

# Notes

## Public Housing: Abandon HOPE, But Not Privatization

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Jack Kemp has a deft populist touch. As Secretary of the Department of Housing and Urban Development ("HUD") during the Bush Administration, Kemp took a dry economic theory, privatization, and recast it as the centerpiece of a radical new low-income housing policy. Borrowing the rhetoric of the "war on poverty" and "empowerment" from the Left,<sup>1</sup> Kemp in 1990 pushed through Congress a program called "HOPE" (Homeownership and Opportunity for People Everywhere), which included among its provisions a proposal to sell public housing projects to the residents (HOPE-1).<sup>2</sup> Kemp virtually banished the term "privatization" from the housing debate. With rhetorical dexterity he forced his opponents to aim their slings and arrows at "homeownership," *sanctum sanctorum* of American politics.

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1. See U.S. DEP'T OF HOUS. & URBAN DEV., WAGING WAR ON POVERTY: HOPE, HOMEOWNERSHIP AND OPPORTUNITY FOR PEOPLE EVERYWHERE 1-3 (1992) [hereinafter WAGING WAR ON POVERTY]; see also Jason DeParle, *How Jack Kemp Lost the War on Poverty*, N.Y. TIMES, Feb. 28, 1993, § 6 (Magazine), at 26 (discussing Kemp's rhetoric).

2. Congress enacted HOPE-1 in the Cranston-Gonzalez National Affordable Housing Act, Pub. L. 101-625, § 411, 104 Stat. 4079, 4148 (1990) (codified as amended at 42 U.S.C.A. §§ 1437aaa to 1437aaa-8 (West Supp. 1993)). Under HOPE-1, resident management corporations or other specified groups may apply to acquire public housing projects. See 42 U.S.C.A. § 1437aaa-5(1)(A-F) (West Supp. 1993). Applicants must devise a homeownership program that provides for eligible families to acquire interests in at least one-half of the units in a project. See 42 U.S.C.A. § 1437aaa-3(a) (West Supp. 1993). Sale prices must allow families to complete the sale without paying more than 30% of their income. See 42 U.S.C.A. § 1437aaa-3(b) (West Supp. 1993). Tenants who do not buy retain their rights as tenants and may not be evicted on account of the homeownership program. See 42 U.S.C.A. § 1437aaa-3(h) (West Supp. 1993).

For Jack Kemp, HOPE and kindred initiatives were not just a housing policy but also a strategy of emancipation for the poor. Kemp sought a "radical restructuring" of what he called the government "plantation."<sup>3</sup> He even evoked Abe Lincoln, the great Republican emancipator, in saying that the Bush initiatives, like Lincoln's 1862 Homestead Act, would spur individual initiative.<sup>4</sup> Kemp believed in the transformative effects of homeownership and freedom from government dependency. HOPE would "tear down the walls that come between people and their self-respect . . . [and] prevent people from exercising their talents and reaching their potential."<sup>5</sup> Faith in markets and private-sector competition was distinctly secondary in the HOPE agenda. Jack Kemp was after the hearts and minds of the tenants. His was a deeply ideological vision of privatization.<sup>6</sup>

Ideology, however, obscured the inefficiency of the form of privatization Kemp trumpeted: selling multifamily public housing projects<sup>7</sup> to low-income residents. The microeconomic theory of housing tenure choice cautions us to examine the ownership decision as a joint consumption and investment decision.<sup>8</sup> The owner-occupant is not only a consumer but also a producer of housing services. The factors of risk, liquidity, transaction costs, and lack of expertise suggest that a low-income public housing tenant, transformed into an owner-occupant, may not be an efficient producer of housing services. This inefficiency is compounded by the inherent costs of collective ownership that HOPE-1 envisions,<sup>9</sup> which would be magnified in low-income projects.<sup>10</sup> Furthermore, HOPE-1's restriction on the alienability of property by resident purchasers, a restriction designed to prevent windfall profits, undermines the very function of private property rights in directing assets to their most-valued

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3. See *Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations for 1993: Hearings Before the Subcomm. on VA, HUD, and Independent Agencies of the House Comm. on Appropriations*, 102d Cong., 2d Sess. 10 (1992) [hereinafter *1993 House Appropriations Hearings*] (statement of Secretary Kemp); Paul Klebnikov, *Showing Big Daddy the Door*, *FORBES*, Nov. 9, 1992, at 149; see also Jack Kemp, *A Homeownership Challenge*, 48 *J. HOUSING* 7 (1991).

4. See U.S. DEP'T OF HOUS. & URBAN DEV., *NEW CHOICES FOR RESIDENTS: OPPORTUNITY AND EMPOWERMENT ACT 1-2* (1992) [hereinafter *NEW CHOICES FOR RESIDENTS*].

5. *WAGING WAR ON POVERTY*, *supra* note 1, at ii.

6. Privatization may be justified on either ideological or pragmatic grounds, which, although often intertwined, are analytically distinct. See E.S. SAVAS, *PRIVATIZATION: THE KEY TO BETTER GOVERNMENT* 4-10 (1987) (distinguishing pragmatic, ideological, commercial, and populist forces behind privatization); Louis De Alessi, *Property Rights and Privatization*, in *PROSPECTS FOR PRIVATIZATION* 24 (Steve H. Hanke ed., 1987) (distinguishing ideology and pragmatism). The approach to justification for privatization favors reducing government intrusion into the lives of individuals and families; it distrusts collective action, and emphasizes personal liberty, choice, and initiative as *inherent* values. The pragmatic approach has a narrower scope; grounded in economic and public choice theory, it addresses the more limited question of efficiency. It is ideologically neutral. A pragmatist would advocate privatization as the most efficient means to effect either libertarian goals or redistributive, interventionist goals.

7. HOPE-1 is not limited to multifamily public housing properties, see 42 U.S.C.A. § 1437aaa-3(d) (West Supp. 1993), but these would be the vast majority of properties in urban centers.

8. See *infra* text accompanying notes 115-20.

9. HOPE-1 permits the tenant organization purchasing a development to choose the form of collective ownership (co-operative, condominium, etc.). See 42 U.S.C. § 1437aaa-3(a) (Supp. III 1991).

10. See *infra* text accompanying notes 146-49.

use.<sup>11</sup> In short, HOPE-1 promotes an inefficient form of ownership to households unable to bear the inherent investment costs and risks or manage the housing stock effectively. Though Dante may disagree, abandoning HOPE-1 would not be an infernal turn of policy.<sup>12</sup>

HOPE-1 has had no shortage of critics,<sup>13</sup> but often their criticism has focused on the wrong issues. First, some critics charge that the cost of selling public housing to the current residents would be exorbitant.<sup>14</sup> They point to subsidies projected as high as \$130,000 per unit in Jack Kemp's showpiece Kenilworth-Parkside project in Washington, D.C.<sup>15</sup> Much of that cost, however, would be incurred to maintain the units as public housing if unsold.<sup>16</sup> In fact, as designed, the sale of Kenilworth-Parkside could possibly save the federal government money,<sup>17</sup> albeit by displacing cost onto the low-income households and thereby endangering the viability of the project.<sup>18</sup> The high cost of Kenilworth-Parkside indicts public housing as much as resident ownership. Second, most critics fail to differentiate resident ownership from privatization, and unreasonably extend their critique of HOPE-1 into a defense

11. See 42 U.S.C. § 1437aaa-4(g)(1) to (2) (Supp. III 1991).

12. DANTE ALIGHIERI, *THE DIVINE COMEDY: INFERNO* 47 (John D. Sinclair trans., Oxford Univ. Press 1939) (n.d.) (inscription on Gates of Hell: "ABANDON EVERY HOPE, YE THAT ENTER").

13. See, e.g., Robert Bodzin, Note, *Is There Hope?*, 4 *HOFSTRA PROP. L.J.* 239 (1992); William L. Clay, *Don't Sell Public Housing!*, 47 *J. HOUSING* 189 (1990); Thomas J. Connelly, Jr., *Resident Initiatives: Hope or Hoax?*, 48 *J. HOUSING* 167 (1991); Michael H. Schill, *Privatizing Federal Low Income Housing Assistance: The Case of Public Housing*, 75 *CORNELL L. REV.* 878 (1990); Michael A. Stegman, *The Limits of Privatization*, in *MORE HOUSING, MORE FAIRLY: REPORT OF THE TWENTIETH CENTURY FUND TASK FORCE ON AFFORDABLE HOUSING* 23 (1991) [hereinafter *TWENTIETH CENTURY FUND*]; Christopher B. Daly, *Housing Plan Too Modest for Problem, Critics Say*, *WASH. POST*, June 23, 1992, at A19.

14. See, e.g., *Report of the Task Force*, in *TWENTIETH CENTURY FUND*, *supra* note 13, at 16 (estimating \$70,000-90,000 per unit); DeParle, *supra* note 1 (noting estimates of \$100,000 per unit).

15. See Robert Guskind & Carol F. Steinbach, *Sales Resistance*, 23 *NAT'L J.* 798, 800 (1991) (reporting estimates of federal and local subsidies, including modernization, mandatory replacement of units lost to the public housing system, and property tax and water/sewer charge abatements).

16. The per-unit cost of the Kenilworth-Parkside modernization is about par for similar work done by the woefully incompetent District of Columbia Department of Public and Assisted Housing (DPAH). U.S. GEN. ACCOUNTING OFFICE, *PUBLIC HOUSING: PLANNED KENILWORTH-PARKSIDE SALE RAISES ISSUES FOR FUTURE TRANSACTIONS* 35 (1989). DPAH costs have been as high as \$95,000 per unit elsewhere. Homeownership Division, U.S. Dep't of Hous. & Urban Dev., Cross-Reference Talking Points 6 (unpublished document, on file with author) [hereinafter *Cross-Reference Talking Points*]. Not all homeownership programs have such high modernization subsidies. A HUD survey of six sales programs conducted by other PHA's found the average subsidy to be only \$12,200 per unit. *Id.* at 1.

17. See LAVENTHOL & HORWATH, *ECONOMIC AND FINANCIAL ANALYSIS OF KENILWORTH-PARKSIDE HOME OWNERSHIP* 2 (1989) (projecting discounted net savings of \$26 million over 40 years in D.C. project). The savings calculated are predicated on a finding that the project will be financially viable under resident ownership. Laventhol and Horwath made some heroic assumptions in finding that Kenilworth-Parkside would be financially viable. The firm assumed that resident incomes were \$8500, although available data suggested actual incomes were closer to \$6000; that incomes of resident households would grow 10% per year for the first five years of the project, and 5.25% thereafter; that the project would achieve 95% occupancy and 90% collectibility of rents; that administrative and operating expenses would be reduced by 5% per year for the first five years; and that utility costs would decrease by 5% per year for the first three years. *Id.* at 5-8.

18. Using more defensible assumptions (e.g., that incomes and expenses would increase at equal rates), the GAO projected that Kenilworth-Parkside would be unable to sustain itself financially by year 13. U.S. GEN. ACCOUNTING OFFICE, *supra* note 16, at 50.

of public housing. This is true even of astute critics like Michael Schill and Michael Stegman, who are well versed in the economic disadvantages of public housing relative to other forms of housing assistance.<sup>19</sup> Their broad-brush defenses,<sup>20</sup> focused on the advantages of well-run public housing, overlook the grave problems concentrated in the largest and most troubled Public Housing Authorities (PHA's).<sup>21</sup> The evidence suggests that, in many such PHA's, operating much of existing public housing is uneconomical, and that conditions are set to worsen.<sup>22</sup> Schill, Stegman, and others undermine their critiques of HOPE-1 by not considering other forms of privatization that might stop the dissipation of scarce federal housing resources.

The advent of the Clinton Administration makes this an opportune time to rethink privatization<sup>23</sup> of public housing<sup>24</sup> in nonideological terms. The new HUD secretary, Henry Cisneros, has distanced himself from HOPE-1, properly wary of the burden it might place on low-income tenants.<sup>25</sup> Yet some radical change of course is necessary. Cisneros has taken the helm of HUD at a time when the ship is veering towards dire financial straits, in part because of the growing costs of the public housing program.<sup>26</sup> Cisneros' statements to date

19. Both Schill and Stegman generally favor expanding demand assistance, in the form of vouchers and certificates, rather than subsidizing new construction. See Schill, *supra* note 13, at 880, 912-13; Stegman, *supra* note 13, at 127-28. Stegman appears to have retreated from his call for an annual goal of 20,000 new public housing units per year. Michael A. Stegman, *The Role of Public Housing in a Revitalized National Housing Policy*, in BUILDING FOUNDATIONS: HOUSING AND FEDERAL POLICY 333, 346 (Denise DiPasquale & Langley C. Keyes eds., 1990) [hereinafter BUILDING FOUNDATIONS].

20. See Schill, *supra* note 13, at 909-13; Stegman, *supra* note 13, at 51-56; Stegman, *supra* note 19, at 362.

21. In a recent article, Michael Schill has adopted a more pessimistic line on distressed public housing. He advocates that government not pursue a "single-minded policy of public-housing preservation" but instead focus on policies that facilitate household mobility, reduce barriers to affordable housing, and enforce antidiscrimination laws. Michael H. Schill, *Distressed Public Housing: Where Do We Go from Here?*, 60 U. CHI. L. REV. 497, 554 (1993). Schill did not reconsider privatization in his article.

22. See *infra* text accompanying notes 198-202.

23. Theories of, and empirical support for, privatization are well discussed in the literature and will not be reviewed here. See, e.g., PRESIDENT'S COMM'N ON PRIVATIZATION, PRIVATIZATION: TOWARDS MORE EFFECTIVE GOVERNMENT (1988); PROSPECTS FOR PRIVATIZATION, *supra* note 6; SAVAS, *supra* note 6; Ronald A. Cass, *Privatization: Politics, Law, and Theory*, 71 MARQ. L. REV. 449 (1988); Schill, *supra* note 13, at 881-87.

24. Federally supported public housing is a joint federal and local enterprise. The federal government, through HUD, finances the building, operation, and modernization of public housing. Federal law governs, inter alia, tenant eligibility, rent structures, and operating guidelines. However, local governmental authorities—the PHA's—own and manage the properties. See generally 42 U.S.C. § 1437 (1988 & Supp. III 1991) (public housing statutes).

25. See Jason DeParle, *H.U.D. Choice Wary of Selling Public Housing*, N.Y. TIMES, Jan. 13, 1993, at A16; Remarks of Secretary Henry Cisneros to the National Press Club Luncheon, FED. NEWS SERV., Apr. 13, 1993, available in LEXIS, Nexis Library, Wires File at \*9-10. The Clinton Administration proposed limiting funding to approved HOPE-1 grants. *Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations for 1994: Hearings Before the Subcomm. on VA, HUD, and Independent Agencies of the House Comm. on Appropriations*, 103d Cong., 1st Sess. 67-68 (1993) [hereinafter 1994 House Appropriations Hearings]. Congress rescinded \$175 million earmarked for HOPE public housing grants. *Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1994*, Pub. L. 103-124, 107 Stat. 1275, 1282 (1993).

26. See Jason DeParle, *Big Bills Coming Due at H.U.D., Crimping Expansion of Programs*, N.Y. TIMES, Apr. 8, 1993, at A1 (discussing budgetary effects of rental subsidy renewals, property preservation,

on public housing, however, seem curiously uncritical. Although he does not advocate new public housing construction,<sup>27</sup> Cisneros has declared that "there is a strong place in American public policy for traditional public housing."<sup>28</sup> The new budget accelerates spending for modernizing public housing with little regard for the economic utility of such a policy.<sup>29</sup> Once again, a focus on housing stock<sup>30</sup> seems to drive policy towards existing public housing, while other modes of serving low-income families fade into the shadows.

The inadequacy of HOPE-1 should not oust privatization from the debate over the future of public housing. Many of the failings of the public housing system—pervasive rentseeking,<sup>31</sup> inefficiency, high cost, and inequity—are due to its insulation from market forces. These failings have now come to a head with increasing vacancy rates and an exorbitant modernization bill to preserve existing stock.<sup>32</sup> The solution lies not in trying to repair such problems within a flawed system, but in efficiency-driven privatization. A focus on efficiency serves two related ends: it ensures that more of every subsidy dollar goes to the housing consumption of assisted families and that the assets (land and housing stock) currently managed by PHA's are channeled to their most-valued use. Privatization strategies should depend on PHA performance and local market conditions. Such strategies may encompass sale of assets—not to tenants, but to the highest bidder—with the funds recycled into rental vouchers or certificates that protect tenants and allow expansion of federal housing assistance to other families in need. Legal reform should focus on enabling market-based decisionmaking: eliminating HOPE-1 preferences; restructuring modernization and operating subsidies into unified market-based payments; liberalizing demolition and disposition laws; granting statutory authority to HUD to mandate the sale of projects to private landlords; and relaxing voucher requirements to expedite the sale of high-cost projects.<sup>33</sup>

Low-income housing is a politically and emotionally charged issue of great complexity. Many families struggle to afford decent housing,<sup>34</sup> and minority

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foreclosed property management, and public housing modernization).

27. Cisneros favors expanding the availability of vouchers, and diverting funding to locally controlled programs. See Rochelle L. Stanfield, *Fewer Strings and Dollars*, 25 NAT'L J. 523 (1993); *HUD Budget Briefing*, FED. NEWS SERV., Apr. 8, 1993, available in LEXIS, Nexis Library, Wires File, at \*11.

28. DeParle, *supra* note 25.

29. *HUD Budget Briefing*, *supra* note 27, at \*11-14.

30. Policy driven by the needs of the housing stock is particularly likely when the construction industry is considered a beneficiary of low-income housing policy. See *Hearing of the Housing and Community Development Subcomm. of the House Banking, Finance, and Urban Affairs Comm.*, FED. NEWS SERV., Feb. 17, 1993, available in LEXIS, Nexis Library, Wires File at \*17-18 (statements of Secretary Cisneros that accelerating modernization spending will create jobs and stimulate industry).

31. An economic rent is a "payment to a factor in excess of what is necessary to keep it to its present employment." THE MIT DICTIONARY OF MODERN ECONOMICS 121 (David W. Pearce ed., 4th ed. 1992). Public housing officials, employees, and contractors all may engage in rentseeking of various forms (e.g., shirking, bribery, cost overruns).

32. See *infra* text accompanying notes 49-72.

33. See *infra* text accompanying notes 204-36.

34. See *infra* text accompanying notes 96-101.

households often contend not only with poverty but with discrimination in the private market.<sup>35</sup> This Note does not offer comprehensive answers to those problems, nor does it address the issue of whether housing aid should be expanded or reduced. However, the privatization strategies proposed herein, which aim to resolve problems at the most troubled large urban housing authorities and are tailored to minimize dislocation for affected public housing tenants, can eliminate waste, improve benefits for assisted households, and free funds to help currently unassisted families.

Part I of this Note outlines the current crisis in the public housing system, especially the high vacancy rates and swelling modernization needs. It discusses how privatization theory predicts the inefficiency that is the source of many public housing woes. Part II explains the inadequacy of resident ownership as a solution to the problems of public housing, particularly in the HOPE-1 context of multifamily projects. Part III discusses the need to reshape low-income housing policy according to the dynamics of urban housing markets. It examines the evidence that, for many markets and projects, conversion to demand-side programs like rental vouchers would be more economical than maintaining existing public housing. Part IV discusses alternative privatization strategies to improve the efficiency and equity of low-income housing assistance, and Part V offers some conclusions.

## I. THE ENDEMIC WOES OF PUBLIC HOUSING

### A. *Current Problems in the Mismanagement and Deterioration of the Public Housing Stock*

Public housing is far more diverse than the crime-ridden, deteriorating, urban high-rise projects that haunt the popular imagination. The 3253 Public Housing Authorities (PHA's)<sup>36</sup> differ greatly in terms of size, markets served, and performance. While some PHA's are colossal (the New York Housing Authority manages nearly 180,000 units),<sup>37</sup> 87% of the PHA's operate fewer than 500 units.<sup>38</sup> PHA's house 1.4 million households<sup>39</sup> in 13,200 developments<sup>40</sup> of highly variegated structures. Fewer than half of public

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35. See *infra* text accompanying notes 175-77; see also Susan M. Wachter & Isaac M. Megbolugbe, *Racial and Ethnic Disparities in Homeownership*, 3 HOUSING POL'Y DEBATE 333, 360 (1992).

36. U.S. DEP'T OF HOUS. & URBAN DEV., CAPITATED PAYMENT FORMULAS FOR PUBLIC HOUSING 115 (1992) [hereinafter CAPITATED PAYMENT FORMULAS].

37. Shawn G. Kennedy, *Housing List in New York Hits Record*, N.Y. TIMES, Dec. 27, 1992, § 1, at 31.

38. CAPITATED PAYMENT FORMULAS, *supra* note 36, at 113.

39. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 1992, at 356 (1992) (Table No. 564).

40. COUNCIL OF LARGE PUB. HOUS. AUTHS. (CLPHA), BASIC FACTS ABOUT PUBLIC HOUSING 1 (1993).

housing units are in high-rises,<sup>41</sup> and federal law now bars the construction of high-rise projects to house families with children if there are feasible alternatives.<sup>42</sup> Public housing developments are not all concentrated in areas of urban decay,<sup>43</sup> nor are they all dens of despair.<sup>44</sup> Some PHA's run quite efficiently; 500 of them require no federal operating subsidy.<sup>45</sup>

Defenders of public housing often emphasize this alternative vision.<sup>46</sup> Two cautions are in order, however. First, the success of some PHA's in implementing public housing within the terms of the program does not mean that public housing is justified vis-à-vis competing housing policies, including privatization. Second, the alternative image of public housing should not distract us from the reality underlying the popular image. The small clutch of suburban garden apartments is not the problem; rather, the distressed and wasteful projects in our central cities should command our attention. It is true that in 1992 HUD designated only twenty-one PHA's—a fraction of 1% of the PHA's—as "troubled;" however, these PHA's alone managed 18% of the nation's public housing units and consumed one-quarter of federal public housing subsidies.<sup>47</sup> The well-known scourges of urban public housing—crime, drug trafficking, vandalism, and concentrated poverty—show no signs of relenting in these or other PHA's,<sup>48</sup> and the evidence now points to a costly crisis in the mismanagement and deterioration of the stock itself.

Vacancies have been growing at an alarming rate. Nearly 8% of all public housing units were vacant in 1991, a total of almost 104,000 units.<sup>49</sup> That is nearly double the number of vacancies that existed in 1986.<sup>50</sup> In troubled housing authorities, vacancy rates reached a staggering 14% of units in 1991. Detroit topped the league with a vacancy rate of 44%, while East Saint Louis

41. COUNCIL OF LARGE PUB. HOUS. AUTHS. (CLPHA), PUBLIC HOUSING TODAY 16 (1988) (estimating 43% of units in high-rises in 1982, only 42% of which housed non-elderly families).

42. See 42 U.S.C. § 1437d(a) (1988).

43. Twenty-five percent are in suburban locations. CLPHA, *supra* note 41, at 5.

44. Surveys generally report high rates of tenant satisfaction. See RACHEL G. BRATT, REBUILDING A LOW-INCOME HOUSING POLICY 63-64 (1989); Schill, *supra* note 13, at 898 & n.85.

45. NEIGHBORHOOD POLICY INST., NATIONAL CTR. FOR NEIGHBORHOOD ENTER., THE SILENT SCANDAL I (1991) [hereinafter THE SILENT SCANDAL].

46. See, e.g., CLPHA, *supra* note 41, at 3; Stegman, *supra* note 19, at 334-37.

47. Michael deCourcy Hinds, *Public Housing Ills Lead to Questions About H.U.D.*, N.Y. TIMES, July 20, 1992, at A8.

48. See, e.g., Ian Fisher, *Promise and Despair Share Project*, N.Y. TIMES, Apr. 11, 1993, §1, at 23 (portraying crime and drug trade at Brooklyn project); Patrick T. Reardon, "We're Crying for Help": Cabrini, the Day After: Anguish, an Arrest, a Call for Troops: City's Public Housing Is Promise Unfulfilled, CHI. TRIB., Oct. 15, 1992, § News, at 1 (detailing crime at Chicago projects); Debbi Wilgoren & Wendy Melillo, *Near SE Playground, a Midday Shooting: Violence in Public Housing: Area Fuels Fear for "Children of War,"* WASH. POST, Aug. 18, 1993, at D3 (describing children injured to killing).

49. 1993 House Appropriations Hearings, *supra* note 3, at 378. The HUD standard for vacancy rates is 3%. See THE SILENT SCANDAL, *supra* note 45, at 28.

50. 1993 House Appropriations Hearings, *supra* note 3, at 195 (testimony of Assistant Secretary Schiff). The rise can be dramatic within a single project. In Chicago, the vacancy rates increased from 8% in 1984 to 45% in 1992 at the Henry Horner Homes, and from 17% to 31% during the same period at Cabrini Green. Gangs proceeded to turn the units into crime and drug havens. See Patrick T. Reardon, *CHA Reeling from Years of Maintenance Neglect*, CHI. TRIB., Nov. 2, 1992, § Chicagoland, at 1.

and Newark weighed in at 38% and 32% respectively.<sup>51</sup> Often, such high vacancy rates signal irresponsible management.<sup>52</sup> None of Detroit's units were deemed uninhabitable in 1990, and a HUD official estimated in 1991 that 2500 of Detroit's 3500 vacant units could have been relet with minimal work like painting and plastering.<sup>53</sup> Perversely, these high vacancies coexist with total PHA waiting lists of nearly one million households.<sup>54</sup>

The stock has been not only underutilized but also neglected. Now the bill is due. In 1992, the Commission on Severely Distressed Public Housing concluded that the total cost of fully modernizing public housing could run as high as \$29.2 billion,<sup>55</sup> a figure which, as one observer noted, exceeds the entire HUD budget.<sup>56</sup> In 1993, HUD estimated that it would take \$16.65 billion just to cover mandatory backlog modernization needs.<sup>57</sup> The Clinton budget, although increasing modernization spending from Bush levels, will not make up the shortfall in the near future. It projects annual modernization expenditures of \$3.1 billion from 1994 to 1998.<sup>58</sup> Given that \$1.8 billion in modernization needs accrue each year,<sup>59</sup> the budget allows only \$1.3 billion per year to redress backlog needs. At that rate, assuming that extraordinary

51. 1993 House Appropriations Hearings, *supra* note 3, at 379.

52. The GAO, studying the issue in 1985 before the burst in new vacancies, cited mismanagement and anticipated modernization or demolition as among the factors causing high vacancy rates. U.S. GEN. ACCOUNTING OFFICE, PUBLIC HOUSING VACANCIES AND THE RELATED IMPACT OF HUD'S PROPOSAL TO REDUCE OPERATING SUBSIDIES 4-6 (1985).

53. THE SILENT SCANDAL, *supra* note 45, at 7; Kim Trent & Valarie Basheda, *HUD Threatens To Seize Detroit Public Housing*, GANNETT NEWS SERV., Dec. 19, 1991, available in LEXIS, Nexis Library, Papers File.

54. CLPHA, *supra* 40, at 4. Some PHA's have closed their lists, and the average wait for public housing is 13 months. Stegman, *supra* note 19, at 333. The existence of waiting lists is not surprising even for unattractive projects, since rental subsidies cover on average 54% of a unit's operating costs. See CLPHA, *supra* 40, at 2.

The problem is not that PHA's are slow to market available units to households on the waiting list, but that PHA's do not swiftly bring units into marketable condition. See *Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations, Fiscal Year 1993: Hearings Before Comm. on Appropriations*, 102d Cong., 2d Sess. 288-89 (1992) [hereinafter *1993 Senate Appropriations Hearings*] (reporting CLPHA survey finding that only 30,000 vacancies were available for occupancy, while 70,000 needed modernization).

55. Schill, *supra* note 21, at 501.

56. DeParle, *supra* note 26.

57. 1994 House Appropriations Hearings, *supra* note 25, at 84 (statement of Michael B. Janis, General Deputy Assistant Secretary, Office of Public and Indian Housing).

Troubled PHA's are the worst offenders. In 1990, the twelve largest "troubled" PHA's, at the time managing 17% of the stock, accounted for 30% of the mandatory modernization needs. *Public Housing and Section 8 Programs: Hearing Before the Subcomm. on Housing and Community Development of the House Comm. on Banking, Finance, and Urban Affairs*, 101st Cong., 2d Sess. 218 (1990) [hereinafter *Public Housing and Section 8 Programs*] (testimony of Dr. Ann Schnare, HUD consultant).

Moreover, because HUD may deny modernization funds to "troubled" PHA's deemed incapable of putting the funds to good use, see 42 U.S.C.A. § 1437l(k)(5) (West Supp. 1993), their stock is in particular jeopardy. The rapid decline of the public housing stock in Chicago resulted in part from a HUD cutoff in modernization funding in the mid-1980's. Chicago received only \$15 million in repair funds when the need had swelled to \$1 billion. Reardon, *supra* note 50.

58. HUD Budget Briefing, *supra* note 27, at \*13.

59. 1994 House Appropriations Hearings, *supra* note 25, at 84 (statement of Michael B. Janis, General Deputy Assistant Secretary, Office of Public and Indian Housing).



modernization appropriations of more than \$3 billion per year can be sustained, it would take a minimum of thirteen years just to restore public housing units to minimally acceptable condition. Stretching out the modernization schedule may itself add even more to the total modernization bill.<sup>60</sup>

Many factors contribute to the high costs of modernizing public housing—notably the age of the stock<sup>61</sup> and the scheme by which public housing has been financed<sup>62</sup>—but mismanagement<sup>63</sup> is surely prominent among them. PHA's commonly defer spending for necessary maintenance of units. For example, PHA's spent an average of only \$700 per unit per year from 1986 to 1988, when \$1,100 per unit per year was required to meet ongoing capital needs.<sup>64</sup> Many PHA's fail to collect rents efficiently, forgoing a primary source of funds for maintenance of the units. In Washington, the average uncollected rents from 1989-1991 were four times (396%) the total monthly rents due the PHA,<sup>65</sup> compared to a HUD standard for Tenants Accounts Receivable (TAR) of 10%.<sup>66</sup> The revenue forgone can be considerable; Detroit's TAR of 33% in 1992 sacrificed almost \$200,000 per month in lost rents.<sup>67</sup> Poor maintenance practices have swelled, and will likely continue to swell, the modernization needs of public housing.

Even if Congress were to increase modernization funding, it is doubtful that HUD or the PHA's would spend it wisely or expeditiously. In January 1993, despite pressing needs, \$6.2 billion in unspent appropriations sat clogged in the modernization "pipeline."<sup>68</sup> More than 40% of the modernization funds

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60. *Cf. Public Housing and Section 8 Programs*, *supra* note 57, at 78 (testimony of Dr. Ann Schnare, ICF consultant, that under funding levels and allocation patterns existing in 1990 the backlog would grow by 3% per year). The rate of growth caused by a stretched-out schedule under proposed 1994 funding levels may be different.

61. One-third of public housing stock was over 25 years old in 1989, with another quarter between 15 and 25 years old. *Id.* at 215. Many of the largest authorities, from whose ranks the troubled PHA's come, have considerably older stock. If we extrapolate figures from the mid-1980's, which is reasonable given the paucity of new construction, *see infra* note 168, the average age of the stock of large PHA's probably exceeds 30 years. *Cf. Mark L. Matulef, This Is Public Housing*, 44 J. HOUSING 175, 178 (1987) (average age 26.7 in 1986); Reardon, *supra* note 50 (70% of Chicago's family units are over 30 years old).

62. *See* BRATT, *supra* note 44, at 57-58; Stegman, *supra* note 19, at 342-52.

63. Mismanagement refers to the mismanagement of the housing asset, and not solely to PHA practices. HUD deserves a fair share of the blame for its misguided practices and regulations.

64. *Public Housing and Section 8 Programs*, *supra* note 57, at 218 (testimony of Dr. Ann Schnare, ICF consultant). ICF estimated that delaying maintenance increased modernization costs by nine percent. *Id.* at 78. *Cf. Reardon*, *supra* note 50 (discussing problems at Chicago housing authority).

65. 1993 Senate Appropriations Hearings, *supra* note 54, at 303. Over the same period, Boston's percentage of uncollected rents stood at 71%, Chicago's at 97%, and Philadelphia's at 269%. *Id.*

66. *See* THE SILENT SCANDAL, *supra* note 45, at 28.

67. *Center Urges Tenant Takeover of Public Housing, Cites Mismanagement of Detroit PHA*, PR NEWswire, May 18, 1992, available in LEXIS, Nexis Library, Papers File; *cf. Cynthia Durcanin, AHA Gets a Dressing-Down; Authority Shows No Improvement, HUD Official Says*, ATLANTA J. & CONST., June 25, 1991, § Local News, at C1 (Atlanta loses \$1.5 million per year because of high vacancies).

68. CLPHA, *supra* note 40, at 7-8. As CLPHA notes, much of the backlog may be due to delays at HUD's Central Office rather than the fault of the PHA's. Still, it is fair to attribute the problem of unspent funds to the collective management of public housing by HUD and the PHA's. *See* Lindsey Gruson, *Housing Aid Goes Unspent by Poor Cities*, N.Y. TIMES, June 15, 1992, at B1 (detailing HUD political skirmishing and New York PHA "bureaucratic labyrinth").

allocated to troubled PHA's between 1986 and 1988, which by law must be spent within three years, remained unspent in 1992.<sup>69</sup> Moreover, in 1990 the HUD Inspector General found that 28 of 34 PHA's audited in a multiregion review "engaged in varying degrees of non-compliance with contract administration requirements" when they did get around to spending the modernization funds.<sup>70</sup> PHA's ignored competitive procurement rules, squandered money on unnecessary contract amendments, and failed to provide documentation for expense increases.<sup>71</sup> Poor planning and execution have caused wasteful delays in modernization projects.<sup>72</sup>

### B. *Privatization Theory*

Defenders of public housing contend that problems of mismanagement are correctable, at least if funding levels are increased.<sup>73</sup> However, the waste and abuses seem endemic to public housing,<sup>74</sup> and support the theory that bureaucratic management of housing will lead to rentseeking and inefficiency.

Privatization theory posits that both private landlords and public housing officials are self-interested.<sup>75</sup> In brief, landlords pursue their self-interest by maximizing a discounted stream of income from their housing assets. In each short-term rental period, a landlord seeks to attract the profitable tenant while minimizing the search and transactions costs of renting (e.g., vacancies).<sup>76</sup> Over time, the landlord adjusts investment in the unit in response to factor costs and market demands.<sup>77</sup> Because the landlord's rights are transferable, the landlord has an incentive to maximize the value of the asset with an

69. NEW CHOICES FOR RESIDENTS, *supra* note 4, at 4-5; see also *Peoria Housing Authority Head Fired*, UPI, Aug. 31, 1992, available in LEXIS, Nexis Library, UPI File (reporting \$14 million in renovation funds unspent).

70. HUD OFFICE OF THE INSPECTOR GENERAL, MULTI-REGION AUDIT OF THE COMPREHENSIVE IMPROVEMENT ASSISTANCE PROGRAM iii (1990), quoted in THE SILENT SCANDAL, *supra* note 45, at 11.

71. THE SILENT SCANDAL, *supra* note 45, at 11-14.

72. See, e.g., Patrick Boyle, *Only Shell Is Left of Complex Plans; Troubles Plague Wilson Dwellings*, WASH. TIMES, Oct. 26, 1992, at B1 (describing D.C. rehabilitation project). HUD had to freeze rehabilitation funding for one Philadelphia housing project after \$5.8 million had produced no usable architectural drawings. See A.J. Hostetler, *HUD Freezes Funding for Rehab Project*, CHI. TRIB., Feb. 9, 1992, at 2D; cf. Jennie Acker, *CHA Ready To Revive Scattered-Site Project*, CHI. TRIB., June 5, 1992, § Chicagoland, at 6 (citing 18-year delay); Gruson, *supra* note 68 (reporting drawings unfinished seven years after construction was to have begun).

73. BRATT, *supra* note 44, at 82-85; CLPHA, *supra* note 40, at 6-10; Chester Hartman, *A Universal Solution to the Minority Housing Problem*, 71 N.C. L. REV. 1557, 1564 (1993).

74. Nine of the "troubled" PHA's have been on the list since it was started in 1979. See Hinds, *supra* note 47.

75. See De Alessi, *supra* note 6, at 25.

76. See JEROME ROTHENBERG ET AL., THE MAZE OF URBAN HOUSING MARKETS: THEORY, EVIDENCE, AND POLICY 131-33 (1991). Vacancies are a search cost because the landlord withholds the unit from the market while waiting to get a more profitable tenant.

77. *Id.* at 165-66.

infinite time horizon. The landlord's pursuit of self-interest is consonant with consumer needs and efficient investment in the housing stock.<sup>78</sup>

No such market forces trouble the public housing official in the pursuit of her self-interest. In order to increase (or at least maintain) the PHA's share of the budgetary pie and thereby improve her own career prospects, the entrepreneurial official has an incentive to stimulate a perceived need for her own programs, no matter what market conditions warrant.<sup>79</sup> Moreover, the public housing official does not have to be directly responsive to tenant needs because (a) the public housing tenant cannot transfer his subsidy to another supplier and (b) PHA revenues depend largely on budgetary allocations, and only partly on tenant rents. PHA officials thus focus on satisfying requirements set by HUD and Congress, which only imperfectly reflect tenant needs and local market supply conditions, including factor costs. Because none of the officials are owners, self-interested officials will concentrate their energies on "salary, perquisites, rank, prestige, and opportunities for promotion."<sup>80</sup> To make these assertions is not to discount altruistic or public-regarding behavior<sup>81</sup> nor direct special cynicism towards public employees.<sup>82</sup> Rather, the point is that to the extent self-interest channels behavior, it is less likely to have socially beneficial effects in public housing than in the private market.

The most egregious rentseeking by public housing officials is outright corruption. The HUD Inspector General reported eleven instances of corruption involving bid-rigging, bribery, embezzlement, or ethics violations, at least nine of which resulted in suspension or criminal sentences for PHA officials between 1988 and 1990.<sup>83</sup> Political corruption drove the Philadelphia PHA into receivership in 1992.<sup>84</sup> A similar fate has befallen five other PHA's since 1989.<sup>85</sup> Fraud and theft have loomed large in recent scandals at PHA's in Washington, D.C. and Boston.<sup>86</sup>

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78. De Alessi, *supra* note 6, at 27.

79. *Id.*

80. James T. Bennett & Thomas J. DiLorenzo, *The Role of Tax-Funded Politics*, in PROSPECTS FOR PRIVATIZATION, *supra* note 6, at 15, 17.

81. See Schill, *supra* note 13, at 886.

82. Walter F. Baber, *Privatizing Public Management: The Grace Commission and Its Critics*, in PROSPECTS FOR PRIVATIZATION, *supra* note 6, at 153, 161 (discussing studies finding similar motivations among private and public employees).

83. THE SILENT SCANDAL, *supra* note 45, at 24.

84. See Dale Russakoff, *U.S. Seizes Philadelphia Public Housing Authority; HUD Acts After Political Corruption Charge*, WASH. POST, May 21, 1992, at A3.

85. See Hinds, *supra* note 47.

86. See Peter S. Cannelllos, *BHA: \$22m Lost to Waste, Fraud at Sites; Funds Could Have Fixed 400 Units*, BOSTON GLOBE, Oct. 21, 1992, at 1; Rene Sanchez, *D.C. Housing Agency Target of Fraud Probe; HUD Says It's Checking Millions in Contracts*, WASH. POST, May 29, 1992, at A1; see also *Former Housing Aide Given 57 Months*, WASH. TIMES, May 29, 1991, at A2 (misappropriation of \$1.7 million in Passaic, N.J.); Elijah Gosier, *Housing Authority Misused Funds*, ST. PETERSBURG TIMES, Oct. 30, 1992, at 3B (\$3.6 million unaccounted for in Saint Petersburg, Fla.); *Head of North Bergen Housing Authority Charged with Bribery*, UPI, Jan. 4, 1991, available in LEXIS, Nexis Library, UPI File (North Bergen, N.J.); *Lawyer for Woods Expected Supreme Court To Reject Appeal*, UPI, Apr. 2, 1991, available in LEXIS, Nexis Library, UPI File (Pittsburgh bribery scandal).

Corruption is an agency cost that also plagues private enterprise, including the private housing market. So conceived, a higher incidence of corruption and rentseeking in the public housing system reflects a greater failure of government "owners" to monitor their agents. Differences in property rights may explain this failure. Because private landlords can transfer their rights in the housing asset and fully recover its value, they have incentives to maximize the asset's profitability over the long term. Competition impels them to use the least-cost combination of inputs in producing a given level of housing output, including monitoring other resource owners (contractors and employees) with whom they form contractual relations to produce that output.<sup>87</sup> By contrast, taxpayers do not own transferable property rights in the assets and cannot recover any surplus that sale of the assets would generate. Because costs are spread over a broad base, taxpayers have comparatively little incentive to monitor their agents in Congress in the spending of tax dollars on the public housing stock.<sup>88</sup> The multilevel structure of the public housing system—Congress, HUD (national and regional), PHA's—makes monitoring difficult and further exacerbates the agency problem.

If this theory is correct, one would expect PHA's to incur substantially higher costs than private housing suppliers. The empirical evidence is unambiguous: a 1982 study done for HUD found that it cost 40% more per-unit to build conventional public housing than unsubsidized FHA housing.<sup>89</sup> Most of the cost differential owed to inefficiency in production, and not to inherent cost differences in the types of projects built.<sup>90</sup>

PHA's also fare poorly in controlling operating costs. Another 1982 study found that PHA per-unit operating costs were 61% higher than costs in the private sector in 1980.<sup>91</sup> In every region, the largest PHA's had the largest

87. See generally De Alessi, *supra* note 6, at 28-31.

88. *Id.* at 31; see also Schill, *supra* note 13, at 883-84.

89. U.S. DEP'T OF HOUS. & URBAN DEV., THE COSTS OF HUD MULTIFAMILY HOUSING PROGRAMS S-17 (1982) [hereinafter HUD MULTIFAMILY HOUSING] (analyzing projects developed between 1975 and 1979). The differential was higher (56%) on a per-square-foot basis. *Id.* at S-7 (comparing development costs per square foot of \$49.80 for conventional public housing to \$31.87 for unsubsidized FHA housing). Earlier studies had estimated public housing to be generally 25-50% more expensive than private housing. John C. Weicher, *The Voucher/Production Debate*, in BUILDING FOUNDATIONS, *supra* note 19, at 286.

90. "Programmatic" costs, which "reflect the relative efficiency of housing production under the different program variants," HUD MULTIFAMILY HOUSING, *supra* note 89, at S-4, accounted for 31 of the 40 percentage point differential between conventional public housing and unsubsidized FHA housing. See *id.* at S-17, S-23. PHA's were especially inefficient in managing "hard costs" of development, which are defined as the costs of land, construction, architectural and engineering fees, and certain off-site costs. *Id.* at S-4 n.1. The hard costs of public housing were 55% higher than their unsubsidized FHA equivalents. *Id.* at S-22. The structure of federal subsidies may have contributed to this inefficiency. Because historically 90% of capital costs were subsidized by the federal government, and operating costs were not subsidized, PHA's inefficiently substituted capital expenditures for current expenditures. See RICHARD F. MUTH, PUBLIC HOUSING: AN ECONOMIC EVALUATION 16-20 (1973).

91. U.S. DEP'T OF HOUS. & URBAN DEV., ALTERNATIVE OPERATING SUBSIDY SYSTEMS FOR THE PUBLIC HOUSING PROGRAM 374 (1982). The 61% differential must be regarded as a rough approximation because data were not directly comparable. See *id.* at 381. However, PHA's were significantly less efficient in all three categories of costs (administrative, utility, and maintenance). *Id.* at 378.

cost differentials.<sup>92</sup> Excessive costs are particularly acute at “troubled” PHA’s. From 1989 to 1991, all but one of the twenty-three PHA’s designated as “troubled” in January 1992 had excess administrative staff by HUD standards, and all but three had excess maintenance staff.<sup>93</sup> Generally, these high costs buy precious little service. The notorious District of Columbia Department of Public and Assisted Housing (DPAH) has consistently failed to fix the heating or roofs at its projects despite having 168 excess maintenance workers;<sup>94</sup> Philadelphia’s 627 maintenance workers had roused themselves to repair only 25 vacant units per year prior to HUD’s seizure of the PHA in 1992.<sup>95</sup>

To recap, vacancy rates are high and rising at PHA’s. Systemic neglect has caused the housing stock to deteriorate, creating mammoth modernization needs. Current spending practices seem unlikely to fix these problems. Large, “troubled” PHA’s are the worst offenders. Although one cannot tar all PHA’s with their sins, many of their problems—high costs, vacancy rates, and modernization needs—beset the public housing system as a whole. Privatization theory predicts these results, given the greater vulnerability of government enterprise to rentseeking and poor monitoring of performance.

Inefficient public housing creates inequity, not just waste. Low-income housing is not an entitlement program. In 1992, almost 4.7 million households received federal rental assistance.<sup>96</sup> However, HUD estimates that another 13 million qualify for aid under federal guidelines, but did not receive assistance because of lack of funding. Of these, 5.1 million unassisted families are considered “worst-case needs” because they have very low income, live in “severely substandard” conditions, and spend more than 50% of their income on rent and utilities.<sup>97</sup> Housing assistance makes a big difference in family

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92. *Id.* at 372. A 1992 HUD study confirmed the inefficiency of the largest PHA’s by comparing their costs to their smaller brethren. Extra-large PHA’s (managing 6500 units or more) garnered \$5127 per household in modernization and operating subsidies from the federal government, versus levels of \$2784 per household in medium PHA’s (500-1249 units) and \$2475 in small PHA’s (under 500 units). *CAPITATED PAYMENT FORMULAS*, *supra* note 36, at 26. If subsidies are adjusted for local cost factors and reallocated among PHA’s on a per-occupant basis, extra-large PHA’s would receive 21% less funding. *Id.* at 50.

93. 1993 *Senate Appropriations Hearings*, *supra* note 54, at 301-02. Six PHA’s had more than double the recommended level of administrative staff. *Id.* at 301.

94. Courtland Milloy, *Another Winter Without Heat*, WASH. POST, Feb. 28, 1993, at B1. Sixty-one of 86 units inspected in a federal audit of D.C. public housing failed to meet HUD standards. Ruben Castaneda, *HUD Calls D.C. Housing Mismanaged; Auditors Question Millions in Spending*, WASH. POST, Oct. 6, 1992, at A1.

95. Hinds, *supra* note 47. The failure to control costs goes hand-in-hand with bad financial management at many PHA’s. See Peter S. Cannellos, *\$1.2m BHA Deficit Discovered; New Chief, HUD Talk of Crisis*, BOSTON GLOBE, at 21; Castaneda, *supra* note 94 (reporting HUD audit tagged DC DPAH with improperly spending \$1.3 million and failing to account for another \$6.1 million from 1988 to 1992); see also *HUD Seizes Chester Housing Authority*, UPI, Nov. 7, 1991, available in LEXIS, Nexis Library, UPI File (reporting \$2 million in losses over 3 years as cause for HUD’s seizure of Chester, Pa. PHA).

96. HOUSE COMM. ON WAYS AND MEANS, OVERVIEW OF ENTITLEMENT PROGRAMS: 1992 GREEN BOOK, 102d Cong., 2d Sess. 1679 (1992) [hereinafter 1992 GREEN BOOK]. Another 826,000 low- or moderate-income homeowners received assistance in that year. *Id.*

97. See DeParle, *supra* note 26; see also CLPHA, *supra* note 40, at 4 (reporting HUD estimate that only 29% of eligible families are effectively assisted). The sharp rise in estimates of “worst case” needs since the mid-1980’s derives in part from the broadening of the definition of “household” to include

budgets. Whereas the average household below the poverty level spends 50% of its gross income on housing costs,<sup>98</sup> assisted households spend only 30-36% of their adjusted incomes<sup>99</sup> on housing costs.<sup>100</sup> Inequity in housing assistance has worsened in recent years, as growth in the number of poor households has outstripped growth in the number of households receiving housing assistance.<sup>101</sup> Wasteful programs only bar the door to more families in need.

The inefficiency of public housing cannot be cured while retaining the present system, especially given the current funding climate and HUD's notorious mismanagement.<sup>102</sup> Jack Kemp had a vision for change: in HOPE-1, he advocated converting the public housing stock from government management to private ownership by selling projects to the residents. This vision, while appealing, is flawed because it involves a form of privatization that is economically untenable. Only after understanding the economic weakness of the Kemp program can we go on to discuss more promising forms of privatization that would better serve current public housing tenants as well as other families not yet given housing assistance.

## II. SELLING PUBLIC HOUSING TO THE RESIDENTS: A FLAWED IDEA

Jack Kemp pressed for HOPE-1 legislation despite the disappointing results of past federal programs to sell public housing to low-income families. As of 1991, PHA's had sold only 60% of the 13,875 units available under Turnkey III, a 1968 program in which PHA-managed units were sold to tenants over time under lease-purchase agreements.<sup>103</sup> The Public Housing

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unrelated individuals. See *Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations, Fiscal Year 1992: Hearings Before the Senate Comm. on Appropriations*, 102d Cong., 1st Sess. 499 (1991) [hereinafter *1992 Senate Appropriations Hearings*].

98. U.S. DEP'T OF COMMERCE & U.S. DEP'T OF HOUS. & URBAN DEV., AMERICAN HOUSING SURVEY FOR THE UNITED STATES IN 1991, at 64 (1993) [hereinafter AMERICAN HOUSING SURVEY]. Households in central cities spend on average 55% of their gross income on housing costs. *Id.* at 389. But see Robert C. Ellickson, *The Untenable Case for an Unconditional Right to Shelter*, 15 HARV. J.L. & PUB. POL'Y 28-30 (1992) (arguing that inaccurate survey data overstates affordability problem).

99. The adjustments include exclusions for earned income, child care, medical care, and dependents, which may be significant for some households. See 42 U.S.C. § 1437a(b)(5) (Supp. III 1991).

100. U.S. GEN. ACCOUNTING OFFICE, ASSISTED HOUSING: RENT BURDENS IN PUBLIC HOUSING AND SECTION 8 HOUSING PROGRAMS 10-12 (1990). By statute, assisted households are supposed to pay the higher of 30% of adjusted monthly income or 10% of total income, see 42 U.S.C. § 1437a(a)(1)(A)-(B) (1988 & Supp. III 1991) (general provisions); 42 U.S.C. § 1437f(o)(2) (1988) (vouchers), but there is some variance depending on how utility allowances are handled. *Id.*

101. See William C. Apgar, Jr., *The Nation's Housing: A Review of Past Trends and Future Prospects for Housing in America*, in BUILDING FOUNDATIONS, *supra* note 19, at 25, 55 (finding growth of 2.8 million households below poverty level from 1974-85 and fewer than 1.4 million net new households below the poverty level receiving subsidy).

102. On HUD's mismanagement, see generally Michael A. Wolf, *HUD and Housing in the 1990's: Crisis in Affordability and Accountability*, 18 FORDHAM URB. L.J. 545 (1991). See also Jason DeParle, *Reports Warning of H.U.D. Problems*, N.Y. TIMES, Mar. 11, 1993, at A21.

103. U.S. Dep't of Hous. & Urban Dev., Turnkey III Log (Nov. 25, 1991) (unpublished data on file with author).

Homeownership Demonstration (PHHD), launched in 1984, met with similar difficulties. Of the 1315 units approved for sale, only 420 (32%) had been sold by mid-1991, with another 280 projected for sale by year's end.<sup>104</sup> Poor program execution contributed to these lackluster results.<sup>105</sup> The deeper problem is that homeownership is uneconomical for many very low-income households. HOPE-1 and other programs for transferring ownership of units to the residents of public housing does not secure the efficiency gains that justify privatization as a policy choice.

The economic argument for privatization of public housing is that it will lead to more efficient transactions between consumers and suppliers. Both the demand and supply sides of a transaction can be privatized in a government-subsidized transaction. Privatization of demand means giving the consumer choice over which unit to occupy, perhaps by a voucher.<sup>106</sup> This is especially appropriate for private goods like housing because they are individually and not jointly consumed, allow exclusive enjoyment, are produced in a competitive market that provides a high degree of choice, and largely internalize the costs and benefits of the transaction.<sup>107</sup> Privatizing demand-side activity recognizes widespread differences in individual preferences<sup>108</sup> and gives incentives for individuals to shop to maximize their utility. Privatizing housing supply recognizes that individuals specialize as housing suppliers because of comparative advantage and produce goods at a wealth-maximizing combination of price, quality, and quantity of output. Market competition eliminates economic profits above the normal rate<sup>109</sup> and ensures that the most efficient producer supplies the service that the consumer wants within the standards set by the housing assistance program.

Any assessment of the efficiency of a housing privatization program must take into account the fact that housing supply consists of an intertemporal flow of services from a unit. Housing supply can be roughly conceptualized as comprising three different value-added functions, which are not always performed by the same producer. The first value-added function is the original production of the durable asset. Because it is durable, the unit can provide a stream of services over time.<sup>110</sup> Some of those services are structural, such

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104. 1992 Senate Appropriations Hearings, *supra* note 97, at 521-22.

105. For example, poor PHA performance in designing and managing the program also hindered sales. See Stegman, *supra* note 13, at 76-80.

106. The economics of vouchers are discussed *infra* at text accompanying notes 170-71, 198-202.

107. See SAVAS, *supra* note 6, at 35-48, 96, 98 (discussing privatization generally). Of course, costs and benefits are not entirely internalized in low-income housing, which is why society chooses to grant housing subsidies. The efficiency-based rationale for government intervention is that there is a "direct consumption externality" in low-income housing (i.e., members of society derive utility from the improved housing consumption of low-income households). GEORGE FALLIS, HOUSING ECONOMICS 138 (1985).

108. See De Alessi, *supra* note 6, at 25.

109. *Id.* at 27-29 (discussing property rights and markets generally).

110. Cf. Allen C. Goodman, *An Econometric Model of Housing: Price, Permanent Income, Tenure Choice, and Housing Demand*, 23 J. URB. ECON. 327, 330 (1988) (asset value related to discounted value of stream of services expected from unit).

as the shelter or aesthetic pleasure a unit provides, and others derive from the location, such as a good school district or convenient access to parks, shopping, or downtown.<sup>111</sup> The second value-added function is the supply of current services that are produced throughout the period of consumption. These include security, common-area upkeep, and ordinary maintenance and repair. A landlord provides these incidental services to a renter, and an owner provides them to herself. The third value-added function is asset rehabilitation to enhance the productivity of unit-based services.<sup>112</sup> When the owner of a housing unit also occupies that unit, the owner is both a consumer of housing services and a producer, performing the second and third value-added functions (either directly or by contracting with another party).

HOPE-1 is an inefficient form of privatization because it vests low-income households with value-added functions (second and third above) for which they are often not well suited. Specifically, many public housing residents lack expertise in managing inputs efficiently as compared to other producers (both landlords and other homeowners). Because the risk/return profile and illiquidity of housing as an asset make homeownership uneconomical for such households, the government would need to provide significant subsidies to make the program work. The commendable fairness provisions in HOPE-1, which restrict resale to prevent windfall profits,<sup>113</sup> limit one of the traditional benefits of privatization, namely that the free alienability of property directs assets to their most valued use. Moreover, the collective ownership involved in HOPE-1 is inherently inefficient. In short, the disincentives for most low-income public housing residents to own their units are so high that subsidies would have to be enormous. The case for subsidizing risky housing *investment* by a subset of low-income households—especially while housing *consumption* needs of other poor families remain unmet—is far from compelling.<sup>114</sup>

Ordinarily, in choosing to own rather than rent, the owner-occupant simultaneously chooses optimal housing consumption and an optimal portfolio investment.<sup>115</sup> As her own landlord, effectively pricing to herself the services demanded, the owner maximizes her net revenue (properly discounted) so as to satisfy her demand for services and earn a competitive return on her

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111. See RICHARD F. MUTH & ALLEN C. GOODMAN, *THE ECONOMICS OF HOUSING MARKETS* 1, 2, 6 (1989).

112. See EXPERIMENTING WITH HOUSING ALLOWANCES: THE FINAL REPORT OF THE HOUSING ASSISTANCE SUPPLY EXPERIMENT 340 (Ira Lowry ed., 1983) [hereinafter HOUSING SUPPLY EXPERIMENT].

113. See 42 U.S.C. § 1437aaa-4(g) (Supp. III 1991).

114. Economists have questioned the wisdom of policies encouraging housing investment generally. See, e.g., Edwin S. Mills, *Social Returns to Housing and Other Fixed Capital*, 17 J. AM. REAL EST. & URB. ECON. ASS'N 197, 207 (1989) (finding real returns to housing capital in the United States from 1929-86 to be only 37% of returns to non-housing fixed capital and more variable). But see Patric H. Hendershott, *Comments on Social Returns to Housing and Other Fixed Capital*, 17 J. AM. REAL EST. & URB. ECON. ASS'N 212, 213 (1989) (finding lower degree of overinvestment).

115. See RAYMOND J. STRUYK, *URBAN HOMEOWNERSHIP* 27-28 (1976); J.V. Henderson & Y.M. Ioannides, *A Model of Housing Tenure Choice*, 73 AM. ECON. REV. 98, 102 (1983).



investment.<sup>116</sup> The demand for housing services turns on many factors, such as permanent income,<sup>117</sup> family characteristics, point in the life cycle, unit price of housing services, and the price of other goods.<sup>118</sup> The demand for housing investment is a function of housing services demand, wealth, expected length of tenure, the expected rate of return on housing investment, the expected rate of return on other forms of investment, the risk of the housing investment, and the degree of risk aversion.<sup>119</sup> Excluding tax effects, the demand function for owner-occupancy would incorporate all those factors, as well as the household's preference for owning versus renting.<sup>120</sup>

Economic theory predicts lower rates of homeownership for the lowest income households,<sup>121</sup> and empirical data indicates a positive correlation between homeownership and income levels for all family types.<sup>122</sup> On an aggregate level, households below the poverty line in central cities are disproportionately likely to be renters.<sup>123</sup> Homeownership has also been found to be strongly linked to employment, which affects both permanent income and mortgage availability.<sup>124</sup> Public housing residents, who have low reported incomes and low rates of employment,<sup>125</sup> generally cannot be homeowners without a special government subsidy.

116. STRUYK, *supra* note 115, at 32. Because of the high transaction costs associated with purchasing a house, the owner maximizes an intertemporal utility function. See FALLIS, *supra* note 107, at 37.

117. Permanent income is the "average income that the individual or household expects to receive over a period of time while retaining his wealth intact." THE MIT DICTIONARY OF MODERN ECONOMICS, *supra* note 31, at 328.

118. STRUYK, *supra* note 115, at 28.

119. See *id.* at 28-29; Yuming Fu, *A Model of Housing Tenure Choice: Comment*, 81 AM. ECON. REV. 381, 383 (1991) (discussing risk); John P. Shelton, *The Cost of Renting Versus Owning a Home*, 44 LAND ECON. 59, 66 (1968) (discussing effects of expected length of tenure).

120. See STRUYK, *supra* note 115, at 35. For most of the very low-income households targeted by HOPE-1, tax breaks would not be an issue.

121. Struyk predicts a nonlinear relationship between income and homeownership (s-shaped function), with very low rates of ownership for the lowest levels of income. *Id.* at 35-37.

122. See STRUYK, *supra* note 115, at 64; Dora J. Moore, *Forecasting the Probability of Homeownership: A Cross-Sectional Regression Analysis*, 2 J. HOUSING RES. 125, 141-42 (1991); Wachter & Megbolugbe, *supra* note 35, at 340-41 ("Virtually all studies of tenure choice have found income a statistically significant determinant of the probability of ownership."). This is not to imply that homeownership is scarce among low-income groups. As discussed above, homeownership decisions are complex and based on many variables, such as the life cycle of a household, its preference for owning, and (for taxpaying households) tax subsidies. See, e.g., MAHLON R. STRASZHEIM, AN ECONOMETRIC ANALYSIS OF THE URBAN HOUSING MARKET 106-07 (1975) (showing different income elasticities of demand for different household types). Rates of homeownership have been significant even among the lowest income quintile. See Thomas M. Holloway, *The Role of Homeownership and Home Price Appreciation in the Accumulation and Distribution of Household Sector Wealth*, BUS. ECON., Apr. 1991, at 38, 40-41.

123. See AMERICAN HOUSING SURVEY, *supra* note 98, at 38, 376 (finding 78% of households below the poverty level in central cities rent, versus 51% of all households in central cities, and 36% of all households nationally).

124. See Axel Börsch-Supan & Henry O. Pollakowski, *Estimating Housing Consumption Adjustments from Panel Data*, 27 J. URB. ECON. 131, 143 (1990). A recent Canadian study contends that current wealth is a stronger determinant of tenure choice than permanent income for young households. Lawrence D. Jones, *Current Wealth and Tenure Choice*, 17 J. AM. REAL EST. & URB. ECON. ASS'N 17 (1989).

125. The average reported household income of a public housing tenant is \$7394. CLPHA, *supra* note 40, at 3 (reporting HUD data). Fifty-eight percent of non-elderly households have no wage earner. Stegman, *supra* note 19, at 335.

One reason for lower rates of homeownership among very low-income households is that they are not well suited to undertake the high risks of housing investment.<sup>126</sup> For them, homeownership is a poor instrument for diversification, because the value of their homes is large relative to the household's total wealth.<sup>127</sup> Housing investment demand increases with wealth if the coefficient of absolute risk aversion is decreasing.<sup>128</sup> This means that poorer households are likely to be more risk-averse than wealthier households because the consequences of loss are severe; thus, poorer households are more likely to invest in assets less risky than a home.

Risks are associated with both the future market value and the costs of owning and maintaining the asset. The market value of the asset may evaporate with physical destruction, rapid neighborhood change, or other alterations in demand conditions.<sup>129</sup> Housing costs are volatile and have risen steeply in recent years. William Apgar estimates that the total annual cost in 1988 dollars of owning and operating a home (adjusting for equity buildup and the opportunity cost of down payment) rose from \$4777 in 1967 to \$8015 in 1988.<sup>130</sup> When it comes time to sell the home, the household may not reap the expected rate of return that justified the investment in the first place. The relatively low demand experienced in Turnkey III and the PHHD,<sup>131</sup> and fears about affordability voiced by assisted households who are prospective owners,<sup>132</sup> may suggest some disinclination to incur risk.

Liquidity constraints also deter homeownership by low-income households.<sup>133</sup> Illiquidity may make it "costly or impossible for potential owner-occupants to obtain the necessary capital"<sup>134</sup> for initial purchase or improvements over time. Because lenders consider the housing asset to be inadequate security for mortgage debt, owner-occupants will face high interest rates or even complete denial of credit.<sup>135</sup> Homeowners facing severe liquidity constraints are unlikely to be efficient producers of housing services. They may not be able to absorb the volatility in housing costs or make supply

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126. Economists agree that housing is a risky asset, but differ as to the magnitude of the risk. Compare Mills, *supra* note 114, at 207 with Hendershott, *supra* note 114, at 216.

127. See Henry Hansmann, *Condominium and Cooperative Housing: Transactional Efficiency, Tax Subsidies, and Tenure Choice*, 20 J. LEGAL STUD. 25, 37 (1991).

128. Fu, *supra* note 119, at 383.

129. See STRUYK, *supra* note 115, at 30.

130. Apgar, *supra* note 101, at 27. Homeownership costs also grew dramatically as a percentage of median income from 1965 to 1983. See William C. Apgar, Jr., *Recent Trends in Housing Quality and Affordability: A Reassessment*, in HOUSING ISSUES FOR THE 1990's 37, 56 (Sara Rosenberry & Chester Hartman eds., 1989).

131. See *supra* text accompanying notes 103-05.

132. See, e.g., Sebastian Rotella, *Pioneering Tenant-Ownership Effort Loses Steam*, L.A. TIMES, Aug. 25, 1991, at B3.

133. See Peter Linneman & Susan Wachter, *The Impacts of Borrowing Constraints on Homeownership*, 17 J. AM. REAL EST. & URB. ECON. ASS'N 389, 398-400 (1989).

134. See Hansmann, *supra* note 127, at 37.

135. See *id.* The liquidity constraints that poor households face may reflect credit market imperfections (e.g., discrimination, redlining) as well as the inherent risk in their undertaking this investment.

adjustments in response to shifts in market conditions or their own demand for services.<sup>136</sup> Homeowners who defer maintenance risk rapid wasting of their assets.<sup>137</sup> A landlord who can easily obtain credit may be able to supply the housing demand of low-income households more efficiently.<sup>138</sup>

Given their liquidity constraints, low-income households often struggle with the financial burdens of homeownership. While long-term data from the PHHD is not yet available, results from the first eighteen months indicate that 10-15% of buyers experienced some difficulty meeting their housing costs. About 31% of buyers interviewed indicated that payments were straining their budgets, and 10% admitted to being in arrears by almost one month.<sup>139</sup> Michael Stegman, one of HUD's PHHD evaluators, predicts that failure rates eventually will approach 10%.<sup>140</sup>

Finally, unassisted low-income households cannot generally afford the high transaction costs associated with home ownership. The administrative costs of changing title and negotiating debt financing are significant, often approaching 10% of house value.<sup>141</sup> Excluding tax effects, transaction costs are such a large factor that homeownership may become economical only if the household stays put for five years.<sup>142</sup> The high risks and costs of homeownership will deter many low-income households from choosing this form of investment, as has been evident in past federal programs to sell public housing units.

HOPE-1 requires an inflated subsidy to offset the high costs of converting low-income tenants to homeownership.<sup>143</sup> Low-income families require the base subsidy of consumption, which is the same if the PHA owns the unit, and an additional subsidy to insulate them from the high costs of riskbearing, illiquidity, and transactions associated with homeownership.<sup>144</sup> Whereas the

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136. Because housing is an illiquid asset and low-income households are particularly vulnerable to unexpected income loss or expenses in other areas (e.g., health care), it is not rational for them to allocate their savings to housing. HOPE-1's resale restrictions make such an allocation particularly ill-advised by prohibiting the low-income homeowner from selling her unit in the first six years for more than her costs (contributions and improvements) plus inflation. See 42 U.S.C. § 1437aaa-4(g)(2) (Supp. III 1991).

137. See HOUSING SUPPLY EXPERIMENT, *supra* note 112, at 340.

138. Liquidity problems have been evident in past homeownership programs. High interest rates prevented some potential Turnkey III buyers from getting mortgages. See Stegman, *supra* note 13, at 46. In the PHHD, only five of the 13 PHA's that sold homes were able to muster private financing for the sales. Private financing was secured for only 25% of the single-family units. *Id.* at 64-65.

139. *Id.* at 71.

140. *Id.* at 72. Some HUD officials disagree vehemently with Stegman's conclusions. They point out that, excluding two Denver cooperatives, PHHD's failure rates accord with FHA experience. Interview with Gary Van Buskirk, Director, Homeownership Programs, U.S. Department of Housing and Urban Development, in Washington, D.C. (Mar. 18, 1993).

141. MUTH & GOODMAN, *supra* note 111, at 6; see also Hansmann, *supra* note 127, at 38.

142. See Shelton, *supra* note 119, at 66.

143. To the extent that public housing residents have persistently low incomes and are not temporarily poor, HOPE-1 subsidies would have to be deeper than a homeownership program aimed at a broad cross-section of low-income households. See Michael A. Stegman et al., *Designing Better Homeownership Assistance Programs Using the Panel Study of Income Dynamics (PSID): An Exploratory Analysis*, 2 J. HOUSING RES. 39, 72 (1991).

144. Such subsidies were evident in the sale of the Kenilworth-Parkside project: a) heavy modernization spending needed to insulate residents from near-term maintenance and rehabilitation costs,

PHHD rigorously screened prospective buyers, under HOPE-1 even the poorest households are able to buy their units for less than 30% of their reported income, thereby magnifying the risks and costs to be offset by subsidies.<sup>145</sup>

The costs of riskbearing, illiquidity, and transactions are inherent in any form of ownership. But there is another significant source of costs that inheres in the form of *multifamily* ownership encouraged by HOPE-1: the costs of collective decisionmaking.

The private-market analogues to HOPE-1 collective ownership are condominiums and cooperatives.<sup>146</sup> In a recent article, Professor Henry Hansmann has suggested that, without large tax subsidies, cooperatives would generally compete poorly with apartment rentals.<sup>147</sup> Collective decisionmaking inflates the costs of cooperatives relative to landlord-operated developments. It also entails high transaction costs and leads to inefficient outcomes because owners' interests are heterogeneous and decisions are made by voting.<sup>148</sup> HOPE-1 will probably exacerbate the problem of collective governance. Since current residents can choose not to buy but have the right to retain their unit as renters,<sup>149</sup> not all HOPE-1 residents will be owners. Non-owning residents will rent from the cooperative, but the relationship will not be one of market contracting at equilibrium rents. The owners may have incentives to act strategically against the interests of the renters, leading to inefficient outcomes in which renters receive lower benefits than if the PHA managed the units.

Given the difficulties faced by low-income households in coping with homeownership costs and the special problems of converting multifamily projects to resident ownership, privatization to tenants may make economic sense under only very confined conditions: namely, selling single family homes to tenants at the high end of the tenant income distribution. Because of what economists term the "fundamental rental externality,"<sup>150</sup> sales of such units

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b) transition subsidies designed to build operating reserves, c) elimination of financing and transfer costs, and d) sale of property for nominal value. See U.S. GEN. ACCOUNTING OFFICE, *supra* note 16, at 17-18.

HOPE-1 also involves costly planning and implementation grants to help inexperienced and inexperienced residents in the transition to ownership. Planning grants have averaged \$130,000 and implementation grants \$1.3 million per resident management council. Interview with Cheryl Fox, Staff Aide, Senate Housing and Community Development Subcommittee, in Washington, D.C. (Mar. 16, 1993).

145. HOPE-1 provides only weak mechanisms to ensure that financially unqualified families will be screened out. The homeownership proposal must identify a method for screening families, see 42 U.S.C. § 1437aaa-3(c)(1) (Supp. III 1991), and HUD's selection criteria must examine the extent to which families will be able to afford homeownership. See 42 U.S.C. § 1437aaa-2(e)(3) (Supp. III 1991).

146. For simplicity, I will refer only to cooperatives for the rest of the discussion, although the argument applies to any form of collective ownership.

147. Hansmann, *supra* note 127, at 68.

148. The preferences of the median voter may not be those of the mean voter. Voting also invites certain stakeholders to act strategically to dominate collective decisionmaking to the detriment of others. By contrast, under rental market contracting, a landlord has an incentive to select policies that are efficient so as to maximize aggregate rents. *Id.* at 34.

149. See 42 U.S.C. § 1437aaa-3(h) (Supp. III 1991).

150. The externality is that tenants do not face the social marginal costs of their utilization of the unit. A landlord can collect from the tenant only part of the costs of the utilization of the unit above the basic

to residents may be economically advantageous,<sup>151</sup> provided that the residents have the financial resources to cope with the costs of homeownership. It is not surprising that, prior to HOPE-1, the vast majority of successful sales of public housing units fit this profile of economic viability.<sup>152</sup>

In sum, there are significant costs associated with transforming low-income tenants into homeowners, particularly when they live in multifamily units. If privatization to tenants makes sense, it is in the limited case of selling high-cost single-family units to tenants with relatively high incomes.<sup>153</sup> Making other forms of privatization to tenants viable would require significant federal subsidies. There seems to be a stronger case for, and greater social consensus on, subsidizing low-income housing consumption instead of housing investment. Jack Kemp made the ideological claim that homeownership would have transformative effects on families now dependent on government

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contract rent. Although landlords may be able to recover for obvious damage to the units, they cannot recover the marginal costs of increased breakdowns and wear and tear on the unit. Because of this externality, contract rents must be sufficiently higher than expected maintenance costs. Henderson & Ioannides, *supra* note 115, at 99-102. The costs of moral hazard are more likely to be significant in rented single-family homes, which explains a U.S. owner-occupancy rate of 85% in that dwelling type. Such costs are less of a factor for multifamily apartment buildings, because unit maintenance by the tenant is minor relative to investments in the exterior shell and utility systems. See Hansmann, *supra* note 127, at 33.

151. There is some evidence that purchasers of single-family units maintain their homes better than public housing authorities. See RAY FORREST & ALAN MURIE, MOVING THE HOUSING MARKET 74-80, 103 (1990) (United Kingdom experience); Stegman, *supra* note 13, at 46 (Turnkey III experience). Single-family ownership ensures that the "landlord" is on-site, which is more efficient and eliminates the costs of a PHA managing scattered-site units. See Frank W. Porell, *One Man's Ceiling Is Another Man's Floor: Landlord/Manager Residency & Housing Conditions*, 61 LAND ECON. 106, 116 (1985) (30% fewer maintenance deficiencies if landlord/manager resident); Stegman, *supra* note 12, at 59-60 (noting PHA view, disputed by HUD, that single-family homes are expensive to manage on a per-unit basis).

152. A 1989 survey covering 1231 public housing units indicated that most were single-family detached or semi-detached homes, and that the average income of the purchaser was \$15,138. *Public Housing and Section 8 Programs Hearing*, *supra* note 57, at 498 (1989 NAHRO survey). Most units sold in the PHHD were single-family units, and the buyers had household incomes averaging \$16,673, with 91.3% of the households having at least one wage earner. See Stegman, *supra* note 13, at 68.

153. Some commentators have argued that family stability and a predictable income of \$17,000-\$20,000 are necessary to support homeownership. See Peter W. Salsich, Jr., *A Decent Home for Every American: Can the 1949 Goal Be Met?*, 71 N.C. L. REV. 1619, 1643 (1993).

assistance. Because that claim remains unproven,<sup>154</sup> HOPE-1 does not at this time justify the risks or diversion of funds it entails.

### III. RETHINKING PRIVATIZATION: RESPONDING TO MARKET INCENTIVES AND MAXIMIZING ASSET VALUES

Abandoning HOPE-1 should not lead us to forswear privatization. The current crisis in the public housing system remains most acute in the larger, poorly managed PHA's. Not only has money been misspent, but deferred modernization and high vacancy rates will likely accelerate deterioration of the housing stock. Meanwhile, as funds are diverted to prop up public housing, many eligible families go unserved. If we are concerned about helping more families within current budgetary limits, we must focus on the efficiency of housing assistance programs. A focus on efficiency leads to two related goals: to ensure that more of every dollar of subsidy goes to housing consumption of assisted families, and to ensure that assets (land and housing stock) currently managed by PHA's are channeled to their most valued use. The latter would entail selling assets to the highest bidder and recycling the funds into rental vouchers that protect tenant interests and allow expansion of federal housing assistance. This privatization strategy is likely to succeed because it integrates housing assistance more fully with local housing markets. Consumers receive wider choice and suppliers react to market incentives.

A market-based housing policy is not a matter of ideological preference. It simply recognizes that, however a housing initiative is structured, the *effects* of that initiative are in large measure market-determined. Housing is a special kind of good,<sup>155</sup> which generates an extremely complex and segmented

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154. There is no conclusive empirical data on the effects of homeownership on very low-income families. Some multifamily ownership cooperatives have failed. In 1986, the U.S. government foreclosed on the Longwood Cooperative, after years of fraud and mismanagement by its board, despite having poured in \$10 million in subsidies. U.S. GEN. ACCOUNTING OFFICE, ASSISTED HOUSING: OVERVIEW OF THE PROBLEMS AT THE LONGWOOD COOPERATIVE IN CLEVELAND, OHIO 2-3 (1988). Failures of collective governance contributed to the 27% turnover rate that afflicted one Denver PHHD cooperative and the 20% delinquency rate that plagued another. See Stegman, *supra* note 13, at 60-61, 72-73. In contexts not directly comparable to HOPE-1, homeownership has not prompted significant behavioral change. See Ray Forrest & Alan Murie, *Transformation Through Tenure? The Early Purchasers of Council Houses*, 20 J. SOC. POL'Y 1, 11 (1991) (finding no long-term effects on occupational position or economic performance of U.K. households buying council homes; however, such tenants are older, more established, and relatively better off than comparable public housing tenants in the U.S.); Ronald Krumm & Austin Kelly, *Effects of Homeownership on Household Savings*, 26 J. URB. ECON. 281, 293 (1989) (finding homeownership does not induce significantly higher overall savings for owner-occupied housing at mean values).

Moreover, to the extent we do want to encourage homeownership among lower income families, subsidies should be directed to households on the margin that would be better able to sustain its costs and risks than the average public housing tenant. A recent study found HOPE-type subsidies, in part because they are available to even very low-income households, to be more expensive than better targeted homeownership programs. Michael A. Stegman et al., *Using the Panel Study of Income Dynamics (PSID) To Evaluate the Affordability of Alternative Mortgage Instruments and Homeownership Assistance Programs*, 2 J. HOUSING RES. 161, 187-88, 191-93 (1991).

155. See ROTHENBERG ET AL., *supra* note 76, at 2-3 (discussing distinctive traits of spatial immobility,

market structure, particularly in urban areas. The economists Rothenberg, Galster, Butler, and Pitkin characterize the urban housing market structure as a "collection of distinct yet interrelated submarkets" that adjust rapidly to changes in demand, costs, or government policy.<sup>156</sup> Whether or not policies will have their desired results depends on the conditions—construction and operating costs, vacancy rates, demand and supply elasticities, existing government policies like rent control—that exist in the affected segments of local markets.<sup>157</sup> These economists caution that government must avoid policies that will cause counterproductive adjustments in a local market, especially those which affect unsubsidized low-income households.<sup>158</sup>

Although they concede that there is "no unambiguously 'best' housing policy in all circumstances,"<sup>159</sup> Rothenberg and his co-authors find that demand-side policies—for example, rental vouchers that allow households to shop in the private market—generally prove superior to other types of policies on both efficiency and equity grounds:

Demand-side approaches are fundamentally different from either supply-side or market-regulatory approaches because they do not engender conflicting [endogenous] adjustments across submarkets which counteract policy intents.

Demand-side approaches directly attack the root of the problem in most markets—the inability of some households to afford decent-quality housing at current rents for such. When rent supplements are provided to these households, the market responds so as to supply more housing to the quality level at which these augmented demands are concentrated . . . . [This benefits] policy participants by lowering market valuations in the target submarkets [without adversely affecting nonparticipants].<sup>160</sup>

Empirical data support the theory that demand-side assistance is the most effective approach. Supply is nearly perfectly elastic over the medium term (about five years) in most submarkets.<sup>161</sup> This means that suppliers will fully meet excess demand generated in rental submarkets.<sup>162</sup> By contrast, there is no evidence that past public housing initiatives have "had a net positive impact on the stock in any rental submarket, and even less evidence that they reduced the occupancy of lower-quality rental submarkets."<sup>163</sup> Integrating

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durability, multidimensional heterogeneity, physical modifiability, etc.).

156. *Id.* at 48.

157. *Id.* at 353-54.

158. *Id.* at 355.

159. *Id.* at 354.

160. *Id.* at 355.

161. *Id.* at 518.

162. *Id.*

163. *Id.* (footnote omitted). Economists who have studied the issue have reached similar conclusions about the inefficacy of public housing and other forms of subsidized production. See Michael P. Murray,

privatization of public housing assets with a voucher program for tenants will likely lead to greater efficiency without adverse market effects.<sup>164</sup>

The last fifteen years have seen a shift into more efficient demand-side programs like Section 8 existing-housing certificates and vouchers. Some commentators<sup>165</sup> cite the dramatic reductions in budgetary authorization for housing aid in recent years<sup>166</sup> as evidence that the government is abandoning low-income housing. In fact there has been a steady increase in the number of families receiving rental assistance over the last fifteen years—from nearly 2.1 million in 1977 to almost 4.7 million families in 1992.<sup>167</sup> Even though the Reagan and Bush administrations brought new public housing production to a virtual standstill,<sup>168</sup> lost production was offset by an increase in household-based assistance for rental housing from 599,000 households in 1981 to 1,166,000 households in 1992.<sup>169</sup>

Demand-side programs like vouchers not only have more beneficial market effects, but also are more cost-effective for government. In 1992, HUD

*Subsidized and Unsubsidized Housing Starts: 1961-77*, 65 REV. ECON. & STAT. 590, 590 (1983); Craig Swan, *Housing Subsidies and Housing Starts*, 1 AM. REAL ESTATE & URB. ECON. ASS'N J. 119, 134 (1973) (finding changes in nonsubsidized starts to offset 85% of changes in subsidized starts); John C. Weicher & Thomas G. Thibodeau, *Filtering and Housing Markets*, 23 J. URB. ECON. 21, 38 (1988) (finding little evidence that subsidized production for poor households reduces incidence of substandard housing). But see Donald F. Vitaliano, *Public Housing and Slums: Cure or Cause?*, 20 URB. STUD. 173, 182 (1983).

164. The Supply Experiment carried out over 10 years in the 1970's found a number of positive benefits to the voucher approach (here used to describe demand-side allowances generally). Vouchers did not result in rent inflation, even in test markets where they were made available as an entitlement. See HOUSING SUPPLY EXPERIMENT, *supra* note 112, at 26; Weicher, *supra* note 89, at 278. Predictably, vouchers did not stimulate new housing production, *see id.* at 280, but they did stimulate widespread, low-cost repairs by landlords and tenants to meet program quality standards. See HOUSING SUPPLY EXPERIMENT, *supra* note 112, at 26, 195-96. Thus, vouchers are effective because the technology of housing services production is very flexible, and landlords can vary factor inputs to expand output (e.g., flow of services) to meet demand. *See id.* at 340-41. Contrast this form of responsiveness with the poor maintenance records of many troubled PHA's.

165. *See, e.g.*, BRATT, *supra* note 44, at 4; Mary K. Nenno, *Reagan's '88 Budget: Dismantling HUD*, 44 J. HOUSING 103, 108 (1987); Stegman, *supra* note 13, at 25-26.

166. In 1992 dollars, net budget authority appropriated for housing aid was more than \$60 billion dollars in both 1977 and 1978. From 1987-90, annual net budget authority was in the \$10-12 billion range, increasing to more than \$20 billion (estimated) in 1992. 1992 GREEN BOOK, *supra* note 96, at 1680. The factors behind the decrease in budget authority are the reduction in the net new commitments to households for assistance; the shift towards cheaper forms of housing assistance; reductions in the term of new commitments; and changes in public housing financing. *Id.* at 1679. The budget authority for adding a public housing unit must cover the capital costs of new construction; it is necessarily higher than the budget authority needed for vouchers, which cover only a portion of a household's rent during a specified time period. Lower levels of budget authority do not mean that commitments to households have been reduced, but only that the required expenditures have been spread over time.

167. *Id.* at 1679. It should be noted that the assisted household is obligated to pay the same percentage of its income for rent under alternative programs, compare 42 U.S.C. § 1437a(a)(1)(A) to (B) (1988 & Supp. III 1991) (public housing and Section 8 certificates) with 42 U.S.C. § 1437f(o)(2) (1988) (vouchers), and *ceteris paribus* will be indifferent to the form of subsidy.

168. Annual public housing completions reached 29,576 in 1981 (based on projects authorized in the 1970's), but fell precipitously in the late 1980's. CLPHA, *supra* note 40, at 5 (using HUD data). During fiscal year 1991, only 2378 new public housing units were begun and 2753 were completed. U.S. DEP'T OF HOUS. & URBAN DEV., ANNUAL REPORT 1991, at 13 (1992). HUD predicts a net reduction in public housing units for the first time in fiscal year 1994. CLPHA, *supra* note 40, at 4.

169. 1992 GREEN BOOK, *supra* note 96, at 1679.



estimated that, over a twenty-year period, building a new public housing unit is 36% more expensive than providing the same subsidy via a rental voucher or certificate.<sup>170</sup> Voucher programs also deliver far superior value to low-income households. In the Housing Supply Experiment, 85% of program dollars in housing were found to serve low-income recipients, versus just 34% of public housing dollars. Builders and administrators captured 60% of the spending on public housing.<sup>171</sup>

Despite abundant evidence of the economic superiority of demand-side assistance, some commentators have voiced concern that reliance on such programs would ill serve minorities, who face especially acute housing problems.<sup>172</sup> De facto racial segregation persists in many housing markets,<sup>173</sup> with detrimental second-order effects on minority welfare.<sup>174</sup> Persistent discrimination in the private sector is to blame, at least in part.<sup>175</sup> Minorities struggle to afford housing, paying on average a higher percentage of their reported income on housing than whites.<sup>176</sup> Because minorities traditionally have had less success than whites in securing housing in the private market with vouchers, critics contend that shifting to voucher programs may worsen the housing status of low-income minority households.<sup>177</sup>

Vouchers are no panacea for racial inequity in housing markets,<sup>178</sup> but the fear that voucher programs would have adverse effects on minorities does not seem well-founded. First, racial discrimination may not fully explain differences in voucher success rates.<sup>179</sup> Second, the relevant comparison is

170. 1993 House Appropriations Hearings, *supra* note 3, at 213-16 (HUD analysis). Prior studies confirm that vouchers are less expensive than new public housing construction. *See, e.g.*, CONGRESSIONAL BUDGET OFFICE, CURRENT HOUSING PROBLEMS AND POSSIBLE FEDERAL RESPONSES 50 (1988) (estimating discounted cost of a new public housing unit for the elderly to be 16-50% more expensive than the cost of Section 8 certificate over a twenty-year period, depending on the discount rate); PRESIDENT'S COMMISSION ON PRIVATIZATION, *supra* note 23, at 11 (estimating 20-year cost of public housing unit 150% that of vouchers or Section-8 certificates).

171. *See* HOUSING SUPPLY EXPERIMENT, *supra* note 112, at 348-49. Housing subsidies function primarily as income supplements; only 8% of the program dollar goes to increased housing consumption in public housing, 10% in Section 8 existing housing, and 15% in housing allowances. *Id.*

172. *See, e.g.*, CLPHA, *supra* note 41, at 10; Hartman, *supra* note 73, at 1565.

173. *See* John C. Boger, *Toward Ending Racial Segregation: A Fair Share Proposal for the Next Reconstruction*, 71 N.C. L. REV. 1573, 1575-76 (1993).

174. *Id.*; *see also* STRASZHEIM, *supra* note 122, at 6.

175. *See* Boger, *supra* note 173, at 1577-78. *But see* Thomas Schelling, *A Process of Residential Segregation: Neighborhood Tipping*, in ECONOMIC FOUNDATIONS OF PROPERTY LAW 307, 310 (Bruce A. Ackerman ed., 1975) (theorizing that segregation would occur even in the absence of discriminatory practices by suppliers if whites and blacks have different preferences for racial mix of neighborhood).

176. *See* John C. Boger, *Race and the American City: The Kerner Commission in Retrospect—An Introduction*, 71 N.C. L. REV. 1289, 1335-36 (1993); Hartman, *supra* note 73, at 1560.

177. CLPHA, *supra* note 41, at 8 (72% failure rate for minorities versus 52% for non-minorities).

178. A 1975 econometric study of the San Francisco Bay Area market suggests that raising household incomes, which is effectively what vouchers do, is unlikely to reduce disparities in black and white housing consumption so long as blacks do not penetrate predominantly white submarkets. *See* STRASZHEIM, *supra* note 122, at 138-41.

179. Undoubtedly, minorities will encounter discrimination in shopping for housing with vouchers. *See Comments by Ann B. Schnare, in* DO HOUSING ALLOWANCES WORK? 141, 143 (Katharine L. Bradbury & Anthony Downs eds., 1979) [hereinafter HOUSING ALLOWANCES] (reporting that 21% of black

the effect on minority groups of vouchers relative to other forms of housing assistance. The possible inequities in voucher programs must be contrasted not with the ideal world, but with the shortcomings of public housing. Although public housing avoids the problem of racial discrimination in the private market, it too has been plagued by discriminatory practices and has contributed to the segregation of urban minorities.<sup>180</sup>

Properly administered, voucher programs can serve the cause of racial integration and provide targeted help to low-income minority families. Arising out of a Supreme Court case in which racially discriminatory practices were found in the management of public housing,<sup>181</sup> the Gautreaux program in Chicago uses vouchers to move minority households out of racially segregated public housing.<sup>182</sup> More than 4500 households have participated in the program since 1976, and more than half of the households have moved to the suburbs.<sup>183</sup> Not only has the program given families the chance to upgrade their housing, but it has had significant positive second-order effects on the educational performance and employment status of children whose families moved to less segregated suburbs.<sup>184</sup> The Clinton Administration has recently announced a "Moving to Opportunity" initiative modeled after Gautreaux to move 3000 poor families from inner-city projects to the suburbs.<sup>185</sup> Because they do not tie families to distressed urban projects, vouchers have great potential to help needy minority families.

The key to improving voucher performance seems to be technical assistance to eligible families. Without such assistance, families might be unable to find housing that meets quality standards within the rent constraints of a program, or might suffer discrimination in the private market. Many

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households in Pittsburgh experiment encountered discrimination). However, racial discrimination may not be important in determining the ultimate success of a household in leasing an apartment with vouchers. The most important factor appears to be the quality of a household's current housing. Voucher programs set minimum quality standards for the physical condition (heating, plumbing, fire safety, etc.) of the apartment. See 24 C.F.R. § 887.251 (1992). If a household lives in an apartment that meets program standards, it can get the rental subsidy without moving. Other households would have to move in order to receive the subsidy, which is a significant deterrent to participating in the voucher program. In EHAP, households whose housing quality was furthest from program standards were least likely to participate. Mahlon R. Straszheim, *Participation*, in HOUSING ALLOWANCES, *supra*, at 113, 129. Because of poverty or discrimination, minorities are more likely to live in substandard housing than nonminorities; similar reasons may explain in part their lower success rates in leasing apartments. See Garland E. Allen et al., *The Experimental Housing Allowance Program*, in HOUSING ALLOWANCES, *supra*, at 1, 25. Economist John Weicher interprets the evidence as indicating that minorities per se may have the same success rates as whites, given the same initial housing condition and location. Weicher, *supra* note 89, at 276-77.

180. See Boger, *supra* note 176, at 1337.

181. *Hills v. Gautreaux*, 425 U.S. 284 (1976).

182. James E. Rosenbaum et al., *Can the Kerner Commission's Housing Strategy Improve Employment, Education, and Social Integration for Low-Income Blacks?*, 71 N.C. L. REV. 1519, 1522 (1993).

183. *Id.*

184. *Id.* at 1553. The availability of role models, better labor markets, and superior schools appear to be the chief reasons for improved achievement. See generally *id.* at 1530-39.

185. See Guy Gugliotta, *Shallow Pockets and Big Needs Prod "Small" Thinking at HUD*, WASH. POST, July 13, 1993, at A6 (describing "Moving to Opportunity" initiative).

minority families are reluctant to transplant themselves into alien and distant white neighborhoods.<sup>186</sup> One of the reasons that the Gautreaux program works relatively well is that the managing agency actively “finds landlords willing to participate in the program, notifies families as apartments become available, and counsels them about the advantages and disadvantages of the move; counselors accompany them to visit the units and communities.”<sup>187</sup> Because poor administrative practices at PHA’s appear generally to reduce voucher success rates,<sup>188</sup> which average an uncomfortably low 65% for rental vouchers and 61% for Section 8 certificates,<sup>189</sup> expanded technical assistance must be a central ingredient of future voucher initiatives.

The advisability of a voucher program, like any housing policy, depends on specific market conditions. For example, it may not work effectively in markets experiencing shortages caused by a rent-control regime.<sup>190</sup> New York, which has rent control, has a low success rate in voucher lease-ups.<sup>191</sup> Interestingly, though, while much concern has been expressed about the decrease in the number of low-rent units in recent years,<sup>192</sup> demand-side programs have been found to work effectively in tight markets. The quality of existing stock and constraints on producers to alter supply appear to bear more on the success of voucher programs than do vacancy rates per se.<sup>193</sup> Moreover, as John Weicher points out, today’s tight markets are neither yesterday’s nor tomorrow’s, and there is no evidence that the government redresses supply shortfalls more quickly than does the private sector.<sup>194</sup> In any event, past failures do not mean that voucher programs should be abandoned: certain markets may need altered rent levels and quality standards,

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186. Rosenbaum, *supra* note 182, at 1553.

187. *Id.* at 1522.

188. See 1993 House Appropriations Hearings, *supra* note 3, at 100 (testimony of Joseph Schiff, Assistant Secretary for Public and Indian Housing).

189. 1992 Senate Appropriations Hearings, *supra* note 97, at 523.

190. See ROTHENBERG ET AL., *supra* note 76, at 354. Because owners of rent-controlled dwellings cannot raise rents, they respond to upsurges in demand by downgrading their units to improve their rate of return. *Id.* at 337. Stimulating demand by housing vouchers would not achieve the policy goal of improving housing conditions for lower income families in markets with rent control.

191. See *Public Housing and Section 8 Programs*, *supra* note 57, at 170 (CLPHA data of 65% failure rate in New York City).

192. William Apgar identified a decrease of 1.6 million units renting for under \$300 between 1974 and 1985. Apgar, *supra* note 101, at 44. Recent data suggest more slack in urban markets. The 1991 Housing Survey indicates an overall rental vacancy rate of 7.8% in central cities, with higher rates persisting in lower cost units (units with monthly costs—rent, utilities, incidentals—below the median cost level of \$392). See AMERICAN HOUSING SURVEY, *supra* note 98, at 17.

193. Weicher, *supra* note 89, at 278-79; see also RAYMOND J. STRUYK ET AL., HOUSING POLICIES FOR THE URBAN POOR 36 (1978).

194. Weicher, *supra* note 89, at 279-80.

increased technical assistance,<sup>195</sup> relocation subsidies,<sup>196</sup> and more enforcement of antidiscrimination laws to enhance program effectiveness.<sup>197</sup>

In most markets, economic considerations clearly favor vouchers over construction of new public housing. However, in select markets and projects, vouchers may be even more economical than already-built public housing. A 1992 HUD analysis found, that on a unit-to-unit comparison, the average twenty-year cost of maintaining the public housing inventory is less than that of converting tenant subsidies to vouchers.<sup>198</sup> However, HUD often pays subsidies for vacant public housing units.<sup>199</sup> Applying the current vacancy rate of 8%, the cost of maintaining existing public housing on a per-occupied-unit basis exceeds the cost of assisting a family with a voucher.<sup>200</sup> Moreover, looking at average costs is misleading. Whereas well-run public housing, usually found in small- to medium-PHA's, may be cost-effective to maintain, preserving the worst parts of the public housing inventory may be far more expensive than voucher conversion.<sup>201</sup> A 1990 study found that modernization needs swell the ongoing costs of 19% of public housing units beyond that of Section 8 certificates.<sup>202</sup> Current public housing stock should not be preserved at any cost; the relative economics of preservation and voucher conversion, which can only be assessed at the project level, should drive policy.

HUD's first priority in an era of tight budgets should be to ensure that its methods of subsidization are economically efficient, provided that any change in policy protects affected families from dislocation and avoids racially disparate impacts. An efficiency-driven policy to privatize public housing must be gradual and targeted to the worst of the PHA's. There are a number of reasons for HUD to proceed deliberately, though steadfastly, in privatization. First, HUD does not have the resources to implement a broad privatization program effectively.<sup>203</sup> Second, privatization must be carefully tailored to the local market and the assets of the PHA. The PHA must assess the market value and cost structures of each of its different developments, the feasibility of voucher conversion, and the sustainability of units that will remain as public housing. A PHA may find that it is maintaining both economically viable and

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195. See Anthony Downs & Katharine L. Bradbury, *Conference Discussion*, in HOUSING ALLOWANCES, *supra* note 179, at 375, 397-99.

196. Cf. Straszheim, *supra* note 179, at 127 (finding significant search and relocation costs to limit participation in EHAP program).

197. Cf. 42 U.S.C.A. § 1437f(t) (West Supp. 1993) (antidiscrimination provision limited to owners under contract to receive payments).

198. 1993 *Senate Appropriations Hearings*, *supra* note 54, at 310.

199. *Id.*

200. *Id.*

201. *Id.*

202. See *Public Housing and Section 8 Programs*, *supra* note 57, at 222-23 (testimony of Dr. Ann Schnare, ICF modernization consultant). If funding were limited to mandatory modernization needs, 10% of units would still be more costly than vouchers. *Id.*

203. See discussion *infra* text accompanying notes 235-36.

unviable developments, in which case it should direct its privatization efforts primarily toward the latter. Third, HUD will need to build a record of success to overcome the political resistance that any privatization policy will encounter. Rather than privatize public housing to the tenants, HUD should adopt a privatization policy that focuses on eliminating waste from the public housing system and making more funds available for unserved families.

#### IV. PRIVATIZATION STRATEGIES

Three privatization strategies should be pursued:<sup>204</sup> (1) "simulated privatization," in the form of conversion of federal subsidies to a payment system based on fair-market rents; (2) statutory reform permitting asset-maximizing disposition of current public housing properties; and (3) direct privatization of economically unviable projects to the highest bidder. The first two strategies should be implemented broadly: they give PHA's the incentives and flexibility to make economically rational decisions in response to market forces and tenant needs. The third strategy should be focused on the largest, urban "troubled" housing authorities. To the extent that any of these strategies require currently occupied units to be emptied, they should protect displaced tenants by converting their subsidies to vouchers.

##### A. *"Simulated Privatization": Shifting to Market-Based Subsidies for PHA's*

The current subsidy and modernization funding systems, which are not responsive to market forces, contribute to mismanagement of the public housing stock. The current system for allocating operating subsidies to public housing is the Performance Funding System (PFS).<sup>205</sup> Under the PFS, subsidies are based on Allowable Expense Levels (AEL's), modeled on the expenditure patterns of well-performing PHA's.<sup>206</sup> The PFS has few fans; its critics complain that its payments are inadequate and that it creates perverse incentives for PHA's.<sup>207</sup> Critics contend that the original design of the subsidies underestimated legitimate costs of PHA's, particularly large PHA's and high-cost PHA's in low-cost regions.<sup>208</sup> Moreover, PFS inflation adjustments have not kept pace with actual cost increases,<sup>209</sup> and PFS has not accounted for new costs that PHA's have had to bear, such as the costs of increased security in crime-ridden areas and implementation of new HUD

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204. These strategies could be pursued independently, but would likely be most effective if conducted simultaneously.

205. See 42 U.S.C.A. § 1437g (West Supp. 1993).

206. See 24 C.F.R. § 990.105 (1992).

207. See CAPITATED PAYMENT FORMULAS, *supra* note 36, at 5; Stegman, *supra* note 19, at 349.

208. See Stegman, *supra* note 19, at 349.

209. See CLPHA, *supra* note 40, at 6; CAPITATED PAYMENT FORMULAS, *supra* note 36, at 6; Stegman, *supra* note 19, at 350.

mandates.<sup>210</sup> The PFS also imposes no market-based cost constraints on PHA's. It grants PHA's full subsidies for vacancy rates below 3% and partial subsidies for vacancy rates above that threshold. The PFS offers a PHA weak incentives to fill vacancies expeditiously.<sup>211</sup>

Current modernization funding also is insensitive to market pressures. Under the current system,<sup>212</sup> HUD awards modernization funds based on a formula that accounts for the backlog and accrued needs of a PHA relative to the needs of other PHA's.<sup>213</sup> Thus, funding is primarily determined by the needs of the stock, rather than by the comparative economics of maintaining current public housing versus serving families by alternative means. Worse yet, in 1992, Congress revised the Major Reconstruction of Obsolete Projects ("MROP") program to permit HUD to divert as much as 20% of funds appropriated for new public housing development to restore "obsolete" projects even if modernization exceeds the cost of new development.<sup>214</sup> Bad projects draw good money.

Private housing suppliers, of course, do not spend money based on the needs of the stock. Nor do they determine capital and operating expenditures independently; the object instead is to maximize the return on all investment. A 1992 HUD study evaluated how PHA's would fare if paid essentially a market rate for providing housing, allowing the PHA's to allocate funds to operating and modernization needs as warranted. The study found, incredibly, that if PHA's were paid on a capitated basis in accord with Fair Market Rents (FMR's), total federal subsidies would be cut by 31%, saving the federal government \$1.4 billion per year.<sup>215</sup> An FMR capitated-payment system would not only save money, it would penalize the worst managed PHA's.

210. See CLPHA, *supra* note 40, at 8-9; CAPITATED PAYMENT FORMULAS, *supra* note 36, at 104; Stegman, *supra* note 19, at 350.

211. "It has been suggested that some PHA's may actually be able to improve their financial situation by sealing off an entire building, thereby minimizing the costs of operating it while still collecting partial operating subsidies." CAPITATED PAYMENT FORMULAS, *supra* note 36, at 7.

212. See 42 U.S.C.A. § 1437l(e) (West Supp. 1993).

213. See 42 U.S.C.A. § 1437l(k)(B)-(C) (West Supp. 1993).

214. Housing and Community Development Act of 1992, Pub. L. No. 102-550, § 111, 106 Stat. 3672 (codified as amended at 42 U.S.C.A. § 1437c(j)(2)(A), (D) (West Supp. 1993)). Obsolete projects have vacancy rates in excess of 25%; significantly high redesign, reconstruction, or redevelopment costs; or other statutorily defined special problems. 42 U.S.C.A. § 1437c(j)(2)(B) (West Supp. 1993).

215. CAPITATED PAYMENT FORMULAS, *supra* note 36, at 66. "Capitated basis" means that subsidies are paid on the basis of the number of households occupying units. Fair Market Rents are benchmarks used to determine federal subsidy payments for HUD-assisted households living in private rental housing. "FMR's are based on rent levels for decent quality housing units at the forty-fifth percentile of the rent distribution for recent movers." *Id.* at 19. On FMR's, see generally 24 C.F.R. § 882.106 (1992).

The capitated payment levels for PHA's analyzed in the study were based on the FMR's for units of different sizes, adjusted for tenant rent contribution and debt service payments made by the federal government. A 7% percent administrative fee is tacked on to compensate PHA's for the administrative burden of income certifications and subsidy calculations. CAPITATED PAYMENT FORMULAS, *supra* note 36, at 19-20.

Less radical solutions would also generate savings. If all backlog modernization were funded on the basis of need, and only operating subsidies and the accrual portion of modernization funding were allocated on a capitated basis, federal subsidies to extra-large PHA's would decline by 11.6%. *Id.* at 74.

Most PHA's that maintained vacancy rates of over 20% would lose over half of their current funding.<sup>216</sup>

Transfer to an FMR capitated-payment system would surely result in reduction of the current public housing stock. Experts consulted by HUD disfavored a capitated funding system for this reason.<sup>217</sup> They predicted that, with more latitude to allocate resources, PHA's would act with short-term vision, spending on annual unit inspections and deferred maintenance rather than making major capital improvements.<sup>218</sup> Vacancies would persist and units would deteriorate, and PHA's would have to vacate additional units that become uneconomic to supply. Some experts feared that displaced households would not succeed in finding private apartments with vouchers.<sup>219</sup> Experts also objected to basing payments on FMR's or private multifamily housing because PHA's face special costs. These include the costs of buildings that have not been modernized or energy-improved, or are saddled with design flaws; the costs of security against crimes, drugs, and vandalism; and special costs associated with housing large or single-parent families.<sup>220</sup>

These objections to capitated funding miss the mark. It is precisely because PHA's have bungled the design, development, and management of buildings, and concentrated poor families in large projects, which breed crime and vandalism, that we should forswear this form of housing assistance if cheaper alternatives exist in the local market. PHA's must be forced to streamline and reconfigure their stock. The imperative for HUD is to ensure that the shift to an FMR-based capitated-payment system would not have draconian effects either on current tenants or on economically viable units.<sup>221</sup>

First, HUD should phase the system in gradually to allow PHA's to shed excess staff or costly units. As part of the transition to a capitated-payment system, PHA's should model the effects of a capitated-payment system on their funding levels, and develop operations and modernization spending plans in anticipation of the new system. PHA's should not have to rely on current funds for investment; like private developers, they should be allowed to "borrow" against future payment streams to modernize units where economically justified (i.e., where the net discounted cost of renovating and operating the unit as public housing over the relevant time period would be less than that of voucher

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216. *Id.* at 73.

217. HUD consulted 13 experts on PHA management and funding, including PHA directors, HUD officials, public housing advocates, and PHA management consultants, for their views. *Id.* at vi.

218. *Id.* at 106.

219. See Stegman, *supra* note 19, at 351 (noting discrimination as factor).

220. CAPITATED PAYMENT FORMULAS, *supra* note 36, at 109.

221. HUD would also have to design a capitated-payment system different from that used in the study's simulations. Since public housing development costs were far higher than private costs, subtracting debt service payments from the FMR would leave too little for legitimate operating and modernization costs. The development costs are already sunk, and the formula should be adjusted to parallel private market operating and modernization costs. FMR's may also need to be refined to address the apparent penalizing of PHA's with large or single-parent families. See *id.* at 91.

conversion). HUD should review the spending plans and implement controls to ensure that the cuts were targeted to waste, in terms of both staff and high-cost units, and not to services to remaining public housing tenants.

Second, HUD must guarantee funding of vouchers to protect tenants who may be displaced by the elimination of uneconomical stock. HUD should have special authority to adjust voucher terms and conditions to expedite tenant conversion in tight markets,<sup>222</sup> and should work with the PHA's to ensure that tenants secure new housing expeditiously. HUD could make additional modernization or operations funding for public housing units available on a showing that voucher conversion is not feasible in a particular market.

### B. *Liberalizing Demolition/Disposition Laws*

A market-based approach to public housing requires that PHA's treat properties as assets whose market values should be maximized. Land on which public housing is built often becomes far more valuable for uses other than low-income housing.<sup>223</sup> Potential expansion of housing assistance has been blocked by staunch resistance to any diminution of the public housing stock.

The hands of both PHA's and HUD are bound by strict statutory demolition and disposition provisions. Those provisions focus on preservation or regeneration of the stock,<sup>224</sup> and include strict one-for-one replacement rules that allow the use of tenant-based assistance only in very limited circumstances and after extensive fact-finding and consultation.<sup>225</sup> Current

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222. For housing assistance connected with the sale of HUD-owned property, HUD can approve rents up to 20% above the FMR in special circumstances. 24 C.F.R. § 886.310 (1992). HUD should have the same flexibility to convert tenant subsidies in uneconomic housing projects to vouchers.

223. In New Britain, Connecticut, the sale of three units in a commercial part of town would have generated funds to purchase ten more units worth \$250,000 elsewhere. *Public Housing and Section 8 Programs*, *supra* note 57, at 10 (testimony of Rep. Nancy L. Johnson). In Houston, the sale of Allen Parkway Village, a substandard, downtown 1000-unit complex, was estimated to be able to generate \$120 million, or enough to house 2000 households. U.S. GEN. ACCOUNTING OFFICE, PUBLIC HOUSING: PROPOSED SALE OF THE ALLEN PARKWAY VILLAGE PROJECT IN HOUSTON, TEXAS 21-22 (1986). The proposal has been ensnared in litigation for about a decade. See James Robinson, *Judge Boosts City Hope of Razing Housing Project*, HOUS. CHRON., Jan. 15, 1993, at A1. Now only 29 of 1000 units are occupied; all 29 are substandard. Eric Hanson, *Housing Project's Occupied Units Called Substandard*, HOUS. CHRON., Dec. 18, 1992, at A40.

224. The provisions bar demolition of a project unless it is "unusable for housing purposes, and no reasonable program of modifications is feasible to return the project or portion of the project to useful life." 42 U.S.C.A. § 1437p(a)(1) (West Supp. 1993). Transfer is only permitted if in the best interests of tenants because developmental changes in the area "adversely affect the health or safety of the tenants or the feasible operation of the project," or "because disposition allows the acquisition, development, or rehabilitation of other properties which will be more efficiently or effectively operated as low-income housing projects and which will preserve the total amount of low-income housing stock available in the community, or because of other factors . . . consistent with the best interests of the tenants or the public housing agency . . ." 42 U.S.C.A. § 1437p(a)(2)(A)(i) (West Supp. 1993).

225. Current disposition law only permits tenant-based assistance if HUD finds, on the basis of objective data, that replacement with project-based assistance is not feasible, and that the market will support all available certificates and vouchers for 15 years. 42 U.S.C.A. § 1437p(b)(3)(C)(i)-(ii) (West Supp. 1993). Tenant-based assistance must generally be granted for 15 years, and may not be in the form of a rental voucher. 42 U.S.C.A. § 1437p(b)(3)(A)(v) (West Supp. 1993). An exception is made for projects



law thus operates to exclude the most efficient form of assisting tenants. The law should be revised to reduce the transactional impediments, as long as tenant interests are protected by a voucher program. A preferable regime would limit HUD review of a transaction proposed by a PHA to certification that (1) the disposition of public housing assets is economically justified (to prevent self-dealing or gross mistakes), (2) there are guarantees to protect current tenants, either by transfer to other units or by 5-year vouchers,<sup>226</sup> and (3) proceeds are efficiently recycled to provide assistance to additional families, after obligations attached to the assets are retired. As long as current tenants can be protected, returning assets to private management at fair value leads to overall economic efficiency: assets are traded to their best commercial use, thereby generating more funds for housing aid.

*C. Direct Privatization of Economically Unviable Projects of Troubled Housing Authorities to the Highest Bidder*

Simulated market incentives and liberalized disposition laws do not fully substitute for the profit motive, and will not turn PHA's into profit-maximizers. Moreover, they will do nothing to solve the urgent problems brewing at the most obdurate "troubled" PHA's—problems which demand swift action by HUD. The agency has substantial authority to take control of those PHA's, or even poorly managed projects, and transfer operating control to private interests.<sup>227</sup> But conversion to private management is by no means a panacea. Because of the difficulty of structuring long-term incentives in a contract, hiring private management companies is a second-best solution.<sup>228</sup> HUD must adopt strategies to have title transferred from PHA's into private hands. As discussed above, these may entail converting the asset to nonhousing

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of more than 200 units; replacements for up to 50% of units may be in the form of 5-year tenant-based assistance, where such assistance is necessary. 42 U.S.C.A. § 1437p(b)(3)(B)(ii) (West Supp. 1993).

226. Congress rarely approves 15-year certificates because the whole 15 years must be authorized in the current-year budget. Interview with John Valencia, Staff Director, House Subcommittee on Housing and Community Development, in Washington, D.C. (Mar. 16, 1993). Congress could facilitate PHA asset management by making more five-year certificates available and by eliminating the restrictive conditions discussed above. Such unencumbered certificates were approved for HOPE-I replacements. 42 U.S.C.A. § 1437aaa-3(g) (West Supp. 1993). Many public housing advocates contend that such short-term commitments put low-income housing at risk. One of the heralded virtues of public housing is its permanence. See HOUSING AND COMMUNITY DEVELOPMENT ACT OF 1987, H.R. REP. NO. 100-122(I), 100th Cong., 1st Sess. 16 (1987), reprinted in 1987 U.S.C.C.A.N. 3317, 3332; Stegman, *supra* note 19, at 340. As I have discussed, that permanence comes at the expense of excluding deserving families.

227. 24 C.F.R. § 901.200 (1992). HUD may intervene upon "substantial default" by a PHA, which is not limited to breaches of or defaults on the Annual Contributions Contract between HUD and the PHA. 24 C.F.R. § 901.205 (1992).

228. The success of private management depends wholly on the incentives structured in the contract. Some private contractors have not even managed to outperform PHA's in the management of public housing. U.S. DEP'T OF HOUS. & URBAN DEV., PUBLIC HOUSING AUTHORITY EXPERIENCE WITH PRIVATE MANAGEMENT: A COMPARATIVE STUDY x-xi (1983) (finding higher rent delinquency and crime/vandalism rates and no cost savings at privately managed sites).

uses and recycling the funds raised to create vouchers for existing tenants and currently unserved families. However, where the asset's best use is as a rental property, or where market conditions are unfavorable for vouchers, the strategy should be to sell the asset to a private landlord, whether for-profit or non-profit.<sup>229</sup> Landlords with alienable property rights will be more likely than PHA's to make economically rational decisions about modernization, closure, and maintenance, which in the long-term will protect the overall stock.

HUD does not have statutory authority to take clear title to public housing properties, even in the face of gross mismanagement.<sup>230</sup> Two options present themselves. First, troubled PHA's must by law negotiate with HUD a Memorandum of Agreement detailing mandatory performance improvements.<sup>231</sup> Using operating and modernization funds as leverage, HUD could demand as a condition of the agreement that PHA's privatize their most costly properties. Second, HUD could seek a grant of new statutory authority to mandate sales of public housing to implement this privatization strategy, similar to that passed as part of the HOPE-1 program.<sup>232</sup> HUD could solicit bids from private landlords<sup>233</sup> and mandate sales to approved bidders unless PHA's, acting under liberalized disposition laws, could fetch a better price for the assets on the open market.<sup>234</sup> Many public housing projects would undoubtedly be unable to attract a private landlord. Where projects are so disadvantaged, and private market alternatives exist to protect current tenants, projects should be eliminated.

This third strategy will only work if, in its initial stages, it is tightly focused on the most troubled PHA's. HUD faces a herculean task in selling foreclosed properties from other failed low-income housing programs.<sup>235</sup> It would be fatuous to suggest that HUD preside over a massive fire sale of public housing properties at the same time. The key is to minimize HUD's role

229. Cf. David Gonzalez, *Defending the Nonprofit Motive; Tenants Decry Sale of Troubled Buildings to Private Owners*, N.Y. TIMES, Sept. 7, 1993, at B1.

230. HUD may take title to projects upon substantial default on the Annual Contributions Contract, but must "redeliver possession of the project as constituted at the time of reconveyance or redelivery" once the default is cured or the contract terminates. 42 U.S.C. § 1437d(g)(2) (1988).

231. 24 C.F.R. § 901.140 (1992).

232. See 42 U.S.C. § 1437aaa-4(a) (Supp. III 1991).

233. Cf. U.S. GEN. ACCOUNTING OFFICE, *supra* note 154, at 2-3, 31 (describing transfer by HUD of failed low-income cooperative to private landlord).

234. The open-market option would alleviate any takings concern under the Fifth Amendment, since PHA's would be able to secure "just compensation" for their assets. See U.S. CONST. amend. V; Schill, *supra* note 13, at 928-35.

235. HUD now owns 170 foreclosed buildings, comprising 29,000 units, which it is anxious to sell. Stephen Engelberg, *HUD's Chief Seeks Wide New Powers*, N.Y. TIMES, July 28, 1993, at A13. Given a high rate of projected foreclosures, HUD estimates the cost of the bailout at \$11.9 billion. *Yet Another HUD Bailout*, CLEV. PLAIN DEALER, June 25, 1993, at 4B. HUD does not now have sufficient resources or statutory flexibility—e.g., the freedom to use 5-year instead of 15-year vouchers—to manage the disposition of those properties. Cisneros has petitioned Congress for relief. See *Hearing on Housing Programs, Senate Comm. on Banking, Housing, and Urban Affairs*, FED. NEWS SERV., July 28, 1993, available in LEXIS, Nexis Library, Wires File, at \*34.

in the management<sup>236</sup> and disposition of the properties. The strategy outlined above relies on oversight, bargaining, and statutory mandates. If pursued in conjunction with a switch to market-based subsidies, this strategy can force PHA's to make the necessary economic choices to privatize public housing.

## V. CONCLUSIONS

A crisis of high vacancy rates and gravely underfunded modernization needs looms in public housing today, particularly in the largest and most troubled PHA's. This crisis results from ill-starred policies, corruption, mismanagement, and the inherent inefficacy of government supply-side intervention in the housing market. Jack Kemp's inefficient solution of selling public housing to the residents, at least in the multifamily context, does not warrant the allocation of the resources it would require. The solution lies in opening low-income housing to market forces through efficiency-driven privatization. The government should undertake to convert tenant subsidies of public housing to vouchers. First, HUD should phase in a market-based, and not stock-driven, subsidy system for all public housing. Second, HUD should initiate a program of regulatory reform that would free PHA's to maximize the economic value of current public housing assets by sale to the highest bidder. Current tenants would be made whole by converting their subsidies to vouchers, and the net savings would be dedicated to *expanding* housing assistance. Third, HUD should aggressively intervene to have "troubled" housing authorities privatize their most costly properties.

In its National Performance Review on streamlining government, the Clinton Administration has embraced privatization as a solution to some bureaucratic ills.<sup>237</sup> HUD Secretary Henry Cisneros has signaled a willingness to be bold in housing policy.<sup>238</sup> The boldest stroke he can make is to recast privatization of public housing as a nonpartisan initiative to improve and expand assistance to families in need.

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236. HUD's most recent attempt, in Philadelphia, to manage public housing properties has been a debacle. See Michael deCourcy Hinds, *Housing Agency's Problems Deepen as U.S. Rescue Effort Proves Futile*, N.Y. TIMES, June 9, 1993, at A14.

237. See Helen Thomas, *Clinton-Gore Offer Plan To Streamline Bureaucracy*, UPI, Sept. 7, 1993, available in LEXIS, Nexis Library, UPI File.

238. See Gugliotta, *supra* note 185.

