Written Testimony of
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Submitted to the U.S. House of Representatives Committee on Financial Services,
Subcommittee for Insurance, Housing and Community Opportunity
May 12, 2016

Good afternoon Subcommittee Chairman Luetkemeyer and Ranking Member Cleaver, and the Members of the Subcommittee. I am Gregory Russ, Executive Director of the Cambridge Housing Authority (CHA), and I would like to thank you for the opportunity to appear before the committee and testify on affordable housing models in the U.S. and U.K. My testimony will focus primarily on the February 2016 Report titled, Lessons of the International Partnership, provided by the Housing Partnership Network, as referenced in your letter of invitation dated May 4, 2016. (Hereafter the HPN Report.)

The HPN Report makes five policy recommendations. I will provide comments on the policy recommendation from the perspective of a mission oriented, entrepreneurial, public housing agency. CHA strongly identifies with the descriptions of the non-profit institutions in the HPN Report. Using both the flexibilities in the Moving to Work (MTW) and Rental Assistance Demonstrations (RAD), CHA has accelerated its entrepreneurial transformation as a public institution while protecting its families, its units, and its mission.

The HPN Report describes a strong non-profit culture referring to "...institutions that combine deep social mission and strong business acumen" and "a fundamental focus on social purpose and a commitment to reinvesting any financial return into their work" and "high-performing, mission-driven actors". These statements apply to many Housing Authorities around the country and there are some non-profits that might not fit the descriptions. The HPN Report also notes, "Tax status is less important than the hybrid of public-private nature of these enterprises." We believe that any recommendations considered by Congress should be "entity neutral" – there are strengths across both the PHA and non-profit worlds. None of the recommendations in this testimony exclude PHAs from participation.

The existing public housing platform is in need of deep reforms because it places heavy requirements on public agencies that hinder capacity building and choke innovation, this does not mean that it is not a more efficient and effective process than the approach suggested by HPN, which proposes radical solutions where more modest changes, some of which have been made already through existing demonstration programs, could achieve similar results. The current public housing system, including HUD itself, rationalizes structure and process over social outcomes, a particularly poor set of choices in the face of the budget numbers that are provided for our programs.

In thinking about the two systems, U.K. and U.S. it seems useful to consider the key fundamentals that shape our public housing system in the U.S.

PHAs are State-created Agencies – It is important to note that while the Federal government funds public housing the housing authorities are not federal entities, they are State created agencies. The housing authorities, not the Federal Government, own the land and the property. The State law establishes the governance structure and powers of the PHA. None of this is under Federal control. Transferring the assets of public housing authorities to non-profits is not something that can be accomplished by the federal government, as the property is not federal property.

The Declaration of Trust limits the use of the assets – The Federal government originally backed the bonds issued by the local PHA to finance the construction of public housing (and eventually paid them off). To protect this Federal interest HUD attaches restrictions to the property deed, the declaration of trust, requiring the continued use as public housing and limiting debt that can be leveraged by the property. With the declaration restrictions in place the value of the assets held by housing authorities is difficult to liberate, collateralization is at best difficult and often impossible. This approach completely ignores the long-term need for real estate to raise capital to reinvest in the units. This is why RAD removes the Declaration of trust and replaces it with a use agreement that is much friendlier to the private financing world. This is an easy to implement modification to the current system that could provide the means to leverage millions of dollars in private capital.

State enabling legislation already includes significant corporate powers – The contrast between non-profits and housing authorities is not as stark as one might think. The State legislation, in addition to enumerating the social and real estate missions of the Housing Authority, also describes the corporate powers vested by the State in the Authority. Sections of the enabling legislation often read like the incorporation papers of a private company: "… to have a seal; to have corporate succession…to receive loans and grants from any other source public or private… to invest in securities, to… execute and carry out contracts and all other instruments necessary or convenient to exercise the powers granted…." [Massachusetts General Laws Chapter 121B, Sections 11 and 26] The referenced sections of the Massachusetts enabling legislation lists 37 different powers granted to PHAs.

PHAs have adapted to the Tax Credit private equity system – The CHA has created four not-for-profit entities primarily to participate in what is now the only capital investment vehicle of scale available for the preservation of public housing, or the potential creation of new units of low-income housing – the Low Income Housing Tax Credit (LIHTC). To use tax credits, CHA operates through its "wholly owned" non-profit subsidiary entities; these non-profits, in turn, become the managing partners, along with the tax credit investor, in the ownership LLC for each property that is developed or preserved. Any non-profit corporation would also need to implement a similar structure in order to participate in the LIHTC program.

PHAs operate with property budgets insufficient to pay much if any debt – This is a key point. PHAs are easy to target for not fulfilling expectations and “permitting” their assets to deteriorate. One reason the British system worked out reasonably well is the universal Housing Benefit provided to the families was calculated to produce enough income for the Council (and later the Housing Association) such that they could pay off the loan for their part of their development cost that was not covered by the grant from the central government. PHA operating budgets and the subsidies received are insufficient on their own to allow debt payments. This is why RAD combines capital and operating into one source. The slim margins provided by adding the capital to the operating subsidy allow for some debt in the operating budget. (This margin, depending on the unit rehabilitation needs and market cost creates a “sweet spot” which is why RAD works well for some properties but not others.)

I want to emphasize these basic structural issues to the subcommittee because public housing agencies, just like our non-profits friends, have shown great adaptability inside this difficult system of funding. This set of structural considerations affects any comparison of the U.S. and U.K. systems. Further, any comparison of the U.S. and the U.K. must start with the undeniable story that the British central government has been a strong and consistent financial supporter of the affordable housing industry for 80 years.

HPN Report Recommendations and comments

1. Expand the Capital Magnet Fund
2. Prioritize preservation and stock transfer to high capacity non-profits (This recommendation also references RAD as sharing some elements with the Large Scale Voluntary Transfers, LSVT, that occurred in the U.K.)
3. Use a portfolio model for multifamily housing preservation
4. Make housing a platform for improving communities and building assets for residents
5. Improve access to affordable homeownership

Expand the Capital Magnet Fund (CMF) – The fund competitively awards grants to non-profit lenders, Community Development Financial Institutions (CDFI), and may finance affordable housing actives. This is great recommendation except … eligibility for CDFI status is limited to non-governmental entities (Tribal governments excluded). Such an expansion is welcome if access to the fund is available to PHAs or their non-profit affiliates. These funds should be available to PHAs and allowed in combination with other sources to preserve or replace public housing units. The mandated leverage ratio of the CMF, private to public is 10:1. CHA’s ratio is 16:1 for our RAD Phase 1 conversion so PHAs can meet this requirement. The expansion with PHA eligibility is highly recommended.

Prioritize preservation and stock transfer to high capacity non-profits – this recommendation touches on two overlapping issues: (a) expansion of RAD; and (b) the suggestion that transfer of public housing to "more cost effective" non-profits (similar to the council transfers to associations in the U.K.) is a strong pathway to preservation. The discussion of this recommendation in the HPN Report also notes that RAD shares common elements with LSVT process in the U.K.

(a) The expansion of RAD above the current unit cap is an option that Congress should consider, but with some qualifiers. Many RAD transfers are platform changes with minimal rehabilitation suggesting that PHAs are opting to exit the public housing model; this is not unexpected given the heavy regulatory burden on PHAs, additionally over the long term the RAD conversion allows better positioning for the property to access private capital if the property is subsequently re-financed. But for units that need deeper rehabilitation RAD seems to fall short because the income stream to support higher debt is not there. More financial modeling is required to understand the financing weaknesses of RAD in those markets where it is not feasible. (See the recommendation on MTW single fund flexibility in the next section.)

(b) In our view it is undetermined that the transfer of aging public housing stock to non-profit social enterprises is the "more cost effective" option. The HPN Report suggests that these entities have the "…business skills to structure complex preservation transactions…" Again our comment on the recommendation is that as a matter of policy we must be entity neutral. Some non-profits are very good at this but are so are many PHAs. PHAs do retain "public agency" requirements that do not apply to non-profits and could add costs; but how all this plays out in preservation activity across different markets is unclear.

Perhaps, of more concern is that all entities, public housing or non-profit, are competing for a <u>limited pool of tax credit capital</u>. As preservation needs escalate the demand for tax credits increases and in some States the current tax credit equity pool is stretched beyond capacity. In traditional public housing there is already a lack of operating subsidy to cover debt, and now there is much stiffer competition across the board for tax credits, no matter the tax character of the entity pursuing the preservation.

One point of discussion in the HPN Report, Large Scale Voluntary Transfers (LSVT), deserves more attention. For this to work in the U.S. major transactional issues must be addressed. To attempt any LSVT three recommendations are offered:

(1) Beyond RAD, or the existing PH disposition process, there should be a third option to release the declaration of trust; specifically, replace the declaration with a long-term use restriction. The use restriction can be drafted to keep the property as a resource for low-income families but also be much more favorable to attracting private capital; this is a change that could be made on a demonstration basis and scaled later for all public housing units. The switch to a use agreement should be separated from the demands of a complex,

preservation and financial transaction. Over time such an action will give the PHA, a non-profit partner, or successor entity immediate flexibility to liberate the value of the asset with private financial opportunities similar to a private owner who has access to the full value of the asset.

(2) In conjunction with (1) create a new type of housing preservation fund that, unlike the LIHTC, is not linked to a property by property conversion but is instead designed to provide funding for portfolio wide repositioning. The fund resides, like the CMF, at treasury and allows a private equity investor to receive a portfolio tax credit $1 for $1 when private capital is deposited for a specific portfolio conversion project. The cost of the credit is covered by a 1/2% adjustment in the mortgage interest deduction. (Such an adjustment is worth about $345M year.) These two steps together could energize a U.S. version of the LSVT targeted at preservation and recapitalization of all affordable units.

(3) The third recommendation is to use the Moving to Work expansion to test these ideas and facilitate the <u>regional MTW agency</u> concept described in last year's expansion legislation. (An existing MTW agency can petition the Secretary to bring in an adjoining Agency under the in-place MTW agreement.) The single fund flexibility provided to MTW agencies would multiply the impact of these efforts. The MTW expansion language also calls for 5 agencies to be selected with RAD portfolio conversions. The existing RAD demonstration language is already flexible enough on it's own to allow this group of agencies use this flexibility.

As with other discussion in this testimony, the LSVT approach should be "entity neutral". In any LSVT the PHA, acting through a non-profit subsidiary, may be the recipient of such a transfer. All of these LSVT recommendations can easily be tested inside the existing MTW/RAD demonstration platform, especially when these two powerful demonstration programs work together as a hybrid for innovation.

<u>Use a portfolio model for multifamily housing preservation</u>

Elements of this recommendation already exist in the U.S. system and ought to be provided to all owners, again in an entity neutral fashion. HUD's current Public Housing Asset Management model, often extended by MTW flexibilities, is capable of achieving many aspects of the portfolio model discussed in HPN. The public housing operating fund regulations at 24 CFR 990 provide for asset management, require property based budgeting and reporting and property based management requirements, but also allow fungibility across properties (see 24 CFR 990.205 and 990.280) when there is excess cash flow. This is good model to transfer across all HUD subsidized properties.

Excess property income over expenses can be moved across properties (strong performers helping weaker ones) or into a central fund that the owner can then provide to a specific property that needs help in a particular year. We still need to know what percentage of the rent we are collecting, what the vacancy rate is and what the preventive maintenance performance is at each distinct property. We also need to know what transfer subsidies are provided each year to each property, because the year may come when we can't do that. This option also creates the possibility of providing a resource for services or community improvements as discussed in the next section. (One tweak for any property is to change existing HUD requirements around energy savings to allow the PHA or non-profit owner to keep all savings earned.)

<u>Make housing a platform for improving communities and building assets for residents</u>

We could not agree more. Carefully crafted programs with respect to youth engagement and asset building can change the course of many lives. This is another recommendation that deserves an opportunity flourish and MTW once again helps U.S. get there. In Cambridge, using MTW flexibilities, we have embarked on three asset development options for low income families: (1) a MTW modified version of Family Self Sufficiency (FSS+); (2) as part of our comprehensive after school support program, **the Workforce**, we have embedded a matched savings component for graduating seniors (who can exit high school with up to $3000); and (3) we are experimenting with an automatic saving program for Public Housing families called **Rent to Save** where a small portion of rent is set aside for the family in an escrow account. Two of these programs are operated in conjunction with our non-profit partner, COMPASS Community Capital. Other MTW agencies are also experimenting with asset building and comprehensive youth engagement opportunities.

The Cambridge Workforce program starts in the 8th grade and runs thought senior year of high school. We have sites at the property and one in the high school. Kids in this program graduate from high school at a rate of 93%, the majority go on to secondary education options, and about 66% are not living in public housing 6 years after high school gradation. In the Urban Institute HPN Report, <u>Atlantic Exchange: Case Studies of Housing and Community Redevelopment in the U.S. and U.K.</u>, best practice recommendations from both the U.S. and U.K. communities stressed the, "… importance of effective youth engagement to the maintenance of a peaceful community, development of future leaders, and the future self-sufficiency of youth. Castle Vale [in the U.K.] offers a model of youth programming with dedicated staff through on-site community centers. The challenge here is securing sufficient funding over time to allow for dedicated staff." [Brackets ours]

Three recommendations in support of the HPN Report follow:

(1) To address the funding needed to build assets we recommend expansion of the existing FSS program but with much more flexibility for local innovation.
(2) To fund such programs, we also recommend expanding, to non-MTW agencies, limited single fund flexibility. (SFF is the ability to move Section 8 and 9 funds without regard to traditional funding restrictions). Single fund use can be targeted to both the preservation of units and/or youth and asset building

programs.

(3) A third use of SFF is to pick up on recent mobility research by Raj Chetty and others to cover the cost of a wide range of mobility interventions and balance mobility move opportunities with the in-place strategies as described in the Urban Institute HPN Report.

<u>Improve access to affordable homeownership</u>

CHA does not work in market where homeownership options for low-income families are viable. (Cambridge rental and sales markets are typically some of the most expensive in the country.) The City of Cambridge estimates that the annual income needed for a family of four to take the first step toward self-sufficiency is $108,800. The cost to jump from either Section 8 or public housing to a private, non-subsidized, rental unit is steep when $7,000 to $10,000 is needed to make the security deposit, first and last month's rent. Beyond this entry issue is the question of whether or not the family can afford the rent over the long term. In our market for rental we see no chance for homeownership. So our response to this recommendation is that access to homeownership is market driven. Further, we do not recommend selling off public or other affordable units as was done in the U.K. with Right to Buy. About 2.2M units have been transferred under Right to Buy but the results are very mixed, especially when selling off units in multifamily sites where the owner has not been able to sustain the unit over the long term.

This concludes my written testimony and I want to thank the committee for this opportunity, my hope is that you find some of these ideas intriguing enough to take the next step.

I also what to thank the conceptual and editorial support I received from Jim Stockard Fulbright U.S. Scholar, 2015-16 currently based at the Glasgow School of Art and the Glasgow Urban Lab, Glasgow, Scotland and former Commissioner of the Cambridge Housing Authority.