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The Transition to Asset Management in Public Housing

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Abstract

The U.S. Department of Housing and Urban Development is requiring public housing agencies (PHAs) to adopt an asset management model of operations. This article describes the conditions existing prior to the new requirement and the reasons for implementing asset management. After reviewing specific elements of the Department's asset management regulations, the article outlines potential advantages and disadvantages from the PHA perspective.

Introduction

In September 2005, the U.S. Department of Housing and Urban Development (HUD) issued a new rule[1] requiring public housing agencies (PHAs) that own 250 units or more to convert their operations to a system of asset management. Under asset management, PHAs must monitor and report on the financial, physical, and management performance of individual housing projects. Asset management is intended to improve public housing as a whole by holding PHAs accountable for the success of each separate property they own. Asset management is also meant to facilitate future private investment in public housing. Critics argue, however, that asset management poses excessive administrative burdens, results in funding imbalances, and requires major operational changes. As PHAs change operations to conform to the new rules, researchers will have an opportunity to evaluate the impact of asset management on public housing.

Background

The conversion to asset management involves applying private, for-profit real estate management principles to public housing. Asset management can be differentiated from other approaches to housing management by its focus on the long-term financial and physical viability of properties. It includes assessing the condition of projects through a physical needs assessment, projecting income and expenses, planning for the best future use of the asset, and reallocating resources to achieve that use. Asset management is intended to facilitate investment decisions by providing measurable performance information that can be compared across projects. The conversion to asset management signals a major shift in the way HUD monitors public housing.

Until the new Public Housing Operating Fund rule was issued, HUD funded the approximately 3,100 PHAs that operate public housing on the basis of their aggregate housing portfolio and evaluated agency performance as a whole as opposed to evaluating individual activity at each project. Since its inception in 1975, the Performance Funding System (PFS) has allocated funds to PHAs based on actual costs in that year, with subsequent annual distributions adjusted for inflation and other factors. Several studies[2] have noted problems with the PFS, such as inadequate base-year funding and subsequent operational costs that exceed the adjustments.

In 1998, the Quality Housing and Work Responsibility Act replaced the PFS by establishing an Operating Fund to make assistance available to PHAs for operating and managing public housing. The amount of assistance to be made available through the Operating Fund was to be determined by a formula developed through negotiated rulemaking. Although HUD completed its negotiated rulemaking in 2000 regarding the Operating Fund, the rulemaking committee determined that further study of the basic underlying costs of operating public housing was needed. During the negotiations, Congress mandated a study[3] to determine the cost of operating well-run public housing in order to establish how funds would be distributed. The study recommended that HUD replace the distribution of operating funds at the agency level with a system of individual allocations based on the characteristics of each housing project. The study further suggested that housing authorities conduct property-based accounting and property-based management, as is common in private industry. After several months of negotiated rulemaking with PHAs, industry groups, and other interested parties, HUD published the Operating Fund final rule. Concurrent with this new rule, PHAs will be required to manage, budget, and maintain accounting information on an individual project level.

Specific Elements of Asset Management

Five major program reforms are associated with the conversion to asset management. These reforms affect funding, budgeting, accounting, management, and performance assessment.

Funding

HUD will allocate funding based on individual project characteristics. In contrast, the current system funds PHAs at the entity level. A major component of a project's subsidy calculation is its project expense level, an estimate of the cost to operate the project, exclusive of utilities and taxes, based on the costs of operating other federally assisted housing with similar project characteristics.

Budgeting

The PHA's governing body must approve project-based budgets before the start of each fiscal year. A project-based budget is a measure of the individual property's financial health. It serves as a guide for operations, decisionmaking, and future income and expense projections. Except in the case of nonperforming projects, such budgets will not be subject to HUD approval and are primarily for internal PHA planning purposes.

Accounting

PHAs must now submit year-end financial statements on each project to HUD. These statements of assets and liabilities will include revenues, expenses, and other balance sheet items. In accounting for project costs, PHAs will be able to charge projects only for services actually received.

Management

PHAs must manage each project in that project's best interests. For example, a project must receive the same level of service from a central landscaping crew as it would obtain through the market or by executing the work with onsite staff. PHAs must assign to each project site-level management personnel with primary authority and responsibility for day-to-day operations.

Performance Assessment

HUD will revise the Public Housing Assessment System (PHAS) to facilitate project-based performance assessment and to emphasize project-based performance monitoring and evaluation. Currently, the PHAS examines PHA-wide, not project-specific, activities. Each project will be evaluated, not just on its physical condition, but also on its financial and management performance. A central part of this new performance measurement structure will be a system of onsite management reviews of each project.

Benefits and Goals of Asset Management

The intention of asset management is to improve the short- and long-term management of public housing through more accurate information and better decisionmaking. Asset management offers three main advantages to housing operators: increased efficiency, improved accountability, and better planning for the future.

Efficiency

By providing appropriate mechanisms for monitoring performance at the property level, HUD anticipates that PHAs will be better equipped to accurately assess individual projects. Property-level reporting should help agencies identify unusually high operating expenses so they can reduce waste. Similarly, a PHA might discover maintenance practices that reduce costs at one project and, as a result, benefit the agency's entire housing portfolio. Furthermore, excess funds resulting from cost-saving measures stay with the PHA.

Maintaining property-level data should also help PHAs better understand and respond to larger project needs. Accurate financial information regarding rent collection rates and vacancy loss can be used to project income. Property-specific physical inspections can help predict system-replacement expenses. PHAs that can better anticipate income and expenses will be well positioned to address annual needs before they exceed available resources.

Accountability

Under asset management, the assignment of dedicated personnel to each project should improve accountability to residents. For example, each project might have its own property manager and maintenance personnel. This staff could address onsite issues more quickly and efficiently than a centralized office searching for available staff and dispatching a different person each time. Residents are likely to see a faster, more personal response to their issues.

Planning

Asset management will help PHAs plan for the future of their housing portfolios. By envisioning properties as assets that require strategic investment, agencies will be encouraged to analyze the long-term physical and financial viability of these assets. Portfolio analyses and market comparability studies will enable PHAs to understand their current position relative to the private housing market. Capital planning needs may lead some agencies to consider a variety of asset-repositioning strategies, including acquisition and voluntary disposition. In general, project-level information should help agencies make better management decisions to preserve and protect each individual asset.

The transition to asset management further represents an effort to align public housing with accepted practice in the private housing market. The multifamily housing industry has long considered asset management to be an essential component of a successful real estate operation. Physical needs assessments, income and expense statements, and debt service coverage ratios represent the language of the for-profit housing industry. If public housing is able to speak in the same terms and provide comparable measures of performance, investors may feel more comfortable putting their money in this asset. PHAs could use public funds to leverage additional private investment to meet their capital needs. By aligning operations with accepted practice, it is believed that the transition to asset management will facilitate future investment and reinvestment in public housing by public- and private-sector entities.

Concerns and Drawbacks of Asset Management

Despite the prevalence of asset management in the multifamily industry, some observers have questioned its value and suitability for public housing. Although funding is a primary concern, the changes to operations necessitated by asset management could also pose problems.

Funding

First and foremost, accumulated funding cuts have left many PHAs and their projects in difficult financial positions. The modernization backlog for public housing is $18 billion, with an annual accrual of $2 billion.[4] No management reform by itself could alleviate this massive shortfall. Asset management might be viewed as simply a new way to distribute smaller pieces of an ever-shrinking pie.

The new Operating Fund rule will change the funding level for all PHAs. Slightly more than one-fifth of all housing authorities (667 out of 3,141) are eligible to receive less funding than they did last year due to the revised formula. Of those agencies with 250 units or more, approximately 150 will see reductions in absolute operating subsidy amounts.[5] In an era of budget cuts and a growing backlog of funding needs, housing authorities are worried that the new Operating Fund rule will worsen the financial position of their agencies.

Some PHAs are concerned that uneven project-level funding could lead to long-term inequities. They fear that HUD's funding methodology might not reflect the regional variations, local circumstances, and special needs inherent to a PHA project's particular situation. A deteriorating building faced with reduced funding may not be able to afford physical improvements. Instead of rehabilitating this project, the PHA may be forced to dispose of the property and lose vital affordable units along with it.

The elimination of centralized funding under asset management could also have a negative impact on resident services, such as supportive services for the elderly and disabled, job training programs for unemployed residents, and recreational programs for children. Social services typically benefit from the economies of scale associated with a unified budget. Because services are often considered incidental to the agency's mission of providing housing, they tend to be the first programs to be eliminated during budget cuts. A shift to property-level staffing could force PHAs to choose between services such as building maintenance and resident service programs. PHAs might reduce or eliminate services due to increased personnel and overhead costs.

Operations

The transition to asset management and accompanying financial limits on centralized services that can be charged to projects will force housing authorities to change many policies and procedures. Staff skills may need to be reassessed and personnel may need to be reassigned from the central office to individual projects. In addition to hiring new employees, PHAs may need to negotiate union titles and job responsibilities.

Another major change involves the financial reporting on asset management projects. Instead of providing one accounting report for the entire agency, PHAs must now produce accounting statements for every project. The additional recordkeeping requirements will likely require more staff hours, improved data-tracking procedures, and updated computer systems.

PHAs currently maintain one centralized waiting list for all their projects. Under asset management, the implementation of multiple site-based waiting lists has the potential to reinforce preexisting segregation patterns within communities. For example, a household of a particular race or ethnicity might apply for the waiting list of only the project closest to their current neighborhood, which happens to be segregated. Furthermore, fair housing laws would come into play when an individual who is disabled cannot enter a project across town to apply for an accessible unit in that project. Housing authorities must bear additional oversight responsibility to ensure that public housing applicants are treated fairly under the Fair Housing Act.

Finally, asset management may reduce savings from the economies of scale associated with centralized purchasing and warehousing. Some PHAs have reaped the benefits of bulk purchases of items such as light bulbs. Large-scale purchase contracts for one item often result in reduced prices for others. The smaller purchase sizes associated with project-based budgeting and accounting may reduce cost savings. Maintaining separate project storage facilities instead of one warehouse could increase overhead expenses. Although private-sector companies use these project-based activities to their advantage, PHA purchases are governed by potentially restrictive procurement rules.

Expected Effects of Asset Management

The first PHAs required to convert to project-based budgeting and accounting must start compliance on July 1, 2007. All PHAs will have implemented at least 1 year of project-based budgeting and accounting by March 31, 2009. Complete transition to asset management operations for all PHAs is expected by 2011.

HUD believes that housing authorities will benefit from asset management by using project-level information to improve decisionmaking. In the short term, PHAs will be expected to reduce maintenance costs, improve vacant unit turnaround times, and streamline operations. Over the long term, PHAs will be expected to leverage funds, access investment capital, and position their assets for modernization or redevelopment.

By more closely aligning public housing practice with that of the private sector, HUD hopes to promote third-party investment. Because public housing will now adhere to multifamily housing reporting standards, project-level income and expenses will be easier to evaluate. In turn, potential investors should feel more confident about their involvement with public housing.

Conclusion

Concurrent with the new Public Housing Operating Fund rule, HUD is requiring all PHAs with 250 or more units to convert operations to asset management. As the accepted standard in private industry, asset management is believed to lead to improved housing management and oversight through project-level reporting. In addition, asset management is expected to help housing authorities plan for the future viability of their housing portfolios and encourage third-party investment. Asset management, however, is not without its critics. PHAs in particular have expressed concerns about increased administrative burdens, the potential for federal micromanagement, and inadequate funding levels. As PHAs begin their transition to asset management, researchers will have the opportunity to evaluate the effects of these new systems on a program that provides housing for many of America's poorest households.

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Notes

1. Revisions to the Public Housing Operating Fund Program; Final Rule, 24 CFR Part 990. *Federal Register* 79 (180) September 19, 2005.
2. For example, see U.S. Government Accountability Office. (1998).
3. See Stockard et al. (2003).
4. See Finkel et al. (2000), U.S. Department of Housing and Urban Development (2003), and *Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Bill, 2003,* 107th Cong. 2nd Sess., S. Rep 107-222.
5. Twenty of these PHAs represent more than three-fourths of the total operating subsidy reduction.

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U.S. Government Accountability Office. 1998. *Public Housing Subsidies: Revisions to HUD's Performance Funding System Could Improve Adequacy of Funding.* Report to the U.S. Senate, Committee on Appropriations, Subcommittee on VA, HUD, and Independent Agencies. Washington, DC: U.S. Government Printing Office. 101 p.

Additional Reading

Preparing for Asset Management Under the New Public Housing Operating Fund Rule (24 CFR 990): A Planning Document. 2006. U.S. Department of Housing and Urban Development.

Further Information

HUD's asset management website: http://www.hud.gov/offices/pih/programs/ph/am/.