which sparked a specific policy debate that I want to direct toward you.

When I served as mayor of the city of Dayton, we had undertaken a fairly significant housing strategy with our view that we needed economic diversity not only in public housing but in our neighborhoods. And in looking at not only how we could use home dollars and other low income tax credit vehicles for providing quality, affordable housing, but ways in which we could bring market housing into our neighborhoods, specifically our inner ring around our downtown, where some of our more historic neighborhoods presented an opportunity for attracting capital.

In one of those neighborhoods, there was a public housing development that was a site for significant criminal activity, complaints from the neighborhood, complaints from those who lived within the development. And it was also strategically located as a piece of property that had significant economic redevelopment value.

Being aware that the public housing authority had a significant vacancy rate overall in its property management, I approached the public housing authority and inquired about the availability of this property for demolition and redevelopment and was surprised to hear from the then-director of the public housing authority that the housing authority was in the process of applying for funds to refurbish and redevelop this facility. They were actually going to be seeking the city's support for that. And they were not interested in

looking at this as a development opportunity that could be leveraged in partnership with the city in development for some of their other housing issues and needs.

The reason I was given by the director of the public housing authority was that the individuals that were living within this facility were not likely to move to the other vacancies that the public housing authority had because they were on the economic borderline of self-sufficiency and that there was significant amount of affordable housing available in the neighborhood in which this was located, that they would probably transition to independence rather than transition to other public housing facilities.

When I inquired, well, isn't that the goal, I was told that the cost to the public housing authority in the overhead charge that they are able to apply to operate this facility was important for them to be able to maintain their staff and functions, for them to be able to provide their services to their other facilities. That is a facility that is transitioning, where ultimately, through change of leadership, there was a desire on the part of the community and the housing authority to partner with the community in ways that site might be redeveloped.

That brought us to the public policy point on which former Secretary Cisneros and Representative Lazio disagreed. That is, there are some who believe that once a piece of ground has been public housing ground, that it should be forever public housing ground, regardless of the change in demographics in the community, regardless of the ability for the land to serve both those who are in public housing and the community itself. And that the goal of providing affordable housing in public housing and assisted housing is not diminished by recognizing that a real estate portfolio of a public housing authority is a dynamic portfolio that can shift.

Could you please tell me what your view and perhaps the current view of HUD is with respect to the transitioning of property where it perhaps has become dilapidated, needs to be addressed as insufficient for satisfying the needs of those who live there, and whether or not communities can work in partnership with their public housing authorities for transitioning of land that at one point made perfect sense to be public housing but perhaps needs to be mixed use and mixed income or mixed housing and commercial?

Mr. BERNARDI. Mr. Chairman, the proposals that we have on the flexible voucher program and the asset management program I think will give me an opportunity to answer your questions. The fact is, the 3,400 plus public housing authorities throughout the country, they are not all the same. Dayton is not like Syracuse, it is not like St. Louis. St. Louis is different from Atlanta.

The fact is, we need to provide more flexibility and more responsibility to the public housing authorities to manage their operations given what is best in their particular locale. I can liken that to, asset management is so important to us, where each entity provides exactly what it takes to operate that entity, is the money that is being utilized there, is it being utilized to the best possible advantage, the best possible services, are the tenants being taken care of properly?

What we presently have is we have each public housing authority without asset management, where they present to HUD and

have for years, here is what it costs for us to operate our certain number of units and certain number of buildings. We need to break that down. That is not unlike a developer, in my opinion, who has three properties. Two are very profitable and doing very well and one is not. But to continue to lump them together, you indicated a particular piece of property in Dayton that the public housing authority had and I think you absolutely were trying to do the right thing, could you work together, and if you can't work together you can't get things done.

That doesn't mean, nor would we propose that we would want to lower the number of units that are available. But if a structure is not performing, if a structure needs to be razed, if you can move individuals within that same neighborhood, if you will, and provide them with affordable housing there, but you also mentioned that someone indicated to you, well, these folks would go out and become independent renters or homeowners, that is what we would all like to accomplish, that is what we are here for.

The fact of the matter is that our budget keeps increasing every year at HUD, as I mentioned earlier to Ranking Member Clay. But we don't serve more people, we don't have more units. I believe I am correct in stating that.

So what we really need to do, and our philosophy is with asset management and with the programs that we have, reducing improper payments and also the Moving to Work status, which we feel very comfortable with, which gives the housing authorities tremendous flexibility to provide employment opportunities, to provide term limits and rent reforms. Right now the rental structure that we have in place, it really lends to individuals, not stating the number of people that are in a unit, either not reporting or underreporting income. We have an awful lot to do.

In my opinion, again speaking for myself and HUD, we need to be as productive as we possibly can with every single unit and every single structure that is out there. The way to do that is to push as much as we can to the local housing authorities. Obviously with the checks and balances in place, but you can't have a big brother from Washington. We provide resources every year and we see basically the same results. I think everyone would like to see that change.

Mr. TURNER. Thank you.

Former Secretary Cisneros, whom I have great deal of regard for and who has certainly been a leader in the issue of economic diversity and addressing the issue of the condition of distressed public housing projects, espoused the view plainly and straightforwardly that once a piece of real estate has been designated as public housing land, it should forever be public housing land. I appreciate your view, which is consistent with former Representative Lazio's that it is a dynamic asset portfolio that we have to reflect, and that public housing is an integral part of a community, not separate from a community, and should be looked at in the overall development plan.

Which raises the next aspect of the exact same development that you actually mentioned in what you believe is important for the community to look to, and that is the preservation of the opportunities for the public housing that is at the site. The public housing

authority in Dayton had placed in its long-term strategy that this would be a facility that would transition, that would be demolished, and the real estate would transition to a mixed use. Their long-term plan included seeking Section 8 vouchers for replacing those units that were not one to one replaced.

Because this site was one that they had begun the process of determining that it would be demolished rather than refurbished, they did not refill each and every unit as they became vacant, which would be consistent with any asset management or property management, you would want to lower your costs, the impacts on the families, the impacts of relocation. And now they are concerned that the policy that they were pursuing of getting the units replaced with Section 8 vouchers and other units that they have, that they might be penalized for their process of having a long-term strategy and plan, and that the Section 8 vouchers may not be available to them for units that they did not fill in planning for the ultimate decommissioning of this facility.

We have heard this concern from other PHAs that as they do the asset management planning and they plan for a facility to be decommissioned, that reducing the population of that facility actually penalizes them, resulting in less qualification for Section 8 vouchers and then units for their management. Are you familiar with this concern and could you give us some thoughts on that?

Mr. BERNARDI. A little bit, and then I will defer to Assistant Secretary Cabrera. It would seem to me that we do not replace one for one when it comes to our HOPE VI program. What we are trying to do, as you mentioned, is to place individuals into affordable, market-rate, low income tax credit housing. I don't think the goal here is to keep the amount of units that you have or to add to these units. I think the big picture needs to be that we would like to lessen the number of units that we have over a period of time, if you want to look 10 or 20 years into the future. We want to be able to provide opportunities for individuals to have short-term housing, but at the same time, have the services that they need, the counseling, the employment opportunities, so they can be self-sufficient. I believe the overwhelming majority of Americans, that is what they would like to do.

Now, as far as the replacement of Section 8 vouchers for the individuals who are not part of the HOPE VI reconstruction, I believe they have those vouchers and they are portable. But I will leave that to Assistant Secretary Cabrera.

Mr. CABRERA. It is helpful when one looks at an issue like that to segregate things into two pots.

Mr. TURNER. Before you continue, this is not a HOPE VI site.

Mr. CABRERA. I didn't assume it was. I assumed it was just a straight demo dispo of some kind. So let's assume that it is a piece of property that is being currently used as public housing. Let us further assume that there are tenants there. They have been now approved for demolition. So that means that they more probably than not receive tenant protection vouchers for those people who were in those units. And those vouchers would be used as any other Section 8 program.

But the reason I wanted to create these two pots is, public housing works at the exclusion of Section 8. It is a distinct program.

So once those tenants have now moved on into units, the PHA would typically demolish the improvement and build something back, using whatever subsidy it wishes to use, private activity bonds, tax credits, if the State, in this case I am assuming it is the State of Ohio, has a State program for soft money for gap financing, great.

But they will build those units. Those units, when they are built, are either going to be given some public housing attribute, some or all of them, or they are not. They are going to be affordable housing units. Affordable housing units serve a wider band of demographics, but vouchers can be used at affordable housing units. Once they have gone and become temporary vouchers, they are inside of the baseline and they will not or should not be lost.

So I am somewhat at a loss for the concern. I think the concern might be coming from another place, which is that there is this sense, and it is the correct sense, that we have seen the Section 8 program grow so enormously that there are stresses building at the fringes over how much more it can grow. The Section 8 program has grown 100 percent in 2006 dollar terms since 1990; 100 percent. I am not talking about 1990 dollars versus 2006 dollars. I am talking about 1990 dollars in 2006 value versus 2006 value today. That is enormous growth.

So I think one of the things you might be hearing is tension over the reality that it can't keep growing, because it is beginning to impact the other programs within the agency, not the least of which is the capital fund, the operating fund. And this causes enormous policy stress.

Mr. TURNER. That gets me to my next question, and that is, Secretary Bernardi, recognizing this stress that is occurring and that people have seen the concern of this sort of pac-man future of Section 8 as it eats away overall at HUD's ability to look in the future for its budget, what are some of the things that HUD is looking toward, recognizing this growing impact on HUD?

Mr. BERNARDI. We need to make sure that our statutory and regulatory environment is conducive to what the public housing authorities need to undertake. I think the simplicity, flexibility, being progressive, I think public housing authorities maybe should look to consolidation. As a former mayor, I realized full well when you didn't have the resources that you could consolidate in such a way that you would be able to provide the same kind of service and increased service at least the same cost, if not a lesser cost.

I think it is going to be very, very important, the asset management program that we have put in place, that the housing authorities utilize that resource. That will give them the kind of control that they are going to need to utilize their resources so that they can stretch them farthest way possible.

Mr. TURNER. The number of PHAs, although our hearings were not budgetary in their focus, many budgetary issues arose. And many of the PHAs claimed that at the end of last month, HUD informed them that the proration of the public housing operating fund for 2006 would be significantly lower than had previously been announced. The PHAs argued that they had been funded at 92 percent of their eligibility for the first 6 months of 2006. Under the new rule, the annual proration would be reduced retroactive to

the first of the year to 85.5 percent, and that would have significant budgetary consequences for the PHAs, since they had planned obviously a certain level spent, as they had been going through the year at a certain level, that the magnitude of the impact then would be felt solely in a half of the year.

Would you want to comment on their concerns?

Mr. CABRERA. Currently we are looking at the issue. The issue is really being driven by utility costs. Utility costs exceeded what was expected by, as I understand it from the industry and frankly internally, approximately $300 million. That is a lot of money when you look at the entire operating subsidy budget.

That is an issue I believe we are going to need to bridge, and certainly we are spending an awful lot of time trying to bridge it as I speak.

Mr. TURNER. My staff has pointed out that a concern is that apparently in the budgetary document that HUD submitted to Congress for 2007 the Department estimated that utility costs would actually decrease from 2006 to 2007 and the budget document further estimates that the total 2-year increase in utility costs from 2005 to 2007 will amount to just 2.4 percent. I don't know if you have anyone with you who wants to speak on that. And I won't ask you a specific question on the budget numbers, other than to reflect that the staff had provided us these numbers. Do you have concerns about the current method in which HUD is looking at its future energy cost structure that impacts PHAs and their management? And what might you be doing to address that?

Mr. CABRERA. We are looking at the whole spate in terms of the budgetary concerns. So I would say that it is basically part and parcel of my previous answer. We are looking at the whole enchilada.

Mr. TURNER. OK. Switching to a random series of topics, rent simplification, Mr. Secretary, you mentioned that as an issue. Many of the PHAs raised it as an issue.

The Boulder Housing Partners gave us some pretty compelling information about what they are experiencing in rent calculation. In fact, they went on to state that, they gave us a story, and the documentation that went with it, in looking at rent calculation of a elderly and disabled resident who, in order to calculate the medication deduction was prescribed things from bananas to vitamin C and that their staff has an enormous task in looking at receipts for various purchases in order to determine what the rent calculation is.

I believe they were saying that 10 percent of their overall budget is devoted to the activities of rent calculation. They speculate that perhaps you might be looking at 3.2 million different rents in the process of calculation, and that there really isn't anyone served by having either the residents have to go through this process, which has to feel very violating at times, or the staff to go through the process of individually calculating a rent based upon expenses and income, rather than looking at some standard deductions and income proofs that would allow both the dignity of the resident, instead of having to come in with bags of receipts, and the staff time of the facility to be freed up and perhaps income confirmation but

expenses by looking at standard deductions. Could you comment on that?

Mr. BERNARDI. The rent reform is a major part of what we are putting forward to change the system. It is a very onerous system when it does come to rent. We need to be looking at flat rent, maybe percentage of income tiered rents. We need to look at this a little differently to allow individuals who perhaps earn additional dollars, maybe they should have an escrow account so they can realize that savings. The rent needs to be matched to local conditions. I don't believe that as a housing authority you are looking to charge rents so that you can have a better bottom line. I think you need to take care of the individuals as opposed to the agency.

We had improper payments back in 2000 that totaled about $3.2 billion. That has been cut better than half now by our review of tenant files, our extensive outreach and training, cooperation with States when it comes to data on HHS, using their income verification efforts along with ours. But in the final analysis, the rent structure needs to be changed. We need to make sure that people aren't working the system against us. A fair rent has to be charged, but I think it has to be transparent. I think it has to be flexible, and it is not flexible now.

Mr. TURNER. Mr. Clay.

Mr. CLAY. Thank you, Mr. Chairman.

Mr. Bernardi, our Section 202 and 811 programs for the elderly and disabled are vital to elderly and disabled individuals, as these households represent about 75 percent of public housing's population. I believe these programs represent those with the greatest needs and must be our first priority when contemplating any future policy changes. Yet HUD's fiscal year 2007 budget request would have made significant cuts to funding for these programs. Fortunately, this funding was restored in the House during the appropriations process.

What is the administration's rationale for trying to cut these programs?

Mr. BERNARDI. Ranking Member Clay, the difficulty in the budget process, Secretary Jackson testified that difficult choices had to be made. I mentioned earlier the amount of dollars that we are spending on our tenant-based and project-based. It is approximately $22 billion of our 2007 budget out of a $32 billion budget. That is 62, 63 percent. Just back in 1998 it was 42 percent.

In the 202 and 811 program, for the elderly and for the disabled, the budget that has been proposed is not going to affect the individuals that are part of the process, or the maintenance of what we have. Unfortunately, what it does affect is creating additional units. We fund all the renewals and the issue is construction funding, as I was saying. There are funds that are unexpended in those accounts.

But in the final analysis, even giving you that kind of information, it is very difficult to balance all of our programs, our home program, our homeless program, housing opportunity for persons with AIDS, our manufactured housing. We have significant challenges, and we would like to be able to fund them all, if we could.

Mr. CLAY. We do have significant challenges. I know that in the coming years, we will experience a huge wave of retirees, with the

aging and graying of the baby boomers, which tells me that we ought to be prepared for that onslaught of new elderly. Would it be helpful if you all were allowed to shift some of this funding? Like you said, there are surpluses in some programs. Do you do that now? Do you shift the funding, the dollars from one program to the next?

Mr. BERNARDI. We try the best that we can to make sure that all of the funding requests, that they are in programs that are functioning to full capacity as possible. We mentioned the HOPE VI program earlier and the amount of money that is in the pipeline.

The fact remains, you are absolutely correct, with the baby boomers coming to their time right now in the next few years, myself included, there is an awful lot of senior citizen and elderly housing that is going to be necessary. I would hope, though, that would be an opportunity in many instances where you would have the private sector, in conjunction with Government, working on that.

Mr. CLAY. Let me ask you about another situation. In St. Louis, there are over 700 units out of 3,700 in the project-based public housing program unavailable because of demolition or modernization efforts. While we want to continue improving our housing choices for our families, many communities face a chronic shortage of vouchers or project-based units. Would you agree that modernization and development efforts for new Section 8 housing are often too slow to meet demand?

Mr. BERNARDI. Well, the demand obviously outstrips the resources that we have. But to do the modernization, unfortunately when you do demolition you are going to have situations where you are not going to be able to replace unit for unit. More resources would be nice, but with limited resources, I believe we are doing the best we can.

Mr. CLAY. Is the modernization project approval process broken, and other processes, are they broken as far as how HUD interacts with public housing authorities?

Mr. BERNARDI. No, I don't believe so. I think the relationship that our Assistant Secretary and his staff has with public housing authorities is a very good one. It is ongoing. There is constant communication. The situation calls for additional resources, and we put those resources to play where we can.

Mr. CLAY. Mr. Cabrera, would you like to comment?

Mr. CABRERA. Yes, I would have to say that it probably is working better now than it has in a very long time, for a variety of reasons. Public housing authorities, like anyone competing for a resource, and I don't mean competing for a HUD resource, I mean competing for resource, when they put together these deals, they have to look at a variety of pools.

The first place they look is not HUD. The first place they look when they want to develop units is the low income housing tax credit. And the reason is because it is not debt, it is equity. Therefore, they are not going to owe any money. Yet they will have units that can serve their residents.

So that is a competitive process. In the case of Missouri, my good friend and now former executive director, Erica Dover, put together

a wonderful program that helped PHAs, I believe, that in Missouri there was a setaside for PHAs.

But what happens is, you can't stop there, because the low income housing tax credit by law cannot finance a deal by itself. It has to be brought into context with other components, other money. That money can be State money in the form of gap financing, that money can be local money. Here is some money that can't or typically is not used if it is done directly. It is very rare to see that kind of development come up with CDBG. Why? Because it is a dollar for dollar reduction in eligible basis, which means you get less tax credits. So you are more likely to see a loan come from a State than CDBG.

You look for other moneys, from non-profits and NGO's. So it is a difficult process to get those units up. But it is multi-layered, it is a cake.

I would like, Mr. Ranking Member, I wonder if I might be indulged to go back to the 811 issue for a moment. I can't speak to 202, 202 is housing, not me. But 811 is in part me. And what is happening in 811 is the voucher programs actually, that budget has increased significantly. So the issue in the debate currently, in that group of stakeholders, is do we want more vouchers so that folks who have disabilities can go out and look for units where they can or where they want to, or do we want to build the units where they will be? That is a debate that has been going on for some time.

But certainly in the budget, the 811 voucher allocation or appropriation is higher, considerably higher than it was the prior year.

Mr. CLAY. I appreciate what both of you all have said and how you have answered the question about the process, saying that it is not broken. However, when we hear from PHAs, they indicate to us that the process is broken, which tells me that there is probably a breakdown in communication between your offices and their operations. Perhaps we could do a little better job of working with each other in that circumstance.

Mr. CABRERA. Mr. Ranking Member, I think most people in the stakeholder community would tell you that they have my e-mail address. The reason is because I give it when I give speeches. And they have my number. And they are not shy about calling, or for that matter yelling.

So at the end of the day, I think what happens is, it is 3,400 PHAs. When you look at the pool of 3,400 PHAs, and those undertaking modernization, most of them would say, no, this is going pretty smoothly. If you were to talk to Chicago, they would say, oh, it is going quite smoothly, because we have moved faster on deals than has ever been the case before. If you look at other cap fund deals throughout the country, they would tell you the same thing.

So my sense of life is it is moving much faster. Is it perfect? No, but I don't think that it can ever be.

And the other truth of the matter is, sometimes we run into PHAs that are not equipped to deal with the process of getting a loan. The reason they are not equipped is they do not have the experience of having done it. So they don't have, for example, a lawyer. This happens a lot. They don't have a financial advisor. So

they will come in on their own looking for a loan, and that can actually exacerbate the problem.

Mr. CLAY. I thank you for that response. In my final question, GAO has done work on the amount of improper payments made under HUD housing programs. One, can you describe for us the extent to which fraud or mismanagement has drained the resources of HUD's housing programs; and two, are there significant managerial challenges that pose a barrier to adequate oversight of agency expenditures?

Mr. BERNARDI. As I mentioned earlier, Mr. Ranking Member, back in 2000, the improper payments totaled $3.2 billion. Through the hard work of our folks at PIH and in conjunction with HHS and income verification with the States, we have been able to reduce that by better than, I think almost 60 percent. We have a rating system, and OMB has given us, I think we are the only agency in the Federal Government in improper payments that has a green light, if you will. We are making good progress. Of course, we want to eliminate it all. We are working toward doing that.

But at the same time, I would like to couple my response with, we really need some rent reform. The system is in place right now, it just tends to have people try to beat the system as opposed to having a system in place that is fair. If people make additional dollars, that does not necessarily mean it does now, that has to go toward rent. I think people need to see a light at the end of the tunnel, if you will, where they can utilize those resources, have an escrow account and then move from public housing Section 8 low income housing tax credits on to self-sufficiency.

Mr. CLAY. Thank you for your response, both of you. I appreciate it, Mr. Chairman.

Mr. TURNER. Thank you, Mr. Clay.

Two other questions of items that have come up in testimony that we have had from other PHAs. In the Moving to Work program, the current rule for Moving to Work work requirements is, I believe, 8 hours per month. There are some PHAs who indicated, who are in the Moving to Work program, their desire to increase that, both with community support and through agency support. And they cited difficulty in the administrative process and working with HUD in order to increase those requirements.

In your both adamant policy commitment and also your eloquent statements of transition, this is a direction that certainly would assist those who are transitioning to independence. Could you please comment on the PHAs' efforts to increase those requirements and provide that assistance to residents?

Mr. BERNARDI. I will start it off, and then give it to Assistant Secretary Cabrera. I think we have about 30 Moving to Work programs—27—27 programs. It has proven in our judgment that if it works real well that they experiment with term limits, with rent reform and employment incentive. We need to do more of that. I know that our PIH department works very closely with the housing authorities to maximize that Moving to Work program. I know that others would like to have that same opportunity.

Mr. CABRERA. If it were an issue, it is an issue of a baseline. If a PHA wants to exceed the baseline, I don't believe that PIH would ever say no.

The issue in Moving to Work has more to do with flexibilities for PHAs to function in a looser regulatory framework than not. So my experience, I was reading the testimony and I was struck by Mr. Moses' testimony when he said the jury is still out. I think if you ask PHAs, the jury is not out. The jury has come back and said, please, please, please, give us Moving to Work. The reason is because in the cases of the high performers, it gives them the ability to deal with those things most critical to them: operating flexibility and attending to their units.

This is the thing that sometimes gets lost in the conversation. Moving to Work has been equally important in those PHAs that have traditionally been troubled. The reason that they have become helpful is because usually when they have been troubled they have been in receivership and you can use the flexibility of Moving to Work to restructure them so that they are healthy when you move them back to normalcy.

So I think on the whole Moving to Work has been a rather resounding success in most cases.

Mr. TURNER. From many PHAs, we hear concerns of the impact of drug dependency being classified as a disability. As PHAs attempt to have senior housing that includes a disability component, many times the clash between those who have been classified as having a drug disability, a drug dependency and therefore a disability, in a facility that is predominantly focused on senior housing as being disruptive and an issue of safety for the residents that are there.

We have heard this from many PHAs. I wondered if HUD had taken up this issue, what your thoughts might be and if you are undertaking a policy review of what might be able to be done there.

Mr. CABRERA. We are not currently undertaking a policy review. Part of this issue comes back to what I noted during my opening statement. Looking at PHAs through a financial prism is quite different than looking at PHAs through a social prism. The thing is, public housing is just one component of a very large issue. That includes issues of drug dependency. HUD is not, and I don't believe anybody would say it is, well equipped to address drug dependency amongst its tenants or anyone else. It might be equipped as one of the places the media by which a drug dependency program could be undertaken.

Mr. TURNER. The question doesn't relate to how to intervene to provide assistance to someone who has drug disability. The question is, the drug disability as a classification carries with it a disability designation which then permits someone to be eligible for housing that is both senior housing and disabled housing. And that drug dependency as a disability causes a disruption and thereby has been a threat to those senior residents who are typically not seeking housing that might have that interruption or influence in their community.

Mr. CABRERA. Mr. Chairman, I am sorry. I misunderstood the question. It is a very short answer. We are not currently looking at that issue.

Mr. TURNER. It is one that we have been looking at with PHAs, and that we may be looking at whether or not there is a legislative fix to provide PHAs the flexibility to be able to say that drug de-

pendency is a disability in areas where they are attempting to provide senior housing perhaps it is not compatible. I raise the issue expecting that you probably did not have a policy aspect on the table, but that you might also want to concurrently look at the issue.

Mr. BERNARDI. We would be happy to convene some of our people and have a discussion on that with your folks.

Mr. TURNER. Great. Thank you.

I would like to recognize our Vice Chair, Mr. Dent from Pennsylvania.

Mr. DENT. Thank you, Mr. Chairman. I appreciate your holding this hearing. I also thank you, gentlemen, for being here today. I know that you have also discussed a little bit about the HOPE VI program, and I didn't hear those comments. But I just wanted to point out again, I appreciate the Department's help with the HOPE VI project that is currently underway in my district. It appears to be attracting considerable private sector investment.

As you know, the administration has recommended not to fund HOPE VI in its recent budget proposals. The main question is to Mr. Cabrera. What is your experience with HOPE VI and if so, what is it about the program that you seem to think might attract that much private investment?

Mr. CABRERA. My experience with HOPE VI when I was the head of Florida Housing was that it tended to consume a lot of resources that were not HUD resources with the resources that Florida Housing was allocating, and not necessarily producing units in a timely way. One reason for that is something, Congressman, we were discussing just a bit ago. So I am going to rehash something, and I am afraid I am going to bore Ranking Member Clay and the chairman.

HOPE VI's issue is one of initial choice when a PHA applies for HOPE VI. If a PHA, which is not a development entity traditionally, and to the extent they have become one, have become one recently, last 5 years or so, undertakes a HOPE VI deal on its own, typically it runs into a problem with reality. And reality is running a construction program is very different than managing units.

So what we have seen over time is HOPE VI deals that have been put together as joint ventures with precisely what you said, which is with the private sector, and I include non-profits, incidentally, in the private sector. They tend to move better. They tend to perform better. The problem with HOPE VI over time has been that one, where originally, and Deputy Secretary Bernardi mentioned it earlier, you had a situation where you didn't even have to show readiness to proceed. And in the case of redevelopment, readiness to proceed is everything. If you are not ready to proceed, it is your sure path to bad things.

So what becomes important is the ability for the PHA community to become more comfortable in partnering with the private sector. One of the problems there has less to do with Congress or Federal policy and more to do with State policy. Many States, most States, all States have statutes that essentially charter PHAs. Many of those statutes have not been visited in 40 years. So PHAs are sometimes working under a rubric where they believe they can only go so far in terms of risk-taking. So they believe they have to do

it themselves. Other times, it is just choice. They want to do it themselves. More often than not, the successes have been when they worked with the private sector.

Mr. DENT. So I guess part of your concern with the HOPE VI is the timeliness of expenditure of the funds, if I understood you correctly, among other things?

Mr. CABRERA. Yes.

Mr. DENT. Detroit had a situation, they had three HOPE VI grants, I believe, and I don't know how quickly those moved, but that was something like 8 years ago.

Mr. CABRERA. They are great examples, Congressman. Thank you. In one case, it is 10 years ago and in the other two cases, it is 8 and 6. Only recently after HUD has taken Detroit Housing Commission into receivership, with the cooperation of the Mayor, have those units been able to move, or those developments been able to move.

Mr. DENT. Is there an effective measure that HUD might be able to implement to regulate the timeframe in which a grant must be utilized?

Mr. CABRERA. It is certainly, I think the fair answer to that is probably yes. I think one effort that was made by my predecessor, Assistant Secretary Liu, was to attack the issue of readiness to proceed. Because essentially it means everyone's skin is in the game.

When you approach development, the issue is precisely what you identified, which is time. When you have private sector involvement in that, their issue is, get it built as quickly as possible, because if you take longer than it should, it is going to cost you a boatload of money. So you don't necessarily need to do that by regulation in terms of giving them a deadline. You need to do it by regulation in terms of making sure all the pins are set prior to shooting your bowling ball down the alley. So that is really where Assistant Secretary Liu focused correctly, and it has been very effective in the last 3 years.

Mr. DENT. Mr. Chairman, I yield back.

Mr. TURNER. Thank you, Mr. Vice Chairman. I have one more easy question for you, Mr. Secretary, then I will open it for you and Mr. Cabrera to make any closing statements that you want. And that is, you had mentioned affordable housing tax credits. We talked to many PHAs who have undertaken tax credit projects as part of their overall portfolio. My understanding is that in the affordable housing tax credit process that HUD does not have a significant role in the administration of that program and yet it is obviously part of the Federal plan for housing. Do you believe that there could be greater coordination between the affordable housing tax credit program and HUD's public housing programs?

Mr. BERNARDI. We obviously like to be involved as much as we possibly can. But at the same time, the affordable housing tax credit program goes to the States and the States distribute it. As far as getting involved in the distribution process, that is a format that the States use. I think they take a look at what is needed and which housing authorities are going to utilize it in the best possible way.

Other than that, I can't see us involving ourselves any further.

Mr. CABRERA. I would like to take my hat off as Assistant Secretary for a little bit and put my hat on as former executive director of Florida Housing. HUD has a very important role to play with respect to the low income housing tax credit in four ways. The Secretary basically designates difficult development areas. The Secretary can name which qualified census tracks are in play for what is called the 40 percent bump. And HUD puts together the rent caps for low income housing tax credit developments.

The beauty of the low income housing tax credit is it is largely autonomous. Because people focus on the developer. The developer is not where the game is with low income housing tax credit. The investor is.

If your deal goes sideways because you did something wrong, the folks who have to deal with the IRS aren't the folks at the development. It is the folks who put the money into the deal. And the recapture provisions are so harsh that there is assurance that there is performance.

From our perspective, certainly, and I think my staff would tell you, I have made it my mission to make sure that folks are better educated on how it works, so that at the very least, from PIH's perspective, we do no harm. That is the issue. We get out of the way. Learning to get out of the way is very important.

So I think my focus has been, look, we need to know this specifically with public housing, our area of public housing investment. Because it gets used so often, it gets used when we deal with HOPE VI, it gets used in other modernization. So it is a good thing. But at the end of the day, I think the biggest role we can play is understanding the limited nature of our role.

Mr. TURNER. I appreciate both your answers to that. I am a big fan of the affordable housing low income tax credit. It has been a great vehicle in my community, specifically in the area of senior housing. I appreciate your perspective on that.

With that, I want to ask, we have had a series of questions, and you might have some thoughts that you want to add to the record before we close, or any statements that you might want to make and things that we have not asked that you have expected or prepared for.

Mr. BERNARDI. Chairman Turner, I want to thank you, and I want to thank you for holding not only this hearing but the previous hearings that you have held in a very important part of the American process. We need to make sure, and we at HUD are committed to making sure that low income Americans have the opportunity for decency and quality housing. Where we will be 20 years from now, hopefully this hearing and other hearings that you put forth will be able to provide greater assistance to the people that are in need. We know there are waiting lists, and we need to make sure that every person that has access to affordable housing has the opportunity some day to be out there on their own, independent, either renting or purchasing a home.

We are committed to the mission, and that mission is to utilize the resources in the best possible way. We need changes, and I think we have brought forth those changes today, with the asset management, with the changing of the rent structure. We are tak-

ing a look again at our HOPE VI program. And Assistant Secretary Cabrera mentioned the low income housing tax credits.

It is an area that is forever evolving, but at the same time, it is staying the same. We can't do that. Everything changes. We need to change our approach. We need to work even more closely with the interest groups and the executive directors throughout this country to make sure that the housing that we provide is not permanent housing, that it is a way station, if you will, to self-sufficiency for more Americans. And I want to thank you.

Mr. CABRERA. First of all, Mr. Chairman, thank you very much. I would like to thank Ranking Member Clay and Congressman Dent as well.

I guess from my perspective, in terms of looking, I would like to focus on the future and what we worry about, what we deal with most. That is, we are currently dealing with a public housing delivery system that is 70 years old, with in many cases, 70 year old improvements. Our issue is dealing with these things, dealing with these improvements as either performing real estate or under-performing real estate. That is going to create a forum where people can have broader conversations than have been had traditionally, conversations about what do we want to do with precisely what you mentioned in Dayton.

Just coming back to Secretary Cisneros, should a piece of dirt have an encumbrance on it that is essentially in perpetuity. And my answer would be, well, it depends. It depends on what you want to do, it depends upon where that is situated. You have to make economic decisions. Most of what we are talking about here has to do with economic decisionmaking. Public housing authorities have traditionally not had to mostly focus on thinking about economics. They have thought about a lot of things, but they haven't really thought about economics and structure. They are moving to a point where they have to access markets. And markets only understand things in the way that markets understand things.

So we can't have PHAs that are incomprehensible to, for example, rating agencies or bond insurers. Because otherwise, they won't have access to money. With 70 year old improvements, they need that access.

The second thing is, we really and truly need to deal with issues like rent reform, like income. Because those are two issues that were in H.R. 1999 that are critical to change. The reason that they are critical is because they evince local control over these issues.

Much of what you have heard us discussing is an impulse to move as much as possible toward a local control on the theory that the local PHA, No. 1, can be trusted because they are tied to their communities, they are accountable to their communities, but No. 2, they know better what their real estate market is than we do. We are working in some cases with respect to rent on 2 year old, not some cases, in most cases, 2 year old information when it comes to rent setting. And that is a very big change from where we were before.

So coming back to it, I think we are focusing on issues of change, of financial management and of a commitment to local control.

I would like to thank your staff, who was kind enough to sit with us for about an hour on the phone and have a good chat. With that, I will close. Thank you very much.

Mr. TURNER. Thank you, Mr. Cabrera. I appreciate your dedication and the expertise you bring to HUD. Mr. Secretary, I greatly appreciate both your bringing your service as a mayor to HUD and also your thoughtfulness to the people who HUD serves and looking holistically at HUD's programs as a part of an overall impact on a community.

Please pass on our appreciation to Secretary Jackson for his leadership of HUD and his commitment. As you and I discussed, he toured Dayton and we were very appreciative of his thoughts as he looked to our development challenges. We certainly would invite and welcome you there so we could show you some of the things that we have both accomplished and see as challenges in the future that go to some of the topics we have discussed today.

I thank you for your preparation. I know that all of you have a pretty strong to-do list. So whenever you take time away to come here and speak on these topics, you not only spend time preparing, but also spend time with us. It gives us greater insight into what we need to do for our job. So I appreciate your willingness to share your knowledge and your time.

I would also like to thank my colleagues for their participation in this hearing. In the event that there are additional questions that we did not have time for today, the record shall remain open for 2 weeks for submitted questions and answers. We thank you all. We are adjourned.

[Whereupon, at 11:35 a.m., the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

Follow Up Questions
Public Housing in the 21st Century: HUD's View
On the Future of Public Housing in the United States
(July 18, 2006 Hearing)

1. The PHAs report the final published Operating Fund rule is significantly different from the rule negotiated between HUD and stakeholders. Your colleagues characterize this issue as among the most controversial the Subcommittee will examine on the topic of public housing. Please describe how HUD arrived at the final rule. Additionally, please discuss the differences between the published rule and the negotiated rule.

Response: The Final Rule on the Operating Fund Program does not vary significantly from the "negotiated rule", i.e., the rule that was developed with industry stakeholders. The Department made only two changes in the final rule from the negotiated rule: (1) the Department eliminated the $2 PUM public entity fee and (2) the Department retained the existing methodology for determining the annual inflation factor. All other provisions remained the same, including the requirements for PHAs to convert to asset management, stop loss, and related timeframes for implementation.

2. The PHAs claim the new Operating Fund rule is unreasonable in its treatment of property and asset management fees. Moreover, the PHAs argue that HUD's guidance on this topic would micromanage the way housing authorities use their funding. They further argue the asset management and bookkeeping fees in HUD's guidance are "one size fits all" and are based on inadequate data.

   a. Can HUD change the new rule's property and asset management fess to better coincide with the way the PHAs say they use their funding? If so, how?

   b. Please also respond to the PHAs' concern that HUD guidance on property and asset management fees is based on inadequate data.

Response: The Department does not believe that the proposed project management fees, bookkeeping fees, and asset management are "unreasonable" or that they represent "one size fits all" response.

- **For project management fees, PHAs may use one of three methods: (1) the fee schedules established for each field office in HUD's multifamily housing programs, (2) the 80th percentile of fees paid in HUD's multifamily housing programs (again, by field office), or (3) other compelling local data that a PHA might submit, e.g., fees paid to private management firms as a result of competitive bidding.**
- **A bookkeeping fee (for reimbursement of the project accounting function) of $7.50 PUM. In FHA housing, the average bookkeeping fee is about $3.50 PUM.**
- **An asset management fee of $10 PUM. This asset management fee is based on an analysis of the cash flow in FHA housing and the fact that some of the "owner functions" that private operators fund through cash flow are funded separately for PHAs through the Capital Fund program.**

The Department would not want to "change the new rule's property and asset management fees to better coincide with the way the PHAs say they use their funding" because one of the major provisions of the final rule, which was agreed to by industry stakeholders, was to conform management practices to those that exist in the world of multifamily housing. In multifamily housing, there are established limits on the management fees that owners/managers can charge their properties.

Finally, the above guidelines are based on the operating cost data of some 1.5 million FHA units.

3. The PHAs suggest that HUD should allow agencies to use transitional property management fees until the 2011 deadline for implementing project-based management.

   a. Can HUD implement a transitional property management fee schedule?

Response: The Department has proposed and will implement a transitional property management fee schedule. The Department has instructed PHAs that, as a reasonable phase-in period, they do not need to abide by these reasonable fee rules until the second year of project based budgeting/accounting (the first PHAs that must implement project-based budgeting/accounting are those with fiscal years beginning July 1, 2007). Hence, most PHAs have more than two years to get ready for these new overhead reimbursement requirements.

   b. If not, why not?

   c. In the Department's view, what are the potential difficulties with this recommendation?

Response: The final rule, agreed to by industry stakeholders, provides that PHAs must, in the conversion to asset management, implement project-based budgeting and accounting. The rule's definition of project-based accounting includes the charging of "reasonable" fees. As noted in the answer to 3a, the Department has instructed PHAs that, as a reasonable phase-in period, they do not need to abide by these reasonable fee rules until the second year of project based budgeting/accounting (the first PHAs that must implement project-based budgeting/accounting are those with fiscal years beginning July 1, 2007). Hence, most PHAs have more than two years to get ready for these new overhead reimbursement requirements. The Department believes that this extra year of phase-in is reasonable and in the spirit of what was negotiated.

4. The PHAs argue that assisted multifamily programs and public housing are subject to very different regulatory and operating limitations. The PHAs argue that HUD should adopt management fees that allow for these differences. What is the Department's response to this argument?

Response: The Department agrees that there are certain regulatory differences between public and assisted housing (see Appendix H of the Harvard Cost Study), which is also one

of the reasons for the phased-in rules regarding management fees. The Department has examined those differences and has a series of initiatives to streamline rules/procedures that it can effect (some differences, such as HUD-Determined Wage Rates, are rooted in statute and the Department looks forward to working with the Congress on this front). For example, this fall the Department anticipates issuing a new public housing program handbook and a new Annual Plan document, both of which will be greatly streamlined from current practice.

Further, by allowing PHAs to charge, as a matter of right, either the fee schedules set for each HUD Multifamily field office, or the 80th percentile of fees paid in these field offices, the Department is allowing PHAs to charge fees that, in many cases, is some 20% higher than the median fees paid in those markets. While HUD sets ceilings for all markets, most operators don't charge those amounts. Hence, PHAs have been permitted to charge fees that are higher than what most firms charge, allowing them more resources to address the potential impact of some of these regulatory differences.

5. The PHAs argue HUD should consider basing property management fees on what the PHAs term true operating costs.

   a. What is HUD's method for determining operating costs for management fees under the new rule?

   b. Why did HUD choose this method over basing management fees on what the PHA's term "true operating costs?"

Response: The management fee guidance that the Department has established is, as indicated above, based on the fees actually paid by FHA operators. Because most PHAs are not operating in an asset management environment, they cannot identify by project which of their costs are front line costs (directly associated with supporting the project) and those costs that would be funded through the management fee. The Department would not consider setting fees "on what the PHAs term true operating costs", i.e., what it currently costs PHAs. Such action would be contrary to the rule that was negotiated, which was to conform public housing to the norms in multifamily.

6. The PHAs argue HUD's Operating Fund rule does not account for geographic and other cost differences in its bookkeeping requirements. They claim that HUD should undertake a review of existing regional data and implement a regional approach rather than adopting a fixed, nationwide bookkeeping fee. Please respond to the feasibility and advisability of this regional approach.

Response: As indicated in the response to Question number 2, the average bookkeeping fee in FHA housing is about $3.50 PUM, well below the national standard that has been set for public housing of $7.50 PUM. For simplicity purposes and ease of implementation, the Department determined that, for this line item, there would be advantages to having one fee (just as there is one national add-on under the final rule for IT fee, resident

participation fee, and asset management fee). The Department will consider the option of varying this fee by region, as requested.

7. The PHAs claim the new Operating Fund rule calls for housing authorities to have the "maximum flexibility" possible. The PHAs argue the rule's proposed guidance does not provide the flexibility housing authorities need to implement the business plans they have developed for their property profiles. In the Department's view, how does the proposed guidance ensure PHAs have the "maximum flexibility" possible as required by the Operating Fund Rule?

Response: The final rule that was agreed to by industry stakeholders provided PHAs with "maximum flexibility" with respect to the presentation of their annual project budgets but otherwise established a new operating structure that was consistent with the norms in multifamily housing. It was universally agreed that public housing should move to a system of project-based budgeting, accounting, and management. As the Department has established implementing instructions, it has, in fact, followed the rules/standards/practices that exist in multifamily housing. PHAs are not, in the conversion to asset management, being asked to do things that are different from operators of assisted housing. In fact, the implementation of this multifamily model will give rise to significant greater PHA flexibility. The Department is not dictating how PHAs should be organized. Instead, the emphasis is on performance and cost-reasonableness. Moreover, the fees that PHAs charge, provided they are reasonable, will no longer be considered "program income" and thus will not be subject to Federal restrictions, consistent with how the Department monitors and regulates operators of assisted housing.

8. The new Operating Fund rule calls for "reasonable" asset management practices. The PHAs argue, however that HUD interprets the term "reasonable" to mean the same requirements and practices as required for HUD multifamily programs. The PHAs further argue HUD should factor into the rule innate differences between the two types of programs. What is the feasibility and advisability of this approach?

Response: The Department has made accommodations for certain differences in public housing in the implementing instructions. For example, whereas a private operator of assisted housing would not be permitted to charge the cost of a supervisor of a central waiting list as a front-line expense, the Department, because of the long history of HUD requiring PHAs to maintain central waiting lists (no longer permitted), has permitted PHAs to include this expense as a project expense.

9. The PHAs argue the new Operating Fund rule's requirement that PHAs pay for "centralized front-line costs" out of management fees is detrimental. Specifically, they claim the provisions effectively "micromanages PHA's organization structures." Does this approach effectively micromanagement PHA organization structures? If the answer is no, please explain why the provision does not micromanage PHA organization structures.

Response: The Department has not "required PHAs to pay for centralized front-line costs out of the management fees." Quite to the contrary, the Department has permitted PHAs to

pro-rate to projects the costs of front-line administrative tasks (say, central rent collection, central reexaminations, etc.), provided those costs are reasonable and necessary (consistent, again, with rules in multifamily). For maintenance, because one cannot simply pro-rate central maintenance, PHAs may either charge actual costs (based on work orders, time sheets, etc.), or they may charge a reasonable fee-for-service (an amount not more than what other projects would normally incur for that service). The Department's implementing instructions only require the PHA to pay for that portion of any centralized front-line cost that is not reasonable and, therefore, should not be a project cost.

10. The PHAs recommend that HUD account for asset management responsibilities and costs using comparable market standards, such as those incurred by private owners and project-based Section 8 contract administrators, instead of adopting a fixed nationwide asset management fee.

    a. Is this a feasible approach to determine asset management cost? If not, why not?

    b. If HUD can adopt this approach, is this method advisable? Why or why not?

Response: As noted in the response to Question number 2 above, the asset management fee is based on an analysis of the cash flow in FHA housing and takes into consideration the fact that some of the "owner functions" that private operators fund through cash flow are funded separately for PHAs through the Capital Fund program. Additionally, the final Operating Fund Rule provides a ten percent non-profit coefficient to take into account differences in operating costs between private owners (for profit entities) and non-profit entities as reflected in the FHA database that was used for the Harvard Cost Study. As the PHAs transition to asset management, the Department will continue to evaluate all aspects of the program and will make adjustments, as necessary, to ensure the effective operation of public housing assets.

11. There appears to be a consensus on the need for rent reform. The Subcommittee understands HUD is also an advocate of rent simplification.

    a. What is HUD's vision of rent simplification?

Response: HUD's vision of rent simplification would be to (1) eliminate the myriad of existing mandatory exclusions and deductions from income, (2) provide PHAs with the local flexibility to establish rent structures that will address the needs and priorities of their communities (such as such as encouraging work by decoupling rent from income), (3) permit PHA flexibility in conducting annual and interim income reexaminations, (4) reduce errors in income and rent calculations, and (5) provide incentives for work and increased income.

    b. Does the Department agree with the rent simplification principles set forth in H.R. 5443, which the Financial Services Committee recently approved? Of the answer is no, please explain why.

Response: The Department does not agree with the rent simplification principles set forth in H.R. 5443. Unlike H.R. 1999, the bill does not simplify rent calculations and income determinations, nor does it provide PHAs with the local flexibility to establish rent structures that will address the needs and priorities of their communities. In fact, rather than reforming what is a very complicated and administratively burdensome process in the existing public housing and housing choice voucher programs, the provisions of this bill will make a bad situation even worse. The bill will result in rent and income provisions that are more complex and not cost neutral, and is likely to increase improper payments, especially in the transition period.

Examples of HUD's specific concerns with H.R. 5443 are summarized below.

- **Income exclusions. Fails to adequately eliminate the myriad of existing exclusions from income and opens the door for additional exclusions and deductions.**
  - **Medical expenses retained, PHA still must calculate.**
  - **Bill provides for other income exclusions established by Secretary or other Federal law. It is extremely difficult for HUD to eliminate long-standing exclusions such as child-care expenses. Interest groups can retain or add additional exclusions by tacking on to other legislation.**

- **New complications. Requires elderly/disabled and dependent deductions to be revised on an annual basis. HUD must also try to calculate an inflationary factor to be used by PHAs for fixed income families that is fair, which may prove difficult given the wide variety of fixed income sources as defined by the bill.**

- **Loss of flexibility for PHAs on conducting interim reexaminations. It mandates when PHA may conduct interim and excludes increases in income. While the bill is attempting to reward work, in an environment of tight budgetary constraints PHA should retain current administrative discretion to determine when and if to require interims for increases in income.**

- **Elimination of housing choice voucher 10% of family income branch for computing tenant rent. Believe this was a drafting error since similar provision for sections 3 and 8(y) were not retained.**

- **Unclear whether these rent provisions apply to project-based assistance programs. HUD would not want these provisions to apply to project-based assistance programs.**

- **H.R. 5443 is not cost neutral. In HUD's preliminary estimate, four "costable" provisions (increase in elderly/disabled deduction, increase in dependent deduction, elimination of annual review, cost savings of rise in threshold for medical expenses) would require additional appropriations of at least $300 million a year.**
  - **PD&R estimated the increase in the elderly/disabled deduction to $750 from $400 would cost approximately $137 million a year.**
  - **PD&R estimated the increase in the dependent deduction to $500 from $480 would cost approximately $97 million a year.**

- **PD&R estimated the decrease in the medical expense deduction (by increasing the eligibility threshold from 3 percent to 10 percent of total income) would save approximately $64 million a year.**
- **PD&R estimated the elimination of annual review of fixed income tenants would cost approximately $117 million a year.**
- **PD&R was unable to cost out the inflationary adjustment for fixed income families, as the Bill offers no direction to the Secretary about how such an adjustment is to be made.**

c. What are the fundamental differences between your approach in H.R. 1999 and those found in H.R. 5443?

Response: Differences between the rent reform approaches of H.R. 1999 and H.R. 5443 are detailed in HUD's response to Question 11.b. In summary, H.R. 5443 will further complicate, not simplify, the tenant rent calculations and income determinations and merely tinkers on the margins. The Bill retains a one-size-fits-all income-based approach to rents and does not provide PHAs with local flexibility to establish rent structures that address local needs and priorities (such as encouraging work by decoupling rent from income).

12. In the past, stakeholders have encountered difficulties obtaining data from HUD about HUD's programs and program participants. Subcommittee witnesses claim that without this data it is nearly impossible to gauge the impacts of proposed policy changes on public housing residents. Does HUD have any plans for improving access to basic data for stakeholder organizations?

Response: Stakeholders have access to information about HUD programs via HUD's website. HUD is also able to provide basic statistical information about public housing participants upon request and payment of the cost for HUD to provide this information under the Freedom of Information Act. HUD is amenable to making information available to stakeholders upon notification of information that is sought. However, data on specific residents, or personal identification information about specific residents will not be released.

13. Subcommittee witnesses claim that HUD requires housing authorities to spend significant amounts of staff time transmitting data via the Public Housing Information Center (PIC). For what specific purposes(s) does HUD use this data and is this activity an efficient and effective use of resources?

Response: The data PHAs transmit allows HUD to report to Congress, as well as the public, on the characteristics of the families the Department serves. This information is also necessary for oversight and monitoring of PHA program compliance. HUD also uses the collected information for determining future budgetary needs. The statistical data derived from the PHA data transmissions is made available to stakeholder organizations upon request.

14. Tenant advocates expressed concern regarding the easing of the Moving to Work program's income targeting standards. According to the National Low Income Housing Coalition (NLIHC), HUD's proposal to expand the Moving to Work program would allow 90 percent of assistance to go to households with incomes up to 60 percent of the area median income (AMI). Please explain how HUD reconciles proposals that would allow higher income targeting in the public housing and section 8 programs with data indicating the most severe housing cost burdens fall upon individuals with extremely low-income.

Response: As part of the proposal to expand the Moving to Work program contained in the State and Local Housing Flexibility Act (HR 1999) PHAs would be allowed to target 90% of all assistance to households with incomes up to 60 percent of the area median income (AMI). In his testimony in support of HR 1999 on May 11 2005, Secretary Jackson stated that this would allow local PHAs to determine the appropriate mix of low-income families to serve. The 90%/60% limit is the same targeting specified in the HOME Investment Partnerships and Low Income Housing Tax Credit Programs. The proposal would allow PHAs to create incentives for voucher recipients to find work or improve their job situation, as well as allowing PHAs to simplify rent calculations.

15. Based on testimony the Subcommittee received in its June 20th hearing, the Jobs Plus program, in at least four cities, appeared to be successful in helping increase participating families' income. According to a study conducted by MDRC, Inc., the program increased participant family income by an average of roughly $6,000 over its 4-year life. Moreover, this success came at a relatively minimal cost to HUD of $3,000 per resident over the life of the program.

    a. Does HUD have any plans to implement this program in other cities?

Response: HUD has no plans to implement the Jobs Plus program in other cities because of the similar but more extensive authorities available under the Moving to Work program.

    c. If the answer is no, is HUD opposed to expanding this program and why?

Response: While not necessarily opposed to the expansion of this program, HUD believes that an expansion of the Moving to Work program would have a greater effect in increasing participant income, as well as lightening administrative burdens on Housing Authorities, and enabling them to increase housing choices for lower income families.

16. In your July 18, 2006, testimony to the Subcommittee, you state, "the same rules that were enacted to safeguard program quality have, in many instances, resulted in poorer quality housing." Please provide examples of rules that have resulted in poorer quality housing.

Response: The reference here is to the larger "regulatory environment" that has been established for public housing that, most agree, has not resulted in greater benefit but has created more red tape for PHAs and added strain on HUD staff to enforce. The Harvard Study (Appendix H) identified 14 operating requirements that are unique to public housing as compared to operators of Federally-assisted housing, which Harvard also recommended

be eliminated. The Department is working to address those that can be handled through notice or regulation; however, some require legislative action. The Department looks forward to working with the Congress to provide this needed administrative relief.

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