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PUBLIC HOUSING

Planned Kenilworth-Parkside Sale Raises Issues for Future Transactions

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Economic Development Division

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The Honorable Alan Cranston
Chairman, Subcommittee on Housing and
Urban Affairs
Committee on Banking, Housing and
Urban Affairs
United States Senate

Dear Mr. Chairman:

As you requested, we have examined various aspects of the pending sale of the Kenilworth-Parkside public housing property in Washington, D.C., to its resident management corporation (RMC). Kenilworth-Parkside was the first RMC to seek ownership of a public housing property under authority granted in Section 123 of the Housing and Community Development Act of 1987. The act encouraged increased resident management and created an opportunity for public housing residents to own their units.

We focused our work on (1) evaluating the planning done for the eventual sale of units from the Kenilworth-Parkside RMC to the tenants, (2) assessing the legality of possible capital-producing arrangements that RMCs could pursue after obtaining ownership, and (3) obtaining information on the potential consequences should an RMC financially mismanage a property. We also pursued several other aspects of the Kenilworth-Parkside property, which we address in appendixes III and IV.

Results in Brief

While the Department of Housing and Urban Development (HUD) has conditionally approved the District of Columbia's plan for selling Kenilworth-Parkside to its RMC, planning to fulfill the ultimate goal of the ownership program—selling individual units to tenants--is incomplete.

We identified three avenues that an RMC might pursue to produce capital once it has title to a property. Two of these—the formation of partnerships to generate tax credits and obtaining a mortgage loan—are not precluded by the 1987 act. Although the language of the act is not explicit, we believe the act precludes the third avenue, the sale of pieces of the property.

An RMC that attains ownership could jeopardize tenant investments and the low-income status of its property through financial mismanagement.

To protect against this possibility, the District plans to retain the option to repurchase the property by satisfying any lien on Kenilworth-Parkside—a safeguard we believe HUD should require in any future sales.

Several policy issues emerged during our review that we believe merit congressional consideration: (1) What is an appropriate length of time that an RMC may take before selling units to individual tenants? (2) Should RMCs be able to use the property for capital-producing activities? and (3) Is there an equitable way to distribute funds between this high priority program and other HUD programs since special funding for this program was not authorized?

Background

Resident ownership of public housing is a recent extension of the resident management initiative that began in the early 1970s in response to poor conditions and social problems in some public housing developments. HUD believes resident ownership instills pride, improves neighborhoods, enhances independence, and encourages stable families. The 1987 act gave RMCs greater financial control and created, on a demonstration basis, a way for public housing residents to own their units. Unless extended, the authority to sell buildings to qualifying RMCs expires September 30, 1990.

The 1987 act requires that a public housing property first be sold to a qualifying RMC, who then may sell units to individual tenants. At the time of our review, two RMCs—Kenilworth-Parkside in Washington, D.C., and Carr Square Village in St. Louis, Missouri—were each seeking HUD approval to purchase their properties for $1.

Kenilworth-Parkside consists of 464 units of family housing located in the northeast section of Washington, D.C. Opened in 1959, Kenilworth-Parkside was managed for the District's public housing authority by a private firm from 1975 to 1982. Dissatisfied with conditions at the property, residents formed the Kenilworth-Parkside Resident Management Corporation, which took over management of the property in January 1982.

On October 10, 1988, the District government submitted for HUD's approval an application and plan for transferring ownership of the property to the RMC. HUD gave conditional approval on October 25, 1988. The actual transfer is projected for 1990. The property is currently undergoing modernization, which is being financed by HUD. Although modernization was scheduled for completion in the fall of 1990, uncertainty about funding to complete the work and problems with the quality of certain work have made it unclear when the modernization will be completed.

Planning for Sale of Units to Tenants Is Incomplete

A key goal of the 1987 act is that resident management corporations sell units to individual tenants. Thus, we believe an initial assessment of the feasibility of ownership by the families residing in the development should be undertaken prior to the sale of a property to an RMC.

Little attention was given to planning for the sale of Kenilworth-Parkside units to its tenants until the summer of 1989. The sales plan that HUD conditionally approved in October 1988 focused almost exclusively on transferring ownership to the RMC. Likewise, additional technical planning initiated subsequently by consultants focused almost exclusively on the feasibility of an ownership transfer to the RMC. Neither of these efforts addressed items such as the price of ownership shares that tenants can afford, nor how the tenants will finance them.

According to HUD's Special Assistant for Resident Management and Urban Homesteading, three planning actions designed to facilitate the sale of units to tenants were initiated during the summer of 1989. First, HUD coordinated meetings between the Kenilworth-Parkside RMC and the National Consumer Cooperative Bank—a U.S.-chartered corporation that provides various financial services benefiting cooperative enterprises, including commercial and residential real estate. The Bank subsequently offered to provide the RMC technical assistance to develop a plan for converting the property to a cooperative and to be a potential source of financing for individuals who wish to purchase shares in the cooperative. Second, the District agreed to finance homeownership transfer training for Kenilworth-Parkside residents and the RMC's Board of Directors. Last, as of October 1989, HUD was finalizing a memorandum of agreement with the District's public housing authority regarding needed management improvements. Among other things, the agreement would require the housing authority to cooperate with Kenilworth-Parkside to provide cooperative ownership training to the residents.

As of October 1989, more detailed planning for establishing the cooperative and selling ownership shares to tenants had not begun. According to the Special Assistant, HUD will have to approve a detailed cooperative conversion plan before it approves the final sales contract, which he estimated will occur in the spring of 1990.

HUD's Office of Resident Initiatives developed draft guidelines in July 1989 to be used in evaluating future resident ownership applications. These guidelines require advance HUD approval for an RMC's sale of units to tenants, but the approval need not precede sale of a property to an RMC. HUD believes this approval should occur shortly before the sale to tenants because financial circumstances may change between the time a property is sold to an RMC and the time an RMC sells units to the tenants. While we agree with HUD's rationale, we also believe an initial assessment of the feasibility of tenant ownership should be completed before title to a public housing property is transferred to its RMC since tenant ownership is a key goal of the program. In response to the concerns we raised with respect to Kenilworth-Parkside, HUD said it would modify its guidelines to require a preliminary assessment of the feasibility of individual ownership before the sale.

Legality of Capital-Producing Arrangements

The consensus of the experts we consulted was that RMCs obtaining ownership could theoretically pursue numerous capital-producing activities—the possibilities of which are limited mainly by the creativity of the individuals involved. However, the experts generally agreed that these possibilities would fall into three basic structures: (1) a mortgage loan using the property as collateral, (2) a joint venture or partnership with private investors who are seeking tax credits, or (3) sale of undeveloped pieces of the property. We assessed whether each option is precluded under section 123 of the 1987 Housing Act.

We used the Kenilworth-Parkside and Carr Square applications as frames of reference. In these two cases, the resident management corporations would receive title to the property for $1 and a commitment of continued federally funded rent subsidies for a period following the sale. The Kenilworth-Parkside RMC initially explored the possibility of taking out a loan to add amenities to the property. The Carr Square RMC plans to generate some of the funds needed to renovate its property by attracting private partners who would invest in the renovation to qualify for low-income housing tax credits.

The amount of mortgage financing for which a resident-owned development could qualify depends primarily on the property's value and the ability of an RMC to pay back the loan. Because there is no precedent for such transactions, it is difficult to assess the value of a property such as Kenilworth-Parkside. A consultant team assisting the RMC arrived at a projected worth for Kenilworth-Parkside of $2.7 million. A loan of 80 percent of this value—which would be the amount a bank usually would lend if the property had sufficient cash flow—would be about $2 million. However, an outstanding mortgage would increase a development's costs, which could increase costs to individual tenants and make their purchase of units less affordable.

The 1987 act does not restrict an RMC's use of the property as collateral for mortgage loans. However, as of July 1989, HUD's Office of Resident Initiatives planned to draft regulations that would require HUD approval of any loan taken out by an RMC using the property as collateral. We believe that HUD's planned actions, if properly implemented, could help protect the residents against unaffordable operating costs and possibly against financial mismanagement by an RMC.

The 1987 act also does not restrict an RMC that purchases its property from conveying an equity interest in the property to a limited partner or partners. Under this scenario, partners would invest in the property in order to qualify for a low-income housing tax credit. The tax credit for low-income housing is a reduction in tax liability each year for 10 years for owners and investors in low-income housing. However, use of the credit would likely delay sale of individual units to tenants because the property is restricted to low-income rental use for 15 years.

Another potential way to produce capital would be by selling off pieces of the property for further development. We believe section 123 precludes an RMC from subdividing undeveloped land conveyed with the buildings and selling it. The act imposes resale restrictions on "property" purchased under the act, and we interpret property to mean the buildings and all land conveyed with the buildings. In addition, through the regulations HUD is drafting, it plans to prohibit sale of the property or any pieces of the property to other than low-income persons.

Consequences of Financial Mismanagement

We also obtained information on the potential consequences of financial mismanagement of the property and the risk to the government should an RMC default on, for example, a mortgage loan. The exact procedure for satisfying creditors would vary depending on applicable law. Under District of Columbia law, if an RMC defaulted on its mortgage, the lender could petition to dissolve the corporation. Once dissolved, all assets of the corporation, including residents' ownership shares, would be turned over to satisfy the corporation's debts. Thus, the lender could acquire ownership of the property through the equivalent of a foreclosure.

In this scenario, the federal government would not be held liable for the debt. However, once the lender took possession, it would not be bound to rent or sell the property to low-income persons because the resale restrictions in the 1987 act apply to property purchased pursuant to the act. Thus, the property's low-income housing status could be lost. To avoid this, HUD or the public housing authority may feel obligated, given the federal government's investment in the property, to repurchase it. In fact, in the case of Kenilworth-Parkside, the sales contract will provide that if the RMC is unable to meet its financial obligations, the lender will give the public housing authority the first right to repurchase the property by satisfying any liens. (Further details on financing possibilities for tenant-owned properties appear in app. II.)

Conclusions and Observations

We recognize that section 123 of the 1987 Housing Act was enacted on a demonstration basis and that policies and procedures for implementing the law are still being developed. Nonetheless, several policy issues emerged during our review that we believe were not contemplated by the Congress. Also, we identified some related improvements that HUD can make.

First, the 1987 act provides little guidance regarding the role an RMC should play following its purchase of the buildings and preceding sale of individual units to tenants. While the 1987 act does provide that lower income families residing in an eligible public housing property shall be provided with the opportunity to purchase units through an RMC, the law does not restrict how long an RMC can operate a property before beginning sales to tenants. Consequently, RMCs may choose to delay individual ownership of units in these projects for 15 years to take advantage of the financing made possible by the low-income housing tax credit program. We believe the goal of the ownership program is for tenants to purchase dwelling units. If this goal is not realized, residents continue as renters and the concept of tenant ownership becomes little more than a continuation of tenant management. At a minimum, we believe the feasibility of tenants owning their units should be established before the development is sold to an RMC. Additionally, the Congress may wish to consider whether to limit the time an RMC may hold a property before commencing unit sales.

Second, although this may not be what the Congress intended, the 1987 act does not prevent RMCs from using the property as loan collateral or conveying an equity interest in the property to a partnership. If financially mismanaged, these arrangements could lead to the property either being (1) lost to creditors, thereby jeopardizing its low-income status or (2) repurchased at federal expense, in order to preserve its low-income status. Planned regulations that would require HUD approval of any loan using the property as collateral should help to avoid this situation. However, we believe the Congress may wish to consider whether additional restrictions on an RMC's use of the property to generate capital are needed to preserve the low-income status of the property and to minimize the government's financial risk. In the interim, we believe that given the taxpayers' investment in such properties, HUD should require that if an RMC cannot meet its obligations, the public housing authority will be given the first right to repurchase the property.

Finally, because no specific level of funding was authorized by the Congress for this high priority HUD program, funds to cover operating and, in some cases, rehabilitation costs after the sale of properties to RMCs will have to come from existing HUD programs. For example, neither of the two RMCs that have thus far applied for purchase can cover their operating costs after the sale without some kind of further subsidy. Both projects have requested rental assistance to subsidize their operations. Also, both projects need extensive rehabilitation. In one case, the rehabilitation is being funded through the public housing modernization program. In the other, the preferred funding plan is to use a combination of funds generated through tax credits, reduced interest rate loans, and HUD community development block grant funds. Unless additional funds are received for these programs, the funds needed for public housing homeownership could potentially take resources from other projects of equal or greater need.

Matters for Consideration by the Congress

If the Congress decides to extend the resident ownership legislation beyond September 30, 1990, it may wish to consider providing more specific guidance regarding whether (1) limits on the time an RMC may hold a property before commencing unit sales are needed, (2) an RMC should be able to use the property for capital-producing activities, and (3) a method is needed to ensure that decisions made by HUD regarding the distribution of funds from other HUD programs to fund public housing homeownership are equitable and in keeping with the tenant ownership intent of the legislation.

Recommendations

We recommend that, at a minimum, the Secretary of Housing and Urban Development direct HUD's Office of Resident Initiatives to revise its guidelines to require: (1) an assessment of the feasibility of ownership by the families residing in a public housing development before the sale of the property to a resident management corporation takes place and (2) that the public housing authority be given the first right to repurchase the property by satisfying any lien on the property in the event the resident management corporation is unable to meet its financial obligations.

Agencies' Comments and Our Response

We requested written comments on this report from HUD, the District's Department of Public and Assisted Housing, the Kenilworth-Parkside RMC, and other affected parties.

HUD said it would oppose legislative limits on the use of tax credits or other means of raising capital it believes are necessary to achieve the broad, socioeconomic benefits of homeownership. HUD believes that the issues we raised for legislative consideration would be better addressed by HUD through its forthcoming regulations on tenant ownership. Also, HUD was particularly concerned that the act requires it to provide technical assistance and training but does not provide funds for these purposes. HUD requested such funds for fiscal year 1990.

HUD, the District's Department of Public and Assisted Housing, and the Kenilworth-Parkside RMC agreed with our recommendations. In response to our first recommendation, HUD said it would modify its draft guidelines for processing and evaluating ownership applications to require an initial assessment of the feasibility of individual ownership before the sale to an RMC. However, in the case of Kenilworth-Parkside, HUD noted that, to some degree, it believes individual feasibility has been taken into account in the financial analysis of the sale to the Kenilworth-Parkside RMC—a position with which we are not in total agreement (see app. VI).

The Kenilworth-Parkside RMC and the National Center for Neighborhood Enterprise, which is under contract to perform further planning for the Kenilworth-Parkside sale, agreed that the sale of units to tenants through a housing cooperative had not received sufficient attention as of late August 1989. The Kenilworth-Parkside RMC said that it believes the feasibility assessment should be completed in a timely manner so that it does not delay transfer of title to the RMC.

In response to our second recommendation, HUD said it would incorporate into its forthcoming tenant ownership regulations a requirement that a public housing agency retain the right to repurchase a sold property in the event an RMC cannot meet its financial obligations.

The written comments provided by HUD, the District's Department of Public and Assisted Housing, the Kenilworth-Parkside RMC, and other affected parties are presented and further evaluated in appendixes VI through XI.

We conducted our review between January and September 1989 in accordance with generally accepted government auditing standards. To obtain information for our review, we interviewed independent experts in the field of low-income housing development and financing, located primarily in Washington, D.C.; representatives of the Kenilworth-Parkside Resident Management Corporation; individuals under contract to provide the Corporation technical assistance; various HUD officials; and organizations active in the low-income housing arena (see app. V). Background information on the sales plan and on our objectives, scope, and methodology are presented in appendix I.

We also responded to your questions on Kenilworth-Parkside related to (1) the level of funding and subsidies provided, (2) HUD's plan to provide section 8 rent subsidies following the sale to the RMC, (3) the District's plan to replace, on a one-for-one basis, the units sold to the resident management corporation, (4) a 1986 cost/benefit study of Kenilworth-Parkside's transition to resident management, and (5) financial projections made by a consultant regarding the feasibility of ownership by the RMC. (This information is contained in appendixes III and IV.)

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days from the date of this letter. At that time, we will send copies to the Secretary, HUD; the Director, District of Columbia Department of Public and Assisted Housing; the Chairperson, Kenilworth-Parkside RMC; and other interested parties.

This report was prepared under the direction of John M. Ols, Jr., Director, Housing and Community Development Issues. Should you require any additional information on this report, please contact him at (202) 275-5525. Other major contributors are listed in appendix XII.

Sincerely yours,

J. Dexter Peach
Assistant Comptroller General

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Abbreviations

CIAP	Comprehensive Improvement Assistance Program
DPAH	Department of Public and Assisted Housing
FHA	Federal Housing Administration
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
KPRMC	Kenilworth-Parkside Resident Management Corporation
MROP	Major Reconstruction of Obsolete Projects
RMC	resident management corporation

Introduction

Resident ownership of public housing is a recent extension of the resident management initiative that began in the early 1970s in response to poor conditions and social problems in some public housing developments. In 1973 the Bromley-Heath Resident Management Corporation in Boston became the first to contract with a public housing agency to manage its property. The number of properties under resident management contracts has since grown to 13. As of July 1989, two of these properties—Kenilworth-Parkside in Washington, D.C., and Carr Square Village in St. Louis, Missouri—had applied to the Department of Housing and Urban Development (HUD) for resident ownership under legislative authority effective in 1988.

Legislative Authority

Section 123 of the Housing and Community Development Act of 1987 (42 U.S.C. 1437s) authorized and established the basic requirements for residents to obtain ownership of public housing properties. Purchase must be accomplished through a qualifying resident management corporation (RMC). In the case of Kenilworth-Parkside and Carr Square, the respective local housing agencies plan to sell the properties to the RMCs, which will later sell equity in individual units to the residents. To qualify for ownership an RMC must, among other things, have demonstrated its ability to manage the property effectively for a period of at least 3 years.

Section 123 also sets forth several conditions for purchase. The RMC must first apply for ownership to the public housing agency. The agency must hold one or more public hearings to obtain citizens' views and must certify that the purchase will not interfere with the rights of families residing in the public housing. The public housing agency must also certify that within 30 months of the sale it will implement a plan to replace each unit sold. In addition, buildings sold must meet HUD's minimum safety and livability standards, as well as receive the Secretary of HUD's approval on purchase price. The purchase price must take into account the fair market value of the property, the ability of the residents to pay for the property and maintenance costs, and other factors the Secretary deems appropriate consistent with increasing the supply of affordable dwelling units to very low income families.

The act imposes tight restrictions on the sale of units by an RMC and the resale of units by residents. An RMC may sell units only to low-income families living in or eligible to live in public or assisted housing. A low-income family may purchase a unit or ownership rights in a unit under any of the following arrangements: cooperative, condominium, fee simple, shared appreciation with a public housing agency providing purchase price financing, or any other arrangement the Secretary determines is appropriate. However, purchase by individual residents is not required. The act guarantees those who do not wish to purchase the right to remain as federally subsidized renters under HUD's Section 8 Existing Housing Program. Residents who purchase their units may resell only to the RMC, another eligible low-income family, or the public housing agency.

The 1987 act also restricts the appreciation an owner can realize from the property. Appreciation is limited to the sum of the equity paid by the owner, adjusted for inflation, and the value of any improvements made at the owner's expense. The RMC or the public housing agency, whichever is appropriate, is responsible for ensuring that subsequent owners are bound by the same limitations on resale and equity appreciation. Once a public housing property is sold, HUD continues to be responsible for retiring the debt incurred for acquiring and/or constructing the property, as provided in its annual contributions contract with the public housing agency. However, once a building is sold by the public housing agency, HUD can no longer provide the public housing agency annual operating subsidies for these units.

Background on Kenilworth-Parkside's Resident Ownership Application

Built in 1957 and 1959, the Kenilworth-Parkside public housing development in Northeast Washington, D.C., consists of 464 family units ranging in size from two to five bedrooms. From 1975 to 1982, a private management firm managed the property for the District. Dissatisfied with the property's condition, residents formed the Kenilworth-Parkside Resident Management Corporation (KPRMC) in March 1981. KPRMC took over management of the development in January 1982 and since that time has been responsible for developing Kenilworth-Parkside's annual operating budget, collecting rents, making disbursements, providing maintenance, providing social services to residents, and establishing and enforcing resident regulations.

On October 25, 1988, KPRMC and the District government agreed to sell the development to the resident management corporation for $1. The actual sale, however, will not take place until 1990. The project is being modernized with funding from HUD's Comprehensive Improvement Assistance Program (CIAP) and Major Reconstruction of Obsolete Projects (MROP) Program. According HUD, work on the renovation was about 15 percent behind schedule as of August 1989. Because of uncertainty about funding to complete the project and the District's rejection of some carpentry and drywall work because of poor quality, officials were unsure when the modernization would be complete. However, HUD officials said that, as of early September 1989, they were negotiating a memorandum of understanding with the Department of Public and Assisted Housing (DPAH) which would, among other things, establish a timetable for completion of the modernization.

The Purchase Plan

On October 10, 1988, DPAH submitted to HUD an application and plan for Kenilworth-Parkside's purchase by its resident management corporation. HUD reviewed the plan and gave conditional approval on October 25, 1988. Key provisions of the plan are discussed in the following sections.

After receiving title, KPRMC plans to operate the development as nonprofit, low-income rental property, later converting the property to a limited equity cooperative and selling cooperative shares to the tenants. Consistent with the 1987 act, purchase of the limited equity cooperative shares will be limited to families residing in, or eligible to reside in, public housing. The plan also incorporated the act's limitations on resale and appreciation and stated that these limitations will be included in the sales contract governing the sale to KPRMC. To further ensure that the units remain available in perpetuity for those with low incomes, the plan states that the District will always retain the right to repurchase the property by satisfying any loan or lien on the property and that it would return the units to the public housing inventory should the KPRMC ever be unable to meet its financial obligations.

During the transition period between KPRMC's receipt of title and the sale of cooperative shares to tenants, HUD plans to assist Kenilworth-Parkside financially with section 8 project-based rental certificates and vouchers. This assistance will be limited to the amount of operating subsidy HUD estimates it would have provided during the period had Kenilworth-Parkside remained public housing (roughly $1.8 million per year according to the most recent financial projections by a technical consultant to KPRMC). This assistance is critical to establishing KPRMC's financial independence after it assumes ownership.

Finally, as required by the 1987 act, DPAH will replace the Kenilworth-Parkside units on a one-for-one basis by rehabilitating vacant public housing units in its current inventory. The application submitted to HUD identified a total of 486 replacement units at four different District public housing locations. However, HUD objected to one of the proposed replacements—an 80-unit building in the Arthur Capper property at 1011 7th St., SE, Washington, D.C.

HUD approved DPAH's application and purchase plan subject to the following four conditions:

1. HUD must determine that upon completion of renovations the units meet applicable safety and livability standards.

2. DPAH must find substitutes for 80 units it proposed to use as replacements for Kenilworth-Parkside (the Arthur Capper units located at 1011 7th Street, SE).

3. HUD will provide project-based section 8 assistance for a 5-year period following the sale, upon DPAH's submission of an acceptable application and subject to applicable statutory and regulatory requirements.

4. HUD must review and approve the actual sales contract between KPRMC and DPAH prior to the actual transfer of title.

(Our evaluation of selected aspects of the Kenilworth-Parkside purchase plan is discussed in app. IV.)

Objectives, Scope, and Methodology

As requested, we focused our work on (1) evaluating the planning done for the eventual sale of units from the RMC to the tenants, (2) assessing the legality of possible financial arrangements by which RMCs could raise capital once they acquire title to a public housing property, and (3) examining the consequences of financial mismanagement by RMCs.

We also pursued questions on the Kenilworth-Parkside property related to (1) the level of funding and subsidies provided, (2) HUD's plan to provide section 8 rent subsidies for a 5-year period following sale to the RMC but preceding sale of units to the residents, (3) the District's plan to replace the Kenilworth-Parkside units in its public housing inventory, (4) a 1986 cost/benefit study of Kenilworth-Parkside's switch to RMC management, and (5) financial projections for the RMC during the period following its acquisition of the property.

We conducted our review between January and September 1989 in accordance with generally accepted government auditing standards. To obtain information on possible financial arrangements available to RMCs that gain ownership, we interviewed independent experts in the field of low-income housing development and financing, representatives of the Kenilworth-Parkside Resident Management Corporation, individuals under contract to provide the corporation technical assistance, and various HUD officials and organizations active in the low-income housing arena. Because of time constraints, we consulted primarily experts from the Washington, D.C., area who were recommended by individuals working in the low-income housing area as most knowledgeable about developing and financing such properties. (See app. V for experts we consulted.)

We obtained operating cost data from annual receipt and expenditure reports prepared by a private certified public accountant engaged by Kenilworth-Parkside, with the exception of utility costs that were provided by the District's DPAH. Modernization costs were obtained from HUD documents and from data supplied by the DPAH. We did not independently verify the accuracy of any data obtained from these sources.

We reviewed the HUD-approved application and plan for selling Kenilworth-Parkside to its resident management corporation. We discussed various aspects of the plan with officials at HUD's headquarters and Washington field offices, officials at the District's DPAH, and representatives of the Kenilworth-Parkside Resident Management Corporation. We also reviewed several legal questions related to the planned provision of section 8 project-based assistance.

Financing Possibilities for Tenant-Owned Properties

As requested, we have consulted with various low-income housing development and financing experts to identify potential capital-producing activities that an RMC might pursue once it has acquired ownership of a public housing property. In the two formally proposed transfers to date (Kenilworth-Parkside and Carr Square Village), the resident management corporations would receive title to the property for a nominal sum ($1) and a commitment of continued federally funded rent subsidies for a period following the sale. While other circumstances may apply to future transfers, there is no way of predicting what they may be. Accordingly, we used the Kenilworth-Parkside and Carr Square cases as frames of reference for identifying potential financing options.

The experts we consulted generally agreed that these circumstances theoretically could create numerous possibilities for specific capital-producing activities—possibilities limited mainly by the creativity of the individuals involved. However, they generally agreed that the options would have one of three basic structures: (1) a mortgage loan using the property as collateral, (2) a joint venture or partnership with private investors who are seeking tax credits, or (3) sale of undeveloped pieces of the property. In examining each option, we explored whether the option is precluded under section 123 of the 1987 Housing Act. We also examined the consequences of financial mismanagement of the property and the risk to the government should an RMC default on its financial obligations.

Feasibility of Obtaining a Mortgage Loan

Transfer of a public housing property to an RMC for $1 provides the RMC with a potentially valuable debt free asset. Current law does not restrict the RMC's use of this property as collateral for mortgage loans. The value of such property may be substantial, especially in the case of properties that are completely modernized using federal funds before purchase by the RMC. However, property value is only one of the criteria lenders take into account in making a mortgage loan.

Financing Criteria Generally Used by Lenders

There are four basic criteria that banks use to underwrite mortgages: credit history of the borrower, character of the borrower, collateral value of the property, and cash flow from the property. It is generally agreed by mortgage lenders that collateral and cash flow are the two underwriting criteria that directly relate to the property in need of financing. Thus, these are the two criteria that borrowers for community development ventures must adequately satisfy if they expect bank financing.[1]

Collateral

Collateral refers to the appraised value of the property that will be used to secure the loan. A bank usually lends no more than 80 percent of the property's appraised value. However, if the venture or its location is considered risky, this percentage may be less.

Real estate values are commonly appraised on the basis of prices recently received for similar properties in the same geographic area. However, as one of KPRMC's consultants wrote in his draft privatization plan, appraising the value of a public housing property such as Kenilworth-Parkside is difficult because Kenilworth-Parkside is the first transaction of this kind in the nation.

In drafting a financial plan for privatizing Kenilworth-Parkside, a team of technical consultants attempted to determine the property's value. The plan, which was still in draft form as of June 1989, outlined how the team arrived at a value. The team ruled out two possible bases for the appraisal—sales cost ($1) and reconstruction cost (estimated at $30 million). They concluded these had no bearing on the value of the property because its use was limited permanently to low-income housing. By looking at income on a capitalized basis, the team assigned a value of $2.5 million (net operating income of $250,000 in the first year following transfer divided by 0.1, a capitalization rate frequently used for apartment buildings and other income-producing real estate). On the basis of the present value of estimated proceeds from the sale of units to the tenants, they estimate Kenilworth-Parkside's value at $2.9 million. The KPRMC consultant team then averaged the two estimates to yield a projected worth of $2.7 million. A loan of 80 percent of this value would be $2.16 million.

Cashflow

When evaluating cashflow, a mortgage lender looks at a property's net operating income (revenue less expenses) to determine what is available to repay its loan. The bank requires a debt service coverage ratio that may vary depending on the value of the property and the financial strength of the customer. A 1.15 debt service coverage ratio is a common requirement, which means that for every dollar of the loan being repaid, there must be $1.15 of net operating income. For ventures perceived as

[1] Karen Kollias, "Community Development Lending: Cutting Edge for Good Business." (Washington, D.C.: American Security Bank, Sept. 1988).

risky, it is likely that a bank would require a minimum debt service coverage ratio of 1.25. Secondary markets often require higher debt service coverage ratios which primary lenders may adhere to if they intend to sell the loans in the secondary market.[2] The Kenilworth-Parkside consultant team anticipates a $250,000 annual cashflow from the property. On this basis, the annual debt service the property could support at a 1.25 coverage ratio would be $200,000. However, as discussed in appendix IV, the projected cash flow is based on assumptions regarding the property's future income and expenses.

Plans to Obtain Financing for Kenilworth-Parkside

A draft financial plan prepared by a team of consultants for Kenilworth-Parkside sought to determine the feasibility of obtaining financing for roughly $1.75 million in improvements not covered by the federally funded modernization now in progress. The improvements were: a year-round swimming pool, a licensed kitchen to prepare residents for careers in the food preparation industry, tennis courts, racquetball courts, and ceiling fans plus two window air conditioning units per apartment. A loan taken out to finance these items would increase the operating costs for the property and could delay the conversion to tenant ownership because each tenant would need increased income to support his or her share of the operating costs. However, consultants to KPRMC from the National Center for Neighborhood Enterprise caution that plans for amenities at Kenilworth-Parkside are not final. They said the final decision will depend on estimates of annual net operating income and a determination of how much of this amount needs to be placed in a operating reserve fund. HUD said that it recommended that Kenilworth-Parkside exclude project amenities because it does not believe adequate justification has been provided. In commenting on our draft report, KPRMC said the amenities were a wish list and that they do not plan to obtain the financing outlined in the plan. In addition, HUD said it plans to require, through regulation, its advance approval of any mortgage financing or other encumbrances on the property.

KPRMC did not determine where it would have gotten financing for the improvements; however, the draft financial plan included the following options:

(1) Conventional sources of financing such as mortgage companies, thrift institutions, commercial banks, and insurance companies.

[2] Kollias, "Community Development Lending: Cutting Edge for Good Business."

(2) Public loan and guaranty programs. Under this option, KPRMC might secure a Federal Housing Administration (FHA) insured mortgage under Section 241 of the National Housing Act, which permits the extension of mortgage insurance to tenant cooperatives and nonprofit organizations when purchasing an otherwise eligible property.

(3) Development finance companies, such as the Local Initiatives Support Corporation, a source of mortgage financing for community development ventures, or foundation program-related investments, through such organizations as the Cooperative Assistance Fund.

Whether or not Kenilworth-Parkside could support such a debt depends in part on the assumptions made in determining the property's income and expenses. One consultant determined through his analysis that Kenilworth-Parkside could support a commercial loan of $1,752,200 at 11.5 percent over 30 years. This determination is predicated on the assumptions he made in his analysis of the financial feasibility of privatization of the property (see app. IV). In that analysis, the consultant assumed that in the first year of KPRMC ownership net operating income would be $250,000. The loan payment would be $208,000, and thus the debt service coverage ratio would be 1.20. According to bank officials we interviewed, this ratio would be sufficient to cover the loan unless the bank considers the venture risky. In that case, the bank would require a 1.25 coverage ratio.

The KPRMC also has plans for various other ventures. For example, KPRMC (1) is currently sponsoring a HUD section 202 elderly rental housing property that will be located near Kenilworth-Parkside, (2) plans to construct up to 20 townhouses, (3) wants to acquire a nearby apartment building to rent primarily to low- to moderate-income families, (4) is developing a reverse commute transportation shuttle service to take Kenilworth-Parkside residents to job sites, and (5) hopes to develop a community shopping center. While the KPRMC chairperson said they have no plans to use the property as collateral for any of these ventures, the existing statute would not bar such uses provided they were within the proper scope of RMC activity according to its charter.

Viability of Establishing Partnerships That Use Tax Credits

An alternative method of generating revenue for rehabilitation of a property acquired by a RMC is through the use of tax credits. To generate tax credits, owners must enter into a partnership with investors who qualify for the credit on the basis of their investments. The Housing Act of 1987 does not expressly restrict an RMC that has purchased its building from creating partnerships to attract private investors.

Tax credits for low-income housing development were enacted in the Tax Reform Act of 1986 to stimulate construction and rehabilitation of low-income housing. The tax credit is a reduction in tax liability each year for 10 years for investors in qualified low-income housing. The amount of the credit is calculated as a percentage of the costs of acquisition and privately financed capital improvements. Low-income housing benefits from the tax credit primarily when the owners of a property, either profit-motivated or nonprofit, take on limited partners who underwrite capital improvements to the property in exchange for the use of the tax credits and other economic benefits. These equity contributions from limited partners reduce the amount of other financing needed to acquire, rehabilitate, or develop a low-income housing development.

Use of Tax Credits for Cooperative Housing

Tax credits have been used following the sale of a 44-unit public housing development in Denver, Colorado, to a tenant cooperative and its partnership. The sale was sponsored under HUD's Homeownership Demonstration Program—a limited, experimental program announced in 1984. The tenant cooperative, which acquired the property in August 1988, began selling ownership shares to the tenants that same month.

The Denver cooperative is eligible to use tax credits because a rental relationship has been established. The tenants are still considered "renters" because they own shares in the cooperative that entitle them to lease a unit for a specified rent. Shareholders in the cooperative are not allowed real estate tax deductions on their individual income tax returns. Another benefit of a cooperative is that shareholders who qualify on the basis of income may also receive HUD-financed section 8 rental assistance.

In this case, a limited partnership has been established between the tenant cooperative corporation (which serves as the general partner), a private investor (who became a limited partner), and the Denver Housing Authority (which is a special limited partner). After the partnership was formed, the Denver Housing Authority sold the buildings and other facilities to the partnership in exchange for cash from the private investor and a promissory note from the partnership for $1,650,000. The note has a 5.25-percent interest rate and is to be paid over a term of 25 years. Thus, the Denver Housing Authority got cash up-front from the transaction plus it receives monthly debt service payments on the note. Also, the cooperative itself owns the underlying land and after 25 years will own the buildings free and clear.

Use of Tax Credits With the RMC Acting as Landlord

Carr Square, (the second tenant-managed development to apply to HUD for RMC ownership) plans to use tax credits to finance the property's rehabilitation. According to its application, the RMC's preferred approach is to use tax credits plus a variety of local and private sources of financing to modernize the property after purchasing it from the St. Louis Housing Authority for $1.

For Carr Square to make use of tax credits, the RMC must transfer the buildings at the property to a limited partnership made up of a corporate general partner and individuals as limited partners. According to the Carr Square application, the purchase and sales agreement being negotiated between the RMC and housing authority allows for this transaction, under the condition that the RMC maintains a major and controlling role in the property. However, the plan, which has been revised to allow the tenants to own the land immediately, does not call for the sale of units to individual tenants until the end of a 15-year period of low-income rental use. The RMC plans to manage the property during this period and require that it will have the right to purchase the buildings back from the partnership at the expiration of the partnership life (15 years) at a reasonable price.

The RMC expects to leverage $11,250,000 through its use of tax credits. This funding will be coupled with below market rate financing from the Missouri Housing Development Corporation and grants from the HUD Community Development Block Grant program, local corporations, or foundations to generate funds totalling about $33.9 million. These funds will be used primarily to rehabilitate the project and seed an operating reserve.

Possibility of Selling Off Pieces of the Property

Another potential way for RMCs and others to profit from the purchase of public housing property for a nominal amount is by selling off pieces of the property for further development. While section 123 is not entirely clear on this point, an RMC buyer would most likely not be able to subdivide undeveloped land conveyed with the buildings and sell it on the open market. Section 123 provides for the RMC's purchase of "buildings" and the sale of "dwelling units" only to lower income families. Further, "property purchased under this section shall be resold only to the resident management corporation, a lower income family. . .or to the public housing agency" (emphasis added). Absent a special definition, the term "property" would include both the land and the buildings.

The attractiveness of subdividing undeveloped land would be partially dependent on the area in which the housing is located. For example, in the case of Kenilworth-Parkside, there is a nearby metro subway stop and there are plans to redevelop the entire area. Thus, it is conceivable that undeveloped land in the Kenilworth-Parkside property could increase in value as the area is revitalized.

Consequences of Financial Mismanagement

In the District of Columbia, if an RMC cooperative association were to mismanage its funds causing it to default on its obligations, and if it had an uninsured commercial mortgage, the lender could, after one year of nonpayment, petition for the dissolution of the association. On dissolution, the residents' cooperative shares would be turned over as corporate assets to satisfy the corporation's debts. This means that a lender could acquire ownership of the RMC-owned property through the equivalent of foreclosure. Because the resale restrictions in the statute apply only to property "purchased under [this] section," a creditor coming into possession would not be bound to rent or sell the property to low-income persons. Other creditors, such as public utilities and construction contractors, have the same rights, even if the services giving rise to the indebtedness were not provided to the property but in connection with some other authorized activity of the RMC. Alternatively, the cooperative members could vote to dissolve the corporation voluntarily. In that case, after paying all creditors, they would distribute any remaining assets among themselves. This also could theoretically end the low-income restrictions. To avoid this, HUD or the public housing authority may feel obligated, given the federal investment in the property, to repurchase it.

The property's low-income status could be assured in two ways, but each creates additional costs for the federal government. First, if the RMC had an FHA-insured loan, the federal government would be liable in the event of default. The government could then, at a cost, guarantee the low-income status of the housing. Second, as is planned in the Kenilworth-Parkside case, the sales agreement and any mortgage instruments could state that in the event of a default, the local public housing agency would be given the right to repurchase the property by satisfying the debt. This provision also would provide protection against loss of the property's low-income housing status.

Costs to Operate and Modernize Kenilworth-Parkside Compared With Other Public Housing Costs

As you requested, we assessed the level of funding provided to Kenilworth-Parkside to subsidize operations and to modernize the property. Operating and modernization funds provided to Kenilworth-Parkside are summarized in table III.1. Kenilworth-Parkside's operating costs were somewhat lower than average for the District's public housing properties during fiscal years 1987 and 1988. On the other hand, its rental income has been substantially less than average, which tends to increase the operating subsidy needed by the property. Modernization costs are much higher than average for HUD-funded properties in either the immediate area or the nation, but are lower than the average cost of combined HUD- and District-funded modernization efforts. Differences in average modernization costs, however, may not indicate differences in efficiency, but may merely reflect differences in the scope of work needed to modernize the units. Likewise, differences in operating costs may be due at least partially to differences in the age and type of facilities managed by different entities.

Table III.1: Summary of Kenilworth-Parkside Costs and Funding Data

Operating costs	**Amount**
Fiscal year 1987	$1,845,101
Fiscal year 1988	$1,881,410
Operating subsidies[a]	
Fiscal year 1987	$1,415,192
Fiscal year 1988	$1,483,509
Modernization funds	
Fiscal years 1979-1989	$25,167,801
Estimated rental subsidies	
5-year period following sale to RMC	$9,286,993

[a]Rental income for the most part covered the difference between operating costs and subsidies. Federal public housing operating subsidies will be replaced by federal section 8 rent subsidies for a period following the sale of the property to the RMC.

Source: Data on operating costs/subsidies and modernization funds were obtained or derived from data supplied by HUD, KPRMC, and DPAH. Estimated rental subsidies following the sale were developed by a consultant under contract to DPAH to provide further technical and planning assistance to KPRMC.

As requested, we also reviewed a 1986 cost/benefit analysis of Kenilworth-Parkside's conversion to RMC management prepared by the accounting firm of Coopers and Lybrand. We found the study was based on a limited amount of information about potential benefits and costs due to a lack of data from DPAH. The study did not contain sufficient information to rule out the possibility that most of the benefits attributed to tenant management might have occurred in its absence. However, it would be quite difficult to satisfy the analytical requirements that would be necessary to rule out this possibility.

Relative Operating Costs and Subsidies

The Kenilworth-Parkside RMC is responsible for managing the property under a contract with the District's DPAH. KPRMC collects rents from the tenants and passes these funds on to DPAH. DPAH in turn pays KPRMC for operating expenses (other than utilities) as they are incurred. Payments are made via monthly vouchers and are subject to a cumulative limit specified in the contract. DPAH pays all utility costs for the property directly.

Kenilworth-Parkside had substantial vacancies during fiscal years 1987 and 1988 due to modernization work. About 41 percent of its 464 units were vacant at the end of fiscal year 1987, and the vacancy rate increased to 54 percent at the end of fiscal year 1988. Utility costs experienced a corresponding decrease, declining by about 7 percent from fiscal year 1987 to fiscal year 1988. However, total operating costs increased slightly (about 2 percent), primarily because of increased ordinary maintenance and general expenses. DPAH said that these operating costs increased despite fewer occupied units because they had agreed to provide KPRMC with additional funds in fiscal year 1988 to make up for budget cuts which occurred in fiscal year 1987. Table III.2 summarizes the main categories of operating expenses for fiscal years 1987 and 1988. Table III.3 shows our calculation of the subsidy that the District paid to Kenilworth-Parkside for fiscal years 1987 and 1988.

Table III.2 Summary of Kenilworth-Parkside Operating Costs, Fiscal Years 1987 and 1988

	Fiscal year	
Cost category	**1987**	**1988**
Administration	$119,704	$137,012
Tenant services	124,611	131,917
Labor for utilities	23,698	22,674
Ordinary maintenance	406,475	447,053
Protective services	2,750	2,008
General expenses (includes insurance)	100,803	154,729
Replacement of nonexpendable equipment	2,970	0
Utilities (paid directly by DPAH)	1,064,091	986,018
Total	**$1,845,101**	**$1,881,410**

Source: Annual statements of operating receipts and expenditures which KPRMC filed with DPAH, except for utility costs, which were supplied by DPAH.

Table III.3 GAO's Computation of Subsidies Paid by the District to Kenilworth-Parkside, Fiscal Years 1987 and 1988

	Fiscal year	
	1987	**1988**
Payments received from D.C. government[a]	$809,682	$881,295
Utility costs paid by D.C. government[a]	1,064,091	986,018
Total D.C. government payments	**1,873,773**	**1,867,313**
Less rental income	(458,581)	(383,804)
Total subsidy	$1,415,192	$1,483,509

[a]These amounts represent payments made by DPAH. HUD provides DPAH an annual operating subsidy for its entire public housing inventory. While available records do not indicate how much of DPAH's federal subsidy is attributable to Kenilworth-Parkside, we believe it is reasonable to assume that the vast majority of DPAH's payments for Kenilworth-Parkside are funded with the HUD-supplied federal operating subsidy.

Source: Payment and utility data supplied by DPAH. Rental income was taken from annual statements of operating receipts and expenditures which KPRMC filed with DPAH.

Table III.4 compares operating receipts, costs, and subsidies on a per-unit, per-month basis for Kenilworth-Parkside and all District public housing properties. District-wide data were taken from end-of-year statements of operating receipts and expenditures that DPAH filed with HUD. The statements identified the operating subsidies that HUD paid to DPAH; however, upon the advice of HUD and DPAH officials, we reclassified as subsidies certain appropriated D.C. government funds that DPAH reported as operating receipts on its statements. According to the DPAH accounting officer who prepared the statements, these are funds that the District government appropriated to DPAH for certain programs that support low-income housing, such as a resident maintenance program and an employment program for former prison inmates. Our reclassification increased DPAH's reported subsidy $49.32 per-unit per-month for fiscal year 1987, by $42.63 per-unit per-month for fiscal year 1988, and reduced DPAH's reported operating receipts by the same amounts.

Table III.4: Comparison of Kenilworth-Parkside and District-Wide Operating Receipts, Operating Costs, and Subsidies, on a Per-Unit, Per-Month Basis

Fiscal year 1987	Kenilworth-Parkside	District-wide
Operating receipts (exclusive of subsidies)[a]	$82.36	$132.28
Less operating costs	(331.38)	(386.40)
Deficit before subsidy	(249.02)	(254.12)
Plus subsidy	254.17	260.10
Net surplus after subsidy	5.15	5.98
Fiscal year 1988		
Operating receipts (exclusive of subsidies)[a]	68.93	143.08
Less operating costs	(337.90)	(367.21)
Deficit before subsidy	(268.97)	(224.13)
Subsidy	266.43	241.82
Net surplus (deficit) after subsidy	$(2.54)	$17.69

[a]Operating receipts consist primarily of rental income but may also include other miscellaneous receipts such as interest income.

Source: GAO calculations based on data contained in annual statements of operating receipts and expenditures which KPRMC filed with DPAH and which DPAH filed with HUD.

Kenilworth-Parkside had lower per-unit, per-month operating costs than did the average District project in both years. However, in fiscal year 1988, KPRMC's operating subsidy was almost $25 per-unit, per-month higher than the District average. This situation is partially explained by Kenilworth-Parkside's lower operating receipts (primarily rental income and interest). The reduced operating receipts were probably due, in part, to the vacancies at the project. (See table III.4.)

On the advice of HUD and DPAH officials, we based our per-unit, per-month computations for Kenilworth-Parkside on all 464 units for a full year even though, as previously discussed, a substantial number of units were actually vacant because of modernization. The officials said that the District-wide figures that DPAH reported to HUD were not adjusted for other units in the city that were vacant because of modernization. Furthermore, it is required by statute that HUD continue to pay public housing agencies operating subsidies for such units.

The District's DPAH cautions against drawing conclusions about the relative efficiency of tenant and traditional public housing agency management by comparing average operating costs. They note that a number of factors can affect costs that have no connection to the management arrangement. Such factors include age and condition of facilities and tenant composition. DPAH officials said it would be best to compare Kenilworth-Parkside to a DPAH-managed development with similar characteristics. This was not possible, however, because DPAH does not maintain individual cost data on the public housing developments it manages directly. Individual cost data were available only for the two developments managed for DPAH by outside entities—Kenilworth-Parkside and Capitol View Plaza, which is managed by a private management firm. Capitol View, however, is not similar to Kenilworth-Parkside. Capitol View was built in 1971 and consists of 320 units, 228 of which are designed for use by the elderly. Kenilworth-Parkside was built in 1957 and 1959 and consists of 464 units in total, all designed for family use.

DPAH and Kenilworth-Parkside officials also believe that costs associated with Kenilworth-Parkside or any other tenant-managed property should be weighed against the substantial human and social benefits that they believe can result from this management arrangement. According to the officials, such benefits can include reduced crime, drug and alcohol abuse prevention, day care and latch key programs, recreational services, entrepreneurial activities, and better job skill training. However, such benefits are not readily quantifiable.

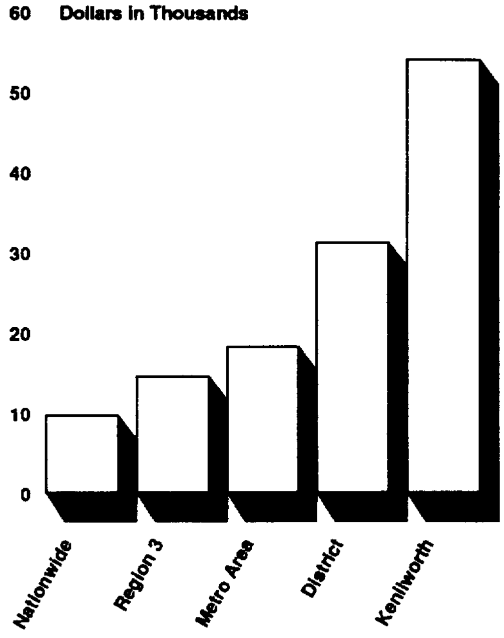
Modernization Costs

Since 1979, Kenilworth-Parkside has received a total of $25,167,801 in modernization funds—$25,003,088 from HUD and $164,713 from the District government. HUD funding was provided under two separate programs—$15,765,613 under the Comprehensive Improvement Assistance Program (CIAP) and $9,237,475 under the Major Reconstruction of Obsolete Projects (MROP) program. CIAP provides funds for modernization to improve the physical condition and management of existing public housing. Eligible projects can vary widely in size and scope. They can be full-scale rehabilitation efforts coupled with those management improvements needed to ensure the property's long-term viability. However, CIAP projects also can be much smaller efforts, such as emergency repairs or energy conservation measures. Management improvements can include purchase of automatic data processing equipment, software, or consultant services for financial or other aspects of management operations. The MROP program, on the other hand, provides funds for reconstructing properties that have design or marketability problems that result in vacancy rates of 15 percent or more and that have estimated modernization costs (exclusive of management improvements) that are 60 percent or more of published cost guidelines for constructing similar units in the area. The modernization must provide for the long-term viability of the property.

The MROP funds were approved in fiscal year 1987 after the bulk of the CIAP funds had already been provided. According to HUD's 1987 notice of MROP funding availability, properties that previously received funding for comprehensive modernization but which require additional funding are ineligible candidates for MROP. The Director, Office of Public Housing, in the HUD Philadelphia Regional Office said he recommended that the CIAP funds, which were mostly unobligated at the time, be recaptured by HUD and an MROP award be made. The official said the decision not to recapture the CIAP funds and to combine MROP and CIAP was made by HUD headquarters. Since Kenilworth-Parkside had received CIAP funds in 1983, the HUD headquarters Office of Public Housing determined that Kenilworth-Parkside was ineligible for MROP funds without a waiver of eligibility requirements. The former HUD General Deputy Assistant Secretary for Public and Indian Housing granted a waiver so that Kenilworth-Parkside could be funded in 1987.

HUD funding for Kenilworth-Parkside was made via several separate awards between 1979 and 1989. The per-unit modernization costs to date, based on HUD funding only, is $53,886. Per-unit modernization costs based on total funding provided by both HUD and the District is $54,241. As shown in figure III.1, the HUD per-unit funding is substantially higher than per-unit modernization costs for the CIAP program in the surrounding area or nationwide. It should be emphasized that these per-unit costs represent only full-scale rehabilitation efforts, but do not take into account differences in the scope of work performed, which is largely determined by the condition of the facilities.

Figure III.1: Public Housing Modernization Per-Unit Cost Comparison



Region 3 includes Pennsylvania, West Virginia, Virginia, Maryland, and Delaware

Source: HUD figures for fiscal years 1981-1987 for nationwide, region 3, metropolitan area, and the District. We calculated the Kenilworth-Parkside figure, which does not include the $164,713 in District funding.

DPAH officials said the District's modernization costs are higher than average because its properties are in poorer condition and have required more extensive renovations than those of most other public housing agencies. The officials said the District often funds modernization projects itself. DPAH officials also pointed out that Kenilworth-Parkside's modernization costs are in line with those for other public housing properties in the District. The officials said that because the District often provides substantial modernization funding, the average cost to modernize a unit in the District (including both HUD and District funds) is $54,389.

Although the funds were provided over a period of years beginning in fiscal year 1983, the bulk of the Kenilworth-Parkside modernization funds was not committed until September 1988. Six contracts totaling $19,350,876 had been awarded as of June 1, 1989. About $165,000 of this amount was District government funds, leaving over $5.5 million in HUD funds uncommitted. The goods and services provided and the status of these contracts are summarized in table III.5. DPAH's Administrator for Development and Modernization said the uncommitted funds originally were to be used for modernizing certain nondwelling areas, for improvements to the heating pipe systems within individual buildings at the property, and for general dwelling modernization. However, these plans subsequently changed, as discussed later in this section.

Table III.5: Summary of Contracts Awarded for Kenilworth-Parkside Modernization Work

Award date	Amount to date	Goods/services provided	Status as of 06/01/89
01/85	$658,641	Architectural and engineering design services during pre-construction phase and inspection services during construction phase.	Design 95-percent complete. (Additional design services anticipated in connection with change orders.) Inspection services 10-percent complete.
12/85	$1,456,876	Roof replacement.	Completed.
04/86	$1,308,000	Construction management services. (Originally there were numerous prime contractors under the overall supervision of a construction management entity. This strategy was abandoned in favor of a single general contractor.)	Terminated for the District's convenience, effective 09/30/88.
09/87	$138,359	Asbestos removal.	83-percent complete. Remaining work awaiting relocation of tenants from occupied units. Work complete in common areas.
09/88	$15,589,000	Construction contract to provide comprehensive modernization of 341 units.	Work 15-percent behind schedule as of August 1989, according to HUD. District notified contractor of substandard subcontractor work and that contract was in jeopardy.
09/88	$200,000	Resident construction services to assist the District. Includes a variety of services, such as monitoring and reporting on construction progress, preparing relocation plans for residents, and proposing employment and training plans for residents. (KPRMC is the contractor.)	On schedule. All deliverables due to date have been provided.

Source: Data supplied by DPAH, except where noted.

According to various HUD and DPAH officials, several events led to the delays in the Kenilworth-Parkside modernization. First, HUD provided the 1983 CIAP funds outside the normal cycle and before an acceptable application was submitted, according to officials at HUD's Washington, D.C., field office and its Philadelphia Regional Office. According to HUD, a former HUD Under Secretary and other top officials supported the project from its inception. Because of this, they wanted Kenilworth-Parkside to receive modernization funds. Funds were allocated for Kenilworth-Parkside in September 1983 and a final application was submitted in November 1983. Following modification, the application was approved by HUD's D.C. field office in May 1984, about 8 months after HUD awarded the funds. According to HUD field office and regional officials, those circumstances resulted in planning that was hastily done and completed after funding was received instead of the other way around.

Second, there were delays in working out KPRMC's role in managing the work. HUD and the District initially agreed to a construction management approach in which KPRMC would be part of a joint venture with a private construction management firm (the 1986 contract for $1,308,000 shown in table III.5). DPAH officials said they approved this approach because they considered Kenilworth-Parkside an experiment and thought the joint venture could provide needed job skill training opportunities for Kenilworth-Parkside residents.

Third, the construction management approach did not work well because the District had to deal with multiple prime contractors instead of a single general contractor. This caused delays because each contract had to go through a series of reviews conducted by the District of Columbia's Department of Administrative Services, Office of Corporation Counsel, Office of the Deputy Mayor for Finance, Office of the Deputy Mayor for Economic Development, the Office of the City Administrator, and the Mayor. In July 1988, DPAH's Director expressed concerns to HUD about completing the modernization within budget and on time because of the multiple contracts. Based on DPAH's experience, the Director recommended using a general contractor, who would be responsible for obtaining subcontractors and who would bear the risk for their performance. The District terminated the construction management contract for its own convenience and awarded a contract to a general contractor in September 1988.

HUD's Special Assistant for Tenant Management and Urban Homesteading and the manager of HUD's Washington, D.C., field office agreed that the delays with the Kenilworth-Parkside modernization were due, in part, to the District's contract approval procedures. The special assistant said that HUD does not want Kenilworth-Parkside's modernization delays to be experienced by other tenant-managed properties.

A fourth reason for delays in the modernization work was that the originally planned work was found to be not comprehensive. This determination was made by a team of HUD representatives that visited Kenilworth-Parkside. The team suggested that additional work be done, such as site improvements, landscaping, and upgrades for handicapped tenants. The HUD regional office worked with KPRMC to develop an application for additional funds, which resulted in the $9.2 million MROP award in 1987.

It should be noted that the principal construction contract awarded in September 1988 (see table III.5) covers modernization of only 341 of Kenilworth-Parkside's 464 units. DPAH had the contractor bid on a "deduct alternate" basis because it was not sure it would have enough money to complete the entire job. Under this procedure, the contractor bid on modernization of all 464 units and on the option of modernizing only 341. DPAH elected to exercise the deduct option.

On February 24, 1989, DPAH submitted a preliminary application for $6,889,484 in additional funding to complete the modernization work. DPAH subsequently reduced the application to $4,029,825. The proposed uses for the funds were as follows:

- Salaries for a 2-year period for inspection personnel, $196,989.
- Additional design and inspection services from the original architect and engineering firm, $300,000.
- Completion of site improvements, including sewers, storm sewers, exterior lighting, paving, fencing, and landscaping, $184,790.
- Dwelling structure modernization for the remaining 123 units, $3,348,046.

In September 1989, HUD awarded about $1.8 million in additional funding for Kenilworth-Parkside. At that time, HUD was also in the process of negotiating a memorandum of agreement with DPAH that would include a requirement that DPAH establish a timetable for completing the modernization and an assessment of the need for additional funds. However, according to a memorandum prepared by the Baltimore Field Office, which now has oversight of Kenilworth-Parkside, it may take from $9 million to $10 million (including the $1.8 million) to complete the modernization by late summer 1990. Additionally, to complete the work by then, the number of persons working at the site would have to be increased from 35 to 250 and the contractor and the DPAH must resolve their current disputes regarding the approval of contract change orders. If an additional $9 million is provided, this would raise the per-unit costs to $69,687. If funds provided to date were used to modernize only the 341 units, the cost would be $73,806 per unit.

1986 Cost/Benefit Analysis

As requested, we are providing our observations on a 1986 cost/benefit analysis of Kenilworth-Parkside that the accounting firm of Coopers and Lybrand performed for the National Center for Neighborhood Enterprise. The study did not address possible future resident ownership, but rather sought to assess the relative costs and benefits to the District of Kenilworth-Parkside's first 4 years under resident management (1982 through 1985). It estimated a net benefit of $785,332 for that period and projected net benefits of $4.5 million for the period 1982 through 1991.

We found that the study was based on limited information about potential benefits and costs of resident management at the property. According to the principal analyst, the District government did not provide enough information to conduct a comprehensive analysis, and that, as a result, conservative assumptions were adopted to compensate for poor data quality. For example, adequate data on the property's rental revenues and costs prior to resident management were not available. As a result, no direct comparison could be made of revenues and costs before and after resident management was introduced. Instead, the study compared rental revenues for the property under resident management with the average rental revenues for all District public housing properties. According to the principal analyst, this comparison was a conservative one because prior to resident management, rental revenues at Kenilworth-Parkside were lower than the District's average rental collections. Data were not available for a similar comparison of costs.

The study cited reasons for expecting that better care of the property and improved living conditions occurred as a result of resident management. While these reasons seem plausible, the study did not provide direct measures of many of these improvements, possibly because of lack of data and the difficulty of quantifying some of these improvements. The study does offer evidence of increased services provided by what it calls social service enterprises, such as a door repair shop, a laundry, and a cafeteria. The principal analyst who prepared the study told us that these increased services were due to improvements in conditions at the property resulting from resident management. These savings make up the bulk of benefits attributed to resident management. However, the study does not contain sufficient information to rule out the possibility that such enterprises might have operated in the absence of resident management. In all fairness, however, it would be quite difficult to satisfy the analytical requirements that would be necessary to rule out this possibility. Nonetheless, HUD and the principal analyst believe strongly that it was safe to assume that jobs associated with these enterprises would not have been created without resident management.

We also found that the principal analyst was unable to verify two statements that could have had a bearing on the study's results. The study states that additional rental revenues "were used to fund additional staff positions and to subsidize KPRMC enterprises that provide service to Kenilworth-Parkside residents." However, the principal analyst told us that this statement was an assumption. The study also states that unlike the private management firm that preceded it, the resident management corporation was responsible for operating deficits exclusive of utility costs. However, the principal analyst told us that this was an assertion of a resident management corporation official. We found that, in fact, the District government normally pays for such deficits.

Evaluation of Selected Aspects of the Purchase Plan

As requested, we have evaluated several aspects of the District's plan to convey Kenilworth-Parkside to its Resident Management Corporation. We assessed the legality of HUD's providing project-based section 8 certificates during the 5-year period following the sale, the status of the District's plan for replacing the units by refurbishing existing vacant public housing, and the reasonableness of financial projections for the period following the sale.

Planned Section 8 Project-Based Subsidies Are Permissible

HUD routinely subsidizes low-income tenants in privately owned rental housing through section 8 certificates and housing vouchers issued under the United States Housing Act of 1937, as amended. When the RMC becomes the owner of Kenilworth-Parkside, it will be on the same legal footing as other private owners of low-income housing property. This means it would be eligible for project-based certificates if it meets the requirements in HUD's regulations, including financing of specified renovations.

With certificates, HUD pays the difference between 30 percent of a qualifying family's adjusted income and an approved monthly rent, which must be equal to or less than a HUD-determined fair market rent for the geographic area. Payments are made directly to the landlord by the local public housing agency with funds provided by HUD. Vouchers entitle the family to a subsidy of an amount equal to the difference between 30 percent of a qualifying family's adjusted income and the established fair market rent for the area, no matter what the family pays. This gives the family the flexibility of selecting units either above or below the fair market rent. The tenant is allowed to keep the difference, if any, or is required to bear the additional cost, if any, between the actual and fair market rents.

Section 8 subsidies have traditionally been "tenant based," which means that the subsidy follows qualifying tenants should they decide to move. However, section 8 was amended in 1983 to permit the Secretary to authorize attachment of certificates (but not vouchers) to an existing structure, if the owner agreed to rehabilitate the structure with funds other than assistance funds provided under the Housing Act. Unlike tenant-based subsidies, property-based certificates stay with the structure even if the tenants move. The Congress hoped that the promise of a steady income would encourage more building owners to commit private funds to rehabilitating low-income housing. Section 8 was again amended in 1987 to authorize local public housing agencies, without consulting HUD, to attach up to 15 percent of their allocated certificates to specific properties.

The District of Columbia's plan for selling Kenilworth-Parkside to the RMC calls for the RMC to operate the development as a rental property for a 5-year period following the sale. During this time, HUD has been asked to provide 414 property-based certificates and 50 vouchers. These subsidies are crucial to the financial success of the property following the sale. In conditionally approving the purchase plan, HUD said it would provide the requested assistance in accordance with standard practice, subject to applicable regulations and the District's submission of an acceptable application.

Interim regulations promulgated on January 4, 1989, specify the conditions a building owner must satisfy to be eligible for property-based certificates. Owners must agree to spend the equivalent of at least $1,000 per unit from sources other than low-income housing funds (Title 42 Ch. 8) on (1) repairs to major building systems, (2) alterations to make the building accessible to the handicapped, (3) space redesign to make the building more suitable for occupancy by large families, or (4) remodeling individual units in compliance with HUD's Housing Quality Standards.

Several questions have been raised about whether the Kenilworth-Parkside purchase plan, the success of which depends heavily on continued section 8 subsidies, conflicts with the statutory and regulatory requirements for project-based certificates. The following section addresses three questions:

(1) At the time of sale, the property will have just undergone an extensive modernization financed primarily with federal funds. Will the property be eligible for project-based assistance, a prerequisite of which would be investing an additional $414,000 in improvements?

(2) Would the 414 project-based certificates promised for Kenilworth-Parkside constitute more than the 15 percent of all section 8 assistance the District is permitted to attach to properties?

(3) Are the certificates promised to Kenilworth-Parkside subject to the project-basing selection procedures the District will be required to develop under the interim regulations on project-based assistance?

Completed Modernization Does Not Exclude Project-Based Assistance

Kenilworth-Parkside is currently undergoing major renovations funded in part by CIAP. As of the date of sale, all modernization funding is scheduled to be obligated. While the work continues, the District government and the RMC are legally obligated to ensure that the CIAP funds have been and are fully and correctly applied. However, they are not required to guarantee that CIAP will have completely renovated all areas of the buildings to meet all applicable standards, thereby obviating the need for any further work in the complex. As discussed in appendix III, the federal modernization funds already provided to Kenilworth-Parkside will not be adequate to complete the modernization of all 464 units at the complex. Qualified financing of all or part of the remaining work might well qualify the buildings for project-based assistance.

The statute that authorizes project-basing of section 8 certificates does not contain any limitation on eligibility based on the building having received previous federal assistance to fund capital improvements. However, such a restriction is included in HUD's interim regulations on project-based assistance (54 Fed. Reg. 238 (1989)).

Under these regulations, a building owner who had received CIAP funds in the last 5 years would not be eligible to receive project-based certificates. However, the regulations create a specific exception for resident management corporations that purchase their buildings if the Secretary determines that providing the project-based certificates would facilitate the sale. This seems consistent with congressional intent to permit RMCs to purchase their buildings. Accordingly, the fact that Kenilworth-Parkside will have just completed major renovations under the CIAP program would not render the project ineligible for project-based Section 8 certificates under the statutes or the regulations.

Kenilworth-Parkside Transaction Is Not Subject to DPAH's 15-Percent Limitation on Project-Based Assistance

A question has been raised whether the provision of 414 project-based certificates to Kenilworth-Parkside is legally permitted since this would constitute more than 15-percent of all section 8 assistance in the District of Columbia. Under our reading of the statute, there is no absolute statutory limit on the number or percentage of project-based certificates that may be provided in any jurisdiction. Accordingly, the provision of 414 certificates to Kenilworth-Parkside would be permitted, even though they would constitute more than 15 percent of all section 8 assistance in the District.

Before it was amended in 1987, the act provided that assistance payments (certificates) could not be attached to a structure unless (1) the

HUD Secretary and the local public housing agency approved and (2) the owner agreed to rehabilitate the structure with funds other than Chapter 8 assistance. Under this provision, if both the public housing agency and the Secretary agreed, all section 8 certificates in a jurisdiction could have been attached to qualifying buildings.

The 1987 amendment retained that provision but added the following at the end:

> ". . .except that the Secretary shall permit the public housing agency to approve such attachment with respect to not more than 15 percent of the assistance provided by the public housing agency if the requirements of clause (ii) are met." [Clause (ii) refers to the private funding requirement.]

We interpret the amending language to mean that a public housing agency can allocate up to 15 percent of section 8 assistance as project-based assistance on its own (without HUD's approval). Because there is no other limitation, additional section 8 assistance could be project-based under the pre-existing authority as long as HUD also approved and private financing was secured.

This interpretation is consistent with the purpose of the 1987 amendment. According to the House Report [H.R. Rep. No. 122, 100th Cong., 1st Sess. 33 (1987)], the express purpose of the amendment was to facilitate the use of project-based assistance. Construing the provision as an absolute limitation would contradict that purpose. Moreover, the language itself does not support interpreting this as an absolute limit. The final phrase of the amendment ("if the requirements of clause (ii) are met") would be redundant under such an interpretation because non Chapter 8 funding was already an absolute requirement before the 1987 amendment was added.

In providing conditional approval to the District's sale plan, HUD has indicated its willingness to approve the requested project-based certificates for Kenilworth-Parkside. HUD will have the opportunity to provide official approval once DPAH formally applies for the project-based assistance. Assuming the HUD Secretary or designee approves the application, there would be no statutory limit on the number of project-based certificates that could be provided to Kenilworth-Parkside.

Kenilworth-Parkside Transaction May Be Subject to Local Selection Procedures for Project-Based Assistance

HUD's January 1989 interim regulations also require that local public housing agencies develop and publish procedures and criteria for selecting units to receive project-based assistance.

According to HUD's Special Assistant for Tenant Management and Urban Homesteading (Assistant for Tenant Management), HUD expects DPAH to develop the required selection procedures and subject Kenilworth-Parkside to those procedures before it applies for the project-based assistance. If DPAH were to subject Kenilworth-Parkside to the required selection procedures, DPAH would most likely place it at or near the top of the selection list. The interim regulations provide guidance on the selection criteria that should be used. One item in the interim regulations encourages public housing agencies to give preference to limited equity cooperatives as recipients of project-based aid. When the units are ultimately resold to the residents, Kenilworth-Parkside will be operated as a limited equity cooperative. This factor should operate in favor of its selection. As of September 1989, DPAH had not developed its procedures for selecting recipients of project-based assistance nor had it formally applied to HUD for project-based assistance at Kenilworth-Parkside.

To avoid cumbersome administrative procedures required to reserve certificates, the Assistant for Tenant Management advised DPAH to defer its application until the fiscal year in which the certificates will actually be used. For Kenilworth-Parkside, that would be 1991. He cautioned, however, that there may not be new section 8 certificates available in fiscal year 1991. Moreover, HUD did not request budget authority for new certificates in its fiscal year 1990 budget. According to the Assistant for Tenant Management, if section 8 certificates are not available when needed, HUD could provide vouchers instead. The disadvantage of this form of subsidy is that vouchers cannot be attached to the property, and thus they would provide a less certain stream of revenue to Kenilworth-Parkside during the financially critical period immediately following the sale.

Replacement Plan Not Yet Finalized

The 1987 act that authorized the sale of public housing to qualifying RMCS also requires replacement of public housing units sold. One of the specified conditions for such sales is that the public housing authority must certify that within 30 months of the sale it will implement a plan to replace 100 percent of the sold units with new construction, new acquisitions, or vacant units that have been rehabilitated.

Alternatively, the purchasing RMC may fulfill the replacement requirement by acquiring any nonpublically owned, decent, and affordable housing units and operating them as rental housing subject to tenant income and rent limitations comparable to the limitations applicable to public housing.

The District proposed a replacement plan as part of the sale plan it submitted to HUD for approval on October 10, 1988. It proposed to replace the 464 Kenilworth-Parkside units by rehabilitating a total of 486 vacant public housing units located at four properties. (See table IV.1.)

Table IV.1: Replacement Units for Kenilworth-Parkside Originally Proposed by the District

Property name	Location	Number of Units
Arthur Capper	1011 7th St. SE	80
Arthur Capper	625 K St. SE	73
Ft. Dupont Dwellings	332 Ridge St. SE	192
James Apartments	1425 N St. NW	141
Total units		**486**

HUD, however, rejected as replacements the 80 Arthur Capper units located at 1011 7th St. SE. In its October 25, 1988, letter of conditional approval of the purchase plan, HUD stated that the District must find suitable alternatives for the rejected units and further stipulated that all replacements must be complete within 6 years of transfer of title to the Kenilworth-Parkside RMC. HUD's position is that the 30-month time period in the act refers to starting implementation of the replacement plan, not completion of the replacement units.

HUD officials who reviewed the replacement plan said they rejected the 80 Arthur Capper units because the District had committed funds to rehabilitating these units and had actually begun work before identifying them as replacements. As noted in the replacement plan, the District also had committed funds to rehabilitating the 73 Arthur Capper units at 625 K St., SE and the 141 units at the James Apartments. HUD accepted these as replacements because rehabilitation work had not actually begun.

We discussed these criteria with HUD's Special Assistant for Tenant Management and Urban Homesteading. (This individual was not with HUD when it reviewed the replacement plan.) He believed the distinction between committing funds versus starting rehabilitation work was unclear, and he informally said that HUD would formulate consistent criteria for evaluating replacement plans in future public housing sales.

In March 1989 the Administrator for Housing Management in the District's Department of Public and Assisted Housing provided us a draft letter to HUD proposing to substitute 80 units at the Valley Green property for the rejected Arthur Capper units. However, as of September 1989, DPAH had not officially recommended alternative replacement units. A September 15, 1989, draft memorandum of agreement being negotiated between HUD and DPAH contained a requirement that DPAH submit its revised plan to HUD by October 31, 1989.

After drafting the original replacement plan, DPAH reassessed the Fort Dupont property and concluded that it may be able to provide up to 270 replacement units instead of the 192 specified in the replacement plan. The change resulted from a reevaluation of four engineering studies of soil stability problems at the site that DPAH commissioned during the period 1982 through 1987. The problem had resulted in major structural damage that caused the vacating of 19 of the property's 27 buildings—196 units in all. The studies were conducted to recommend ways of returning the property to service.

Each of the studies concluded that the soil was unsuitable to support the existing buildings because of their age and weight. (The development was built in 1939 by the military and consists of townhouses and walk-up apartments.) Each study recommended that all or some of the existing buildings be demolished and replaced with alternative buildings featuring new, lighter weight materials and more modern structural support systems. When DPAH prepared the replacement plan it assumed that 192 of the existing units would be rehabilitated. According to its Administrator for Development and Modernization, DPAH believes it now can provide up to 270 new units at the site by demolishing existing buildings and building new ones.

Financial Projections

As you requested, we reviewed the analyses completed by Dennis Eisen and Associates, a subcontractor to the National Center for Neighborhood Enterprise under its contract with DPAH to provide technical assistance to the Kenilworth-Parkside RMC. Under the contract, Eisen and Associates assessed various aspects of the feasibility of privatization of the Kenilworth-Parkside property. Among other things, Eisen and Associates:

- Developed financial proforma statements showing projected receipts and expenditures over a 20-year period.
- Assessed the financial and social program resources necessary for KPRMC's long-term self-sufficiency and viability as a community. These include such items as funds from outside sources to support day care and job training and loans from private sector sources to finance improvements to the complex above the standard allowed by the federal CIAP funding (see app. II).
- Analyzed the need for project-based section 8 assistance required to support the property during the first 5 years.

In accomplishing the first task, Eisen and Associates developed financial projections on the basis of various assumptions. First, it assumed an average annual family-adjusted gross income of $10,200. This is consistent with the average income of tenants currently living in the project. Tenant incomes were assumed to increase 6 percent a year over the 20-year period. Second, it assumed that each family would pay 30 percent of its income for rent. In this calculation, the firm factored in a vacancy rate of 5 percent and a sliding scale noncollection rate beginning at 25 percent and stabilizing at 7.5 percent after 4 years. Third, the firm assumed a section 8 subsidy starting at $1.75 million and increasing to $1.97 million in 5 years. The amount of section 8 subsidy shown in the first year of RMC ownership was calculated on the basis of 300 section 8 certificates and a 5-percent vacancy rate. This amount was indexed for inflation. Fourth, the operating expenses were based on historical data and inflated by 4 percent a year. Fifth, a debt service was calculated to represent the portion of remaining cash flow to be used for the repayment of funds borrowed to finance an amenities package (see app. II). Sixth, the other expenses represent the portion of remaining cash flow that could be used for funding social services or other expenses such as real estate taxes. Seventh, the reserve column, which is made up of surpluses shown in the previous column, is invested at 8 percent a year. As shown in table IV.2, the project is self-perpetuating if the assumptions hold true.

Table IV.2: Kenilworth-Parkside Financial Projections

Year	Annual income	Tenant payments	Section 8 subsidy	Total rents	Operating expenses	Debt service	Other expenses	Surplus (+/-)	Reserve fund
1	$10,200	$1,011,636	$1,750,178	$2,761,814	$1,720,000	$208,233	$41,767	$791,814	$791,814
2	10,812	1,143,823	1,802,743	2,946,566	1,788,800	208,233	41,767	907,766	1,762,925
3	11,461	1,288,231	1,856,364	3,144,595	1,860,352	208,233	41,767	1,034,243	2,938,201
4	12,148	1,445,849	1,911,020	3,356,870	1,934,766	208,233	41,767	1,172,104	4,345,361
5	12,877	1,575,172	1,966,688	3,541,860	2,012,156	208,233	41,767	1,279,704	5,972,694
6	13,650	1,669,683	0	1,669,683	2,092,642	208,233	41,767	(672,960)	5,777,549
7	14,469	1,769,863	0	1,769,863	2,176,348	208,233	41,767	(656,485)	5,583,268
8	15,337	1,876,055	0	1,876,055	2,263,402	208,233	41,767	(637,347)	5,392,583
9	16,257	1,988,618	0	1,988,618	2,353,938	208,233	41,767	(615,320)	5,208,671
10	17,233	2,107,935	0	2,107,935	2,448,095	208,233	41,767	(590,160)	5,035,204
11	18,267	2,234,411	0	2,234,411	2,546,019	208,233	41,767	(561,608)	4,876,413
12	19,363	2,368,476	0	2,368,476	2,647,860	208,233	41,767	(529,384)	4,737,142
13	20,524	2,510,584	0	2,510,584	2,753,774	208,233	41,767	(493,190)	4,622,923
14	21,756	2,661,219	0	2,661,219	2,863,925	208,233	41,767	(452,706)	4,540,051
15	23,061	2,820,892	0	2,820,892	2,978,482	208,233	41,767	(407,590)	4,495,665
16	24,445	2,990,145	0	2,990,145	3,097,621	208,233	41,767	(357,476)	4,497,843
17	25,912	3,169,553	0	3,169,553	3,221,525	208,233	41,767	(301,972)	4,555,699
18	27,466	3,359,726	0	3,359,726	3,350,386	208,233	41,767	(240,660)	4,679,495
19	29,114	3,561,310	0	3,561,310	3,484,401	208,233	41,767	(173,092)	4,880,763
20	30,861	3,774,988	0	3,774,988	3,623,777	208,233	41,767	(98,790)	5,172,435

We reviewed the assumptions underlying financial projections for the period following the sale to determine whether they are realistic and reflect the full costs and value of the property. We discussed the analysis with experts who generally agreed that the financial proformas developed by Eisen and Associates are reasonable, if the assumptions made in them are valid. However, four independent experts and DPAH believe the assumption that tenant income would increase by 6 percent annually was too optimistic. In addition, another expert not only questioned the consultant's use of a 6-percent rate of increase for tenant incomes, but also said that if he were assessing the feasibility of privatizing Kenilworth-Parkside, he would inflate both incomes and expenses at the general rate of inflation. This way, if the project can be shown to succeed with typical income increases, any extra income will be a bonus to the RMC rather than a necessity.

HUD and a consultant team for the National Center for Neighborhood Enterprise believe the 6-percent annual increase for tenant incomes is actually a conservative estimate, especially when taking into consideration the education, training, social services, and entrepreneurial opportunities planned for the residents. They contend that, as a result, residents will be able to move to higher-paying skilled jobs, secondary family members will be able to join the workforce, residents will have easier access to higher-paying job opportunities due to better transportation and daycare, and residents will declare additional income they are already making. However, if the 6-percent annual income increase is dependent upon additional opportunities, then funding to support them must be available. As shown in table IV.2, Eisen and Associates projects that $41,767 will be available annually to cover all expenses not included in the other categories. Unless funds from outside sources such as federal or private grants can be obtained, the education, training, social services, and entrepreneurial activities would have to come out of the $41,767, as would property taxes. Regarding property taxes, Eisen and Associates suggested a phased approach which it estimated would result in a steady annual cost of $42,120 in years 10 and beyond. However, because details regarding a possible 5-year tax abatement had not been worked out, Eisen and Associates did not factor property tax costs into its financial projections.

Because (1) the long-term success of Kenilworth-Parkside appears contingent upon the ability to raise tenant incomes by 6 percent annually and (2) the supply of funds from within Kenilworth-Parkside's budget to support the education and services to realize this increase appears questionable, we revised the projections by inflating both incomes and expenses at a 5-percent annual rate to determine the effect on project viability. We found that with all other things being equal, the project could not support itself beyond year 13 under this assumption. (See table IV.3.) However, KPRMC could revise its budget to reduce expenses by postponing the addition of amenities to the project. We used a very conservative 5-percent income growth figure because various U.S. Census Bureau income statistics show income growth ranging from 5.3 percent to 7.1 percent annually during the 1980s. Additionally, many forecasters predict a long-term inflation rate of 5 percent. Thus, we inflated operating expenses by 5 percent a year.

Table IV.3: Kenilworth—Parkside Financial Projections Assuming 5-Percent Inflation

Year	Annual income	Tenant payments	Section 8 subsidy	Total rents	Operating expenses	Debt service	Other expenses	Surplus (+/-)	Reserve fund
1	$10,200	$1,011,636	$1,750,178	$2,761,814	$1,720,000	$208,233	$41,767	$791,814	$791,814
2	10,710	1,133,032	1,802,743	2,935,775	1,806,000	208,233	41,767	879,775	1,805,316
3	11,246	1,264,039	1,856,364	3,120,403	1,896,300	208,233	41,767	974,103	3,001,773
4	11,808	1,405,314	1,911,020	3,316,334	1,991,115	208,233	41,767	1,075,219	4,403,152
5	12,398	1,516,568	1,966,688	3,483,256	2,090,671	208,233	41,767	1,142,585	5,989,396
6	13,018	1,592,397	0	1,592,397	2,195,204	208,233	41,767	(852,808)	5,547,516
7	13,699	1,672,016	0	1,672,016	2,304,965	208,233	41,767	(882,948)	5,037,733
8	14,352	1,755,617	0	1,755,617	2,420,213	208,233	41,767	(914,595)	4,452,988
9	15,070	1,843,398	0	1,843,398	2,541,233	208,233	41,767	(947,825)	3,785,576
10	15,824	1,935,568	0	1,935,568	2,668,285	208,233	41,767	(982,717)	3,027,088
11	16,615	2,032,346	0	2,032,346	2,801,699	208,233	41,767	(1,019,352)	2,168,355
12	17,445	2,133,964	0	2,133,964	2,941,784	208,233	41,767	(1,057,820)	1,199,378
13	18,318	2,240,662	0	2,240,662	3,088,873	208,233	41,767	(1,098,211)	109,260
14	19,234	2,352,695	0	2,352,695	3,243,317	208,233	41,767	(1,140,622)	(1,113,870)
15	20,195	2,470,330	0	2,470,330	3,405,482	208,233	41,767	(1,185,153)	(2,482,945)
16	21,205	2,593,846	0	2,593,846	3,575,756	208,233	41,767	(1,231,910)	(4,012,043)
17	22,265	2,723,539	0	2,723,539	3,754,544	208,233	41,767	(1,281,006)	(5,716,493)
18	23,379	2,859,715	0	2,859,715	3,942,272	208,233	41,767	(1,332,556)	(7,612,973)
19	24,548	3,002,701	0	3,002,701	4,139,385	208,233	41,767	(1,386,684)	(9,719,629)
20	25,775	3,152,836	0	3,152,836	4,346,354	208,233	41,767	(1,443,518)	(12,056,199)

In determining the need for section 8 subsidies, Eisen and Associates did not assume that the subsidies would be phased out over the first 5 years. However, the application submitted by the District of Columbia stated that section 8 assistance would be phased out as tenant incomes increased. We were asked to determine how the financial feasibility, costs, and impact on tenants would differ if the section 8 assistance was phased out as indicated in the plan. There are no plans to phase out the section 8 assistance over the first 5 years unless tenant incomes increase to the point that the assistance is not needed. Thus, financial feasibility and impact on tenants would not change as a result of a phase-out. However, cost to the government could decline if fewer certificates are needed. According to the consultant team, the discrepancy between the plan and the application occurred because, in an earlier version of the plan, section 8 assistance was planned to be used and phased out over a 15-year period.

Experts GAO Consulted Regarding Financing Options Available to Resident Management Corporations

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- Gordon Cavanaugh, Attorney
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- David Freed, Housing Consultant
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- Vincent V. Lewis, President
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- Michael Mayer, Program Director
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- Marilyn Melkonian, President
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- Richard Y. Nelson Jr., Executive Director
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- Paul L. Pryde Jr., Chairman[1]
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- A. Bruce Rozet, Chairman
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[1]These individuals or groups are under contract with DPAH to provide technical assistance to KPRMC.

- Robert L. Woodson, President[1]
  David K. Groo, Program Manager
  National Center for Neighborhood Enterprise
  Washington, D.C.

[1]See footnote 1

Comments From the Department of Housing and Urban Development

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410

OFFICE OF THE ASSISTANT SECRETARY
FOR PUBLIC AND INDIAN HOUSING

SEP 7 1989

Mr. John M. Ols, Jr.
Director, Housing and
Community Development Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Ols:

Attached pleased find the Department's comments on GAO's draft report entitled Public Housing: Planned Sale of Kenilworth-Parkside Project Raises Issues for Future Transactions.

The response requests that changes be made to the draft report in order to accurately and fairly represent the Department's activities in approving the sale of Kenilworth-Parkside and in requirements planned for future sales.

Thank you for the opportunity to comment on the draft report.

Sincerely,

Thomas Sherman
Thomas Sherman
Acting General Deputy
Assistant Secretary

COMMENTS ON GAO DRAFT REPORT

September 7, 1989

Public Housing: Planned Kenilworth-Parkside Sale Raises Issues for Future Transactions

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I. Introduction

Overall, we believe GAO has presented a positive and useful report on the sale of Kenilworth-Parkside public housing project and the corresponding envisioned social and economic benefits to the residents of that community. Working in a cooperative manner with GAO, the Department has incorporated into its operations the report's recommendations, as explained below, in order to make a good project even better at Kenilworth-Parkside.

The Department is strongly committed to the development of homeownership opportunities for low-income families residing in public housing. As Secretary Kemp recently commented, "Public housing can be a tremendous asset for our nation's poor if residents are allowed to buy their own homes." Public housing homeownership sales under section 21 of the U.S. Housing Act of 1937 is an important vehicle in an array of Departmental strategies to empower the poor through community capacity building, economic mainstreaming, resident leadership training and homesteading opportunities. These opportunities extend to cooperative conversion programs in federally assisted, private, multifamily projects and to the efforts of the private, non-profit sector.

Homeownership instills pride, improves neighborhoods, enhances independence, and encourages stable and intact families. The Department looks forward to working with the Congress and interested parties in helping to make the dream of homeownership become a reality for all Americans. The provision of homeownership opportunity and economic empowerment of the poor truly represents a second era of civil rights progress in America.

II. Response to GAO Recommendations

In general we have not commented on items which we are in agreement with and that, in our view, do not need correction. However, two conclusions that we find particularly useful include the GAO's opinion that:

(i) the feasibility of tenants ultimately owning an interest in their unit should be established before the project is sold to the RMC; and

(ii) public housing authorities should have the first right to repurchase the property by satisfying any lien in the event the RMC cannot meet its financial obligations.

GAO's first recommendation that the feasibility of individual ownership should be established before sale to the RMC is a sound and well reasoned recommendation. The PIH homeownership protocol which guides such sales requires this information (copy attached

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as Exhibit A). We discussed this modification with the GAO, and we were told that this change would probably not be reflected in the draft due to report preparation deadlines. In addition, the Department's forthcoming regulation on section 21 of the U.S. Housing Act of 1937 will provide for additional guidance on the expeditious conversion of RMC owned buildings to individual ownership.

See comment 1.

It should be noted that, to some degree, individual feasibility has been taken into account under the analysis of sale to the Kenilworth-Parkside Resident Management Corporation (KPRMC). A resident management corporation, as in a cooperative, is only as financially sound as its individual members and level of outside financial resources such as Section 8 assistance which can be used by both entities. As a result, the proforma contained in the application provides the necessary assurance that, given the current earning characteristics of the project's population, the principal barrier to low-income homeownership -- the ongoing need to adequately meet operating costs -- is sufficiently addressed. Of course, the sales price of individual units or cooperative shares and requisite financing must also be delineated, and this refinement will occur under the cooperative conversion planning underway for Kenilworth-Parkside as discussed in Section III.

GAO's second recommendation that public housing authorities should have the first right to repurchase the property by satisfying any lien in the event the RMC cannot meet its financial obligations is also sound. As noted in the GAO draft report, this provision has been included in the planned sale of Kenilworth-Parkside and is included in the directions for developing a contract of sale. Additionally, the Department concurs with this general recommendation and will incorporate the PHA right to repurchase in its section 21 regulation currently under development.

III. <u>Response to Additional GAO Observations</u>

The Department believes the report has several observations, items short of GAO recommendations, that should be addressed and modified in light of the following additional information:

A. <u>Planning Done for Sale of Units to Tenants</u>

See comment 2.

The report does not adequately represent the phased nature of the approvals over the sale of Kenilworth-Parkside, and the state of work on cooperative conversion for tenants. The Department notes that the sale to Kenilworth-Parkside Resident Management Corporation (KPRMC) in October, 1988, was a conditioned approval which was accompanied by a technical assistance award pursuant to section 21. Kenilworth-Parkside and DPAH are currently utilizing HUD approved technical assistance to aid the residents

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in developing a comprehensive cooperative conversion plan prior to completion of sale. At the time of conditional approval it was understood by all parties that additional time existed, up to one and one-half years, to complete a plan for cooperative conversion. Thus, we believe GAO should note that this technical planning process is currently under development. The Department will approve the final disposition of the property after completion and review of a satisfactory resident homeownership conversion plan submitted by KPRMC and DPAH.

The Department has initiated the development of a Memorandum of Agreement with DPAH, in light of the troubled management conditions at the Authority. These conditions, as noted in the draft report, contributed to the delays in implementation of modernization at Kenilworth-Parkside. HUD will establish performance targets and time-lines for all major facets of the Authority's operations in the MOA. The MOA will stress the need to complete modernization efforts in a timely and cost-effective manner and, thus, assist in meeting the timing requirements of a cooperative conversion.

The Office of Resident Initiatives (ORI), created by the Secretary to provide technical assistance pursuant to the provisions of the Housing and Community Development Act of 1987, has also initiated technical planning and support for the Kenilworth-Parkside project. ORI has conducted meetings with Kenilworth-Parkside and DPAH, and recommended that the actual cooperative conversion begin immediately instead of the originally proposed five year waiting period.

B. <u>Assumptions Used for Financial Projections</u>

See comment 3.

The report presents an alternative projection for revenues and expenses of the project using a five percent annual increase. The Department believes that it is important to note that, even under this alternative, project expenses can be met with gross operating income. The Department is not satisfied that adequate justification for additional mortgage debt for an amenities package, beyond the need of expending $1,000 per unit for project-basing requirements, has been provided. The Department has recommended that Kenilworth-Parkside exclude project amenities.

In any event, any mortgage financing or other encumbrances on the property would, under the Department's proposed section 21 regulation, have to be approved, in advance, by the Secretary. Should KPRMC apply for such approval, the Department will conduct an additional detailed financial analysis to ensure that the project remains affordable under economic conditions existing and projected at that time.

See comment 4.

The Department believes that KPRMC's assumed six percent (6.00%) income growth projection is in fact conservative, in light

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See comment 5

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of the aggressive entrepreneurial and vocational development programs already underway at Kenilworth-Parkside. The Department is strongly committed to supporting such job creation and economic mainstreaming endeavors of low-income resident organizations seeking to provide homeownership opportunities.

C. Federal Funds to Finance Social and Economic Development Programs Kenilworth-Parkside

The draft report provides the mistaken impression that the only funds available for employment and social improvements for the residents must be derived from the project's proforma. The opportunity for a highly motivated, non-profit RMC to receive other foundation, governmental and private funds are far greater than if the residents remained unorganized. In the case of Kenilworth-Parkside, significant funding has been granted to the KPRMC from the U.S. Urban Mass Transit Administration, the AMOCO Foundation, and the District of Columbia for both employment enhancement and social development programs.

The Department has extensive efforts underway to attract both additional federal and private sector funding for resident improvement efforts in public housing. The KPRMC has an exemplary record in attracting such funds and the report should, based on KPRMC's experience, provide a more realistic view on availability of additional funding for social and economic development programs.

The report should also note that, aside from funding, important social dynamics are created when a new set of individual incentives in the form of empowerment and homeownership is provided to low-income persons. This change in and of itself can lead to real benefits in economic and social development.

IV. Additional Corrections and Observations

The Department discovered several references within the report that need correction. These include the following:

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See comment 6.

- The Department notes that section 21 sales are in a very early demonstration phase, and that many of the scenarios raised by GAO will in fact never occur.

See comment 7.

- The risks of financial mismanagement in the program are diminished by an aggressive Departmental plan in process to provide financial management training and control mechanisms for all resident management corporations. These measures include: {i} development of additional program regulations and program handbook procedures; {ii} financial management training and technical assistance; and, {iii} active program oversight by HUD personnel.

See comment 8.

- Regarding the sale of the Carr Square Village public housing project, an immediate sale and homesteading of the land to the residents through a cooperative is planned.

See comment 9.

- The benefits of job training, reduced crime and other social improvements under resident management, while difficult to measure, are nevertheless real. We recommend that GAO, through opinion survey of the KPRMC and the District of Columbia provide some conclusions in this regard. The GAO's assertion that improvements to the lives of Kenilworth-Parkside residents might have occurred without their organization and work under the RMC is highly questionable.

See comment 10.

- The report calculates that the total District of Columbia payments for Kenilworth-Parkside, net of rental income, totals $1,415,192 for FY 1987 and $1,483,509 for FY 1988. The Department concurs that these payments are derived from federal operating subsidy. The Department also believes that significant additional federal funds attributable to Kenilworth-Parkside are used by DPAH to cover general administrative and overhead costs.

See comment 11.

- The comparison of modernization costs in the report and accompanying chart should be modified to reflect projects in the District of Columbia, as done in the earlier preliminary GAO findings. Such local comparisons provide a more accurate picture of the problems in contracting costs (PHA-wide) in troubled authorities (chart is attached as Exhibit B).

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See comment 12.

- The citation that a former HUD Undersecretary supported CIAP funding in response to pressure by KPRMC is misleading. In fact, the HUD Undersecretary and other officials strongly supported the CIAP award as a means of demonstrating Department policy to encourage successful resident management programs. This reference should be modified in the final report.

See comment 13.

- The question of whether additional modernization funds are needed for Kenilworth-Parkside is under current review by the Department. No final decision has been made regarding this issue.

V. Recommended Additions to Final GAO Report

See comment 14.

The following describes recommendations by the Department that should be added to the GAO final report to ensure fair representation of all issues facing future transactions under the authority of section 21:

A. Need to Extend 1990 Sunset Date

The 1990 sunset date on section 21 presents a major roadblock to further sales under this particular statutory authority. It is the Department's experience that homeownership demonstrations involving cooperative conversions require a period of up to three years for technical assistance, board development, financing and other legal and technical facets required to implement multifamily homeownership. In addition, the provision that resident management corporations must first successfully manage the public housing development for a minimum of three years further limits the potential for this authority.

Therefore, the Department recommends removal of the 1990 sunset along with a provision requiring a report to Congress within three years following the sunset removal.

B. Need to Broaden Replacement Plan Options

The current one-for-one replacement plan is unnecessarily rigid, particularly in light of the fact that housing sold under this authority effectively remains in the low-income inventory due to limited equity recapture and resale restrictions limiting sales to low-income residents.

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In light of this condition that stock sold under section 21 be retained in perpetuity as low-income housing, the Department recommends allowing use of section 8 vouchers and certificates, as well as privately built non-profit and for-profit housing that is dedicated for low-income use for a substantial time period, such as housing built in conjunction with low-income housing tax credit, as replacement components in addition to the current allowances.

C. Additional Information

The Department wishes to reiterate the Administration's support for a FY 1990 appropriation of $44,000,000 for grants to states, units of general local government, and private non-profit organizations to assist in providing homeownership opportunities for lower income persons. The development of public housing homeownership would be an eligible item for funding under this appropriation. We urge the United States Congress to act favorably on this appropriation to increase the housing opportunities available to low-income families.

The Department also wishes to provide the attached additional background material (see Exhibit C), The Washington Post article dated July 30, 1989, as reference information for inclusion in the final GAO report.

We have included the Department of Housing and Urban Development's comments on our recommendations in the basic letter of this report. The following are GAO's responses to more detailed comments in HUD's letter dated September 7, 1989.

GAO Comments

1. The financial analysis referred to by HUD is discussed in appendix IV. It showed that, on the whole, if certain assumptions prove valid, the RMC can meet the property's operating costs. However, the analysis assumed that tenants would pay 30 percent of their incomes for rent, and that rental assistance or operating reserves would pay for the remainder of the property's expenses. Unless the Kenilworth-Parkside RMC plans for individual owners to continue to pay 30 percent of their incomes for rent, the analysis does not demonstrate the feasibility of individual tenant ownership.

2. We believe our draft report adequately recognized that HUD expects further planning to be complete before Kenilworth-Parkside is sold to the RMC. We also discuss establishment of the Office of Resident Initiatives. However, we have updated the report to include information on the development of a Memorandum of Agreement with DPAH.

3. We clarified appendix IV to indicate that KPRMC probably could reduce some of its expenses by delaying desired amenities. In appendix II, we added that HUD recommended that Kenilworth-Parkside exclude project amenities because HUD does not believe adequate justification has been provided. We also added information about HUD's proposal to require that any mortgage financing or other encumbrances be approved in advance by HUD.

4. We added HUD's position to the final report (app. IV).

5. We revised appendix IV to clarify that funding may be available from outside sources to finance employment and social programs. We do not doubt KPRMC's abilities to attract such funding; however, it was not within the scope of our review to predict how well KPRMC might do in attracting such funding. It also was beyond the scope of our review to assess the potential impact of social dynamics created by incentives provided to low-income persons.

6. While we agree with HUD that it is too early to tell which of the scenarios we outlined in appendix II will actually occur, we believe that the

scenarios are reasonable. In fact, two of the scenarios, using the property as collateral for mortgage loans and using tax credits, have already been considered by the Kenilworth-Parkside and Carr Square Village RMCs, respectively.

7. While our report discusses the potential consequences of financial mismanagement by an RMC, it does not attempt to assess the likelihood of such mismanagement.

8. We have updated appendix II to note this change in plans for the Carr Square Village public housing development.

9. The survey suggested is beyond the scope of our review. We critiqued the Coopers and Lybrand study from strictly an analytical standpoint. Analytically, there is no way to conclusively demonstrate that the increase in services at the site was attributable to resident management. However, we added a statement to appendix III to clarify that HUD believes it is safe to assume that the benefits are due to resident management.

10. Our intent was to show the actual subsidy that the District's Department of Public and Assisted Housing provided to the Kenilworth-Parkside RMC in fiscal years 1987 and 1988. By presenting the amount of subsidy that actually passed through to the RMC, we are not questioning whether additional federal funds were used by DPAH to cover its general administrative and overhead costs associated with Kenilworth-Parkside.

11. DPAH provided us with an average modernization cost per unit for its projects. This figure includes HUD and District funds. We have included DPAH's estimate in appendix III of the final report.

12. We revised the statement in appendix III of the final report to reflect HUD's interpretation.

13. HUD subsequently decided to provide Kenilworth-Parkside about $1.8 million in fiscal year 1989 CIAP funds. We updated appendix III to reflect this.

14. We have not added this information to our final report because it relates to issues beyond the scope of this review. Also, we have not reprinted the exhibits accompanying HUD's comments.

Comments From the District of Columbia's Department of Public and Assisted Housing

Note GAO comments supplementing those in the report text appear at the end of this appendix.

GOVERNMENT OF THE DISTRICT OF COLUMBIA
DEPARTMENT OF PUBLIC AND ASSISTED HOUSING
1133 NORTH CAPITOL STREET NORTHEAST
WASHINGTON D C 20002-7599

SEP 5 1989

REPLY TO

Mr. John M. Ols
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Ols:

Thank you for the opportunity to comment on GAO's draft report on the planned Kenilworth/Parkside sale. The report raises some important issues that we at the Department of Public and Assisted Housing (DPAH) also believe will affect the viability and success of not only the Kenilworth project, but other resident homeownership ventures as well.

The following are our comments on these issues:

1. Initial Assessment of Feasibility of Ownership Should be Completed Before Title to Property is Transferred

We agree that there should be some initial preliminary assessment of affordability to ensure homeownership for residents before sale to the RMC.

DPAH is committed to a successful sale and turnover of the Kenilworth units to the RMC. One of our key concerns for any homeownership activity is the affordability of units for residents. We too believe residents should be protected against unaffordable operating costs.

HUD must be prepared to provide the funding needed for such assessments. In addition, in terms of resident protection it is crucial that requirements for technical assistance and training for the transition to homeownership before and after sale be requested as part of any HUD regulations. The 1987 Housing Act requires such training as the Secretary determines to be necessary to prepare families for homeownership.

2. Legality of Capital Producing Arrangement

DPAH expresses caution over the use of the RMC property as collateral unless there is some assurance that the property will be returned to low income use.

We concur with GAO that a standard provision should be included to allow the PHA the first right of purchase. Such action would ensure the return of this property to the public housing stock to serve the low-income and allow other opportunities for resident participation.

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Homeownership opportunities are a way of ensuring upward mobility for low-income residents, particularly the very low-income residents of public housing. Congress, through the 1987 Housing legislation, expressed a deep concern to ensure these projects are maintained for low-income usage by requiring conditions of resale only to other low-income families who meet federal guidelines for eligibility. We believe further language may be needed through the statute to extend this condition to any financial arrangements made with the property.

The other concept of selling off pieces of the property for further development we believe is also contrary to congressional intent. We concur with the report's interpretation of the law that "property" means land or building.

However, if there is to be a provision to allow sale of underdeveloped land. We agree it must be clearly mandated by law that such land be used to serve the same low income population as required under federal guidelines. HUD regulations that include such a provision would only be in keeping with the law.

3. Cost to Modernize Units

The report seems to represent some contradictions on the cost of modernizing DPAH units. The chart on page 42 indicates an average cost in the district of approximately $30,000. Yet, several times throughout the report it states that DPAH officials have cited project renovation costs for other projects either in the same range or higher than Kenilworth.

See comment 1.

The average costs for modernizing units at DPAH are $54,389. This change should be reflected in your charts.

In addition, your national mod costs in this chart average about $10,000. It might be useful to note that this average includes housing factors such as age of building, conditions, housing and rehab costs in an area, etc. In addition, you are combining modernization costs for many very small PHA's with costs for larger PHA's. The factors affecting the two are very different. According to a NAHRO survey, there are other cities in the country that approximate DPAH mod costs. As example, NAHRO reports the following costs for these cities:

Newark - $35,000
Boston - $60,000
Baltimore - $50,000
Atlanta - $26,000
Detroit - $17,000

The significance of such a variance is important in understanding the total mod dollars needed for a given project. High mod costs will definitely deplete a limited pot.

-3-

See comment 2

The GAO report highlights that there were not sufficient funds to complete the total modernization of all Kenilworth units. The report noted that HUD indicated it would decline DPAH's request for additional funding to complete the 123 additional Kenilworth units and that funding must be sought elsewhere. Since this report, however, HUD has requested that the District submit another application for the funding of the remaining units.

4. Financial Projections

See comment 3

In terms of project affordability for residents, we agree that a 6% projection of resident income increase yearly is high. Such projections are liberal even assuming all families are working. In addition, as the consultant indicates, extensive educational, job training, and social service assistance would be needed to maintain such projections and guarantee steady employment: We agree that these services should be funded as part of the homeownership initiative to ensure success for these low-income families.

We hope these comments are useful as you finalize your report. We stand willing to help in any way that we can.

If there are any comments or requests for additional support, please let us know.

Sincerely,

Roland L. Turpin
Acting Director

We have included the Department of Public and Assisted Housing (DPAH's) comments on our recommendations in the basic letter of this report. The following are GAO's responses to more detailed comments in DPAH's letter dated September 5, 1989.

GAO Comments

1. The figure of approximately $30,000 shown in the chart is the average per-unit cost of HUD-funded (CIAP) modernization projects in the District. We have updated appendix III in the final report to show the $54,389 average per-unit modernization cost for all modernization projects (both HUD and District funded) in lieu of the per-unit modernization costs for specific projects that appeared in the draft report. We believe our report adequately recognizes that the average costs do not take into account differences in the scope of work performed, which is largely determined by the condition of the facilities.

2. We have updated appendix III to reflect HUD's position as of September 1989.

3. We added DPAH's position on the projected 6-percent income increase to appendix IV.

Comments From the Kenilworth-Parkside Resident Management Corporation

Note GAO comments supplementing those in the report text appear at the end of this appendix.

4500 QUARLES STREET, N.E.
WASHINGTON, D.C. 20019
(202) 399-4477

September 1, 1989

John M. Ols, Jr.
Director, Housing and
Community Development Issues
United States General Accounting Office
Washington, DC 20548

Dear Mr. Ols:

Thank you for providing me with a draft copy of the General Accounting Office (GAO) proposed report entitled Public Housing: Planned Sale of Kenilworth-Parkside Project Raises Issues for Future Transactions (GAO/RCED-89-201). We have reviewed the draft document and offer the following analyses and comments prior to its submission to Senator Alan Cranston (Chairman,Subcommittee on Housing and Urban Affairs, Committee on Banking, Housing and Urban Affairs - United States Senate) and its issuance in final form.

At the outset, we shall focus our assessment on the proposed letter to Senator Cranston, particularly since the letter is, in major part, a summary of the report.

See comment 1.

First, there is an excessive use of the word project. Perhaps, GAO should reorient its thinking to consider public housing complexes as residential properties comprised of low-income Americans. Therefore, we suggest the use of the following term: public housing property rather than project.

Second, we are in complete agreement with GAO's analysis that insufficient technical planning has taken place with respect to the proposed sale of individual units to residents of Kenilworth/Parkside (K/P). Indeed, considerable thought should be given to resolving this issue. However, if GAO strongly believes and, in fact, recommends to the Congress that the feasibility of resident ownership should be completed prior to the transfer of title of a public housing property to a Resident Management Corporation (RMC), then we shall insist that the mentioned assessment should be completed in a timely manner. Its lack of completion should not delay the proper transfer of title to the RMC. Moreover, this recommendation does not apply to K/P.

See comment 2.

Third, please note the first sentence on page four regarding the comprehensive modernization of K/P. The sentence does not adequately reflect the record - a record of unconscionable delays, bureaucratic inertia, egregious mishaps by federal and municipal housing officials, shoddy work and an interminably slow pace of modernization by the general contractor. All of these factors contribute to undue hardships on the part of residents and to inefficiencies by the RMC. Admittedly uncertainties abound; however, the reasons for such should be made clear to any reader of your report.

See comment 3.

Fourth, K/P does not plan to obtain financing for approximately $1.8 million to add innumerable amenities to the complex, amenities that were not included in the "extensive federally-funded modernization." Instead, officers of K/P submitted a wish list of items to their consultants to ascertain the financial obligations attendant to the list. Your report should reflect this important distinction!

See comment 4.

Fifth, there is a paternalistic tone to certain parts of the text, particularly in the analysis of affordable operating costs and the possibility of financial mismanagement by the RMC. Moreover, the report is uncharacteristically silent on certain relevant issues that should have merited the immediate attention of GAO.

- For example, to what extent, if any, are there inefficiencies of scale, exorbitant costs of comprehensive modernization and undue hardships borne by residents of public housing that can be traced to the policies, regulations, guidelines, actions and inactions of the Housing Departments of federal and municipal governments - the Department of Housing and Urban Development (HUD) and the Department of Public and Assisted Housing (DPAH)?

- To what extent, if any, do these actions and inactions limit home ownership opportunities for myriad residents of public housing and retard the progressive development of RMCs?

Sixth, we concur with GAO's analysis of capital-producing arrangements for RMCs, particularly since they are limited, generally, by the creativity of the principals involved. There will be instances when an RMC, after purchasing its real property, will decide to convey an equity interest to a limited partner or partners in order for the partners to qualify for tax credits.

See comment 5.

Unfortunately, since Congress enacted the tax credit program for low-income housing production, it has been the source, in innumerable instances, of abuse and scandal. For example,

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there have been windfall profits through tax credit syndications; certain developers have inflated their rehabilitation costs and have generated exorbitant fees at the expense of quality renovation and the future safety of residents.

HUD officials have admitted their concerns and have acknowledged the Department's shortcomings. In light of specific testimony by the HUD Inspector General before the Congress and the recent statements of HUD Secretary Jack Kemp, GAO should have had a substantive analysis on this point, one that could provide insight on this issue of national importance. We recommend such. Further, we recommend that an RMC should make every effort to obtain funds for modernization of its property from the grant funds of HUD, rather than jeopardize its future through the machinations of limited partnerships and investment tax credits.

Seventh, we agree that the public housing authority should be given the first right to repurchase the property (if the RMC cannot meet certain financial obligations) to ensure that the units remain available for low-income Americans.

There are other points, however, worthy of consideration-points that are a pertinent part of the report rather than the cover letter to Senator Cranston.

See comment 6.

- Note the last sentence on Page 17, a sentence that ends at the top of page 18. We disagree with the DPAH assessment that as of June 1989, the modernization of K/P was about 11% behind schedule. Instead, the renovation was over 35% behind schedule, since Phase I (132 units) should have been completed by June 1989 and, in addition, work should have started on Phase III.

See comment 7.

- Although K/P is exploring the legal format of a cooperative arrangement with its consultants, a decision has not been finalized by officers of the corporation.

See comment 8.

- Please note Figure III.1 (Public Modernization Per-Unit Cost Comparison) on Page 42. We believe the graph is an inaccurate and superficial portrayal; indeed, several public housing properties in the District have exceeded or will exceed K/P's per unit cost: Arthur Capper ($92,335); Greenleaf ($60,326); 1200 Delaware SW ($69,006); Ellen Wilson ($72,000); and Frontiers ($79,248); etc. Without an asterisk and a clear and definitive explanation of the principal factors that influence per unit cost, the graph is a major disservice to the report.

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See comment 9.

We generally concur, as stated above, with the GAO report. However, GAO's omissions limit the report's perspective. For example, there is a paucity of data and analysis of quantifiable conditions of public housing in Washington, and the devastating impact of these conditions on residents. Not only is our community faced with the twin issues of affordability and poor housing stock, but pathologies abound; these deeply rooted pathologies demoralize the spirit, limit expectations, retard development, spread self-hatred and promote early death.

In the midst of this urban crisis, K/P has generated progressive programs of community need - drug and alcohol abuse prevention, college scholarships for youth, job training and employment, day care and latch key, entrepreneurial activities, recreational services, etc. Admittedly, it is difficult to quantify the human rewards that are inextricably linked to the mentioned programs, however, our meritorious efforts and qualitative actions have brought us national and international acclaim.

Our actions and programs should have been a major part of the assessment of the corporation. Indeed, they are as pertinent as the assessment of K/P's per unit cost. Therefore, we believe that the Congress and the American people should have been provided a more comprehensive perspective of our activities.

Sincerely,

Kimi O. Gray

Kimi O. Gray
Chairperson

- 4 -

**The National Association
of
Resident Management Corporations**

4500 Quarles Street, N.E., Washington, D.C. 20019 (202) 396-2327

September 1, 1989

John M. Ols, Jr.
Director, Housing and
Community Development Issues
United States General Accounting Office
Washington, DC 20548

Dear Mr. Ols:

We have reviewed a draft copy of the General Accounting Office (GAO) proposed report entitled Public Housing: Planned Sale of Kenilworth-Parkside Project Raises Issues for Future Transactions (GAO/RCED-89-201). Indeed, we are appreciative to have this opportunity to comment on behalf of the National Association of Resident Management Corporations (NARMC).

Please note, however, that we fully concur with the comments, analyses, and recommendations of the Kenilworth/Parkside Resident Management Corporation (KPRMC). Kenilworth/Parkside's comments were of a substantive nature and were presented in a cogent and persuasive manner. Indeed, KPRMC demonstrated in its comments a keen knowledge of public housing policy at the national level; in addition, the comments reflected a clear understanding of the tragic circumstances of certain residents who currently live in public housing at the local level. Therefore, as stated above, our national organization supports the written comments of KPRMC.

Sincerely,

Kim O. Gray

Kimi O. Gray
Chairperson

We have noted KPRMC's agreement with our recommendations in the basic letter of this report. The following are GAO's responses to more detailed comments in KPRMC's letter dated September 1, 1989.

GAO Comments

1. We have substituted the terms "property" and "development" in the final report.

2. The report segment to which KPRMC refers was intended to provide the status of the modernization effort as it relates to the actual transfer of title to the RMC. Delays in modernization work are also discussed in appendix III.

3. We revised the final report to reflect KPRMC's current plans.

4. The scope of our review was limited to certain specific objectives and was not intended to be a comprehensive review of public housing management, modernization, or home ownership programs.

5. Again, the issue raised by KPRMC is beyond the scope of our review.

6. We updated the report to reflect the status of construction as of September 1989.

7. We have revised our report to make it clear that no final decision has been made regarding the establishment of a cooperative.

8. We believe the figure accurately compares per-unit modernization costs financed by HUD and that our report adequacy discloses the limitations of per-unit cost comparisons. We have, however, revised our final report to more clearly show that Kenilworth-Parkside's modernization costs are in line with the District average when District and HUD funds are considered.

9. As previously stated, we were asked to pursue certain specific objectives related to the planned transfer of ownership of Kenilworth-Parkside to the KPRMC. These objectives were designed to meet specific information needs of the requester. Our review was not intended to be a comprehensive evaluation of the RMC's performance nor of public housing conditions in Washington, D.C. While we did not attempt to independently assess the benefits attributable to the RMC, our draft report did attempt to recognize the benefit as seen by District of Columbia public

housing officials. We have supplemented this in the final report with the accomplishments as seen by the RMC.

Comments From the National Center for Neighborhood Enterprise

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

National Center for Neighborhood Enterprise
1367 Connecticut Avenue, N.W., Washington, D.C. 20036 / (202) 331-1103

August 28, 1989

Mr. John M. Ols, Jr.
Director, Housing and
Community Development Issues
Resources, Community, and
Economic Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Ols:

I appreciate you sending NCNE a copy of GAO's proposed report entitled Public Housing: Planned Sale of Kenilworth-Parkside Project Raises Issues for Future Transactions (GAO/RCED-89-201) to review. The analysis done by GAO was both thoughtful and constructive, while the issues raised were appropriately presented. The criticism that the sale of units to tenants through a housing cooperative has not yet received sufficient attention by NCNE and its consultants is valid.

With regard to GAO's coverage of project amenities and economic development, NCNE would ask GAO to opt for a somewhat different perspective. Points that need to be considered are as follows:

See comment 1.

1) Plans for amenities at Kenilworth-Parkside are not final. Air conditioning will be included. Whether a swimming pool and perhaps other recreational facilities will also be included has not yet been determined. The final decision will depend on a) the best estimate of annual net operating income (i.e. monies with which to cover debt service in financing any amenities) over the first five years after the sale of the project to the resident management corporation, and b) how much net operating income needs to be added to the reserve fund over the first five years to insure self-sufficiency. Air conditioning is important enough to schedule for year 1. Other amenities could be postponed for 3-5 years, if necessary. Also, specific operating expenses linked to any amenities will be identified and taken into account.

2) Economic development funds for transportation, job training, and entrepreneurial opportunities can be obtained from sources other than the property management cash flow for Kenilworth-Parkside. Included would be Federal agencies and private foundations offering grants as well as participating business firms offering subsidies or in-kind contributions. The programs themselves, having few fixed costs, will be administered at whatever level of funding is available. The plan for constructing a licensed kitchen to provide food preparation services would simply have to be postponed, if net operating income does not cover debt service for the required financing.

"Turning Problems Into Opportunities"

Mr. John M. Ols, Jr.
August 28, 1989
Page Two

Again, thank you for giving NCNE a chance to comment on this report. As NCNE and its consultants continue updating and expanding the contents of the homeownership disposition application, the GAO Evaluators are welcome to ask for information at any time.

Sincerely yours,

David K. Groo

David K. Groo
Program Manager

The following are GAO's comments on the National Center for Neighborhood Enterprise's letter dated August 28, 1989. The Center's comments were favorable overall. Through its comments, the Center also provided additional information that we incorporated into the final report.

GAO Comment

1. This comment provides updated information. The information has been incorporated into appendix II of the final report.

Comments From Dennis Eisen and Associates

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

MEMORANDUM

Date: August 24, 1989

To: Susan Beekman

From: Dennis Eisen

Re: GAO report on Kenilworth-Parkside

In keeping with GAO's request for comments on the above-captioned report, I would like to raise the following points:

See comment 1.

1. The GAO report keeps referring to the loan of $1.75 million to be placed at Kenilworth-Parkside only in terms of "recreational facilities and air conditioning" -- overlooking the fact that a significant portion of the loan is to be used for the construction of training facilities and training equipment; e.g., a licensed kitchen to prepare residents for careers in the food preparation industry. Characterizing the loan only in terms of its nontraining components is certainly biased and even misleading to the uninformed reader.

See comment 2.

2. The GAO report disagrees with the Consultants' expectations that family income can increase at the rate of six percent a year at Kenilworth-Parkside, and makes the recommendation that family income be increased strictly in lockstep with the general rate of inflation assumed for operating expenses. The GAO report cites several "experts" who would agree with that.

What this completely overlooks is that the six percent figure used in the Consultants' study is <u>not</u> predicated on annual raises of six percent occurring across the board for Kenilworth-Parkside residents. As was explained during the course of the interviews with GAO staff (and in the technical reports made available to GAO), several things are expected to happen as a result of the job training, day care, transportation, and homeownership efforts:

o A significant number of residents will be able to move from low-paying jobs to much higher-paying ones upon the acquisition of basic skills;

o A significant number of secondary family members will be able to join the work force;

o Residents will have much easier access to those higher-paying job opportunities (through transportation and day care); and

o In order to prove themselves financially capable of purchasing their apartments, a significant number of families will declare the additional income they are already making.

The Consultants' believed (and still do believe) that the net effect of all this will be to see overall income increase substantially over the intermediate and long-term future at Kenilworth-Parkside -- even in the absence of inflationary forces. In this sense, the 6 percent figure was thought to be a very conservative one.

3. The GAO report disagrees with the Consultants' assumption that operating expenses will increase at 4 percent a year over the next two decades, and recommends 5 percent instead. It is to be noted that the Office of Planning within the General Services Administration is using 4 percent for the predicted rate of growth in operating expenses over the next two decades, a figure based on the thousands of buildings owned and hundreds of millions of square feet leased. Granted GSA's data is for office buildings, but there is no reason to suppose any difference for apartments.

See comment 3.

4. The figure of $1.4 million or so cited on page 36 of Appendix III of the GAO report for the operating subsidy received by Kenilworth-Parkside in 1987 and 1988, while technically true, fails to take into account the high overhead and administrative costs incurred by the DC government. It is HUD's estimate that the portion of the Federal funds paid to the DC government on behalf of Kenilworth-Parkside are in the range of $1.7 to $1.8 million, and it is this level of Federal funding which the Consultants' quite properly used in adhering to the constraint of "revenue neutrality" in conducting its analysis of the annual amount of post-sale Section 8 subsidy funds required.

The following are GAO's comments on Dennis Eisen's memorandum dated August 24, 1989.

GAO Comments

1. We relied on a draft privatization plan that Dr. Eisen prepared for Kenilworth-Parkside to identify planned uses for the funds. His plan said the loan was necessary to support "certain amenities." According to Dr. Eisen's plan, the major planned use for the funds was a year-round swimming pool with an estimated construction cost of $1 million. The licensed kitchen, at an estimated cost of $200,000, was the only proposed use related to the training facilities and equipment identified in Dr. Eisen's plan. We added the kitchen to our discussion of planned uses for the loan in our final report.

2. Our report does not conclude that Dr. Eisen's assumed rates of increase for tenant incomes and operating expenses are incorrect, nor do we recommend that both be assumed to increase at the general rate of inflation. The experts we consulted were less optimistic than Dr. Eisen about increases in tenant incomes. The District's Department of Public and Assisted Housing expressed a similar opinion in commenting on our draft report, as did a subsequently released study performed for KPRMC by the accounting firm of Laventhol and Horowath. We recognize that in projections of this nature there is room for differences of opinion among knowledgeable parties. We did not intend to imply that one estimate is more accurate than the other. Rather, our intent is to recognize the existence of a more conservative opinion and to show how it would affect Dr. Eisen's projections. While our draft report recognized that the KPRMC consultants believe the 6- percent increase is reasonable because of training and entrepreneurial opportunities, we have added clarification to this section in the final report.

3. Our intent is to show the actual subsidy that the District's Department of Public and Assisted Housing provided to the Kenilworth-Parkside Resident Management Corporation in fiscal years 1987 and 1988. The HUD estimate mentioned by Dr. Eisen attempts to measure the portion of total operating subsidies that HUD paid to DPAH attributable to Kenilworth-Parkside. By presenting the amount of subsidy that actually passed through to the RMC, we are not questioning the accuracy of HUD's estimate nor the consultants' use of that estimate in their analysis of post-sale section 8 subsidy requirements.

Comments From Coopers and Lybrand

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Coopers & Lybrand | certified public accountants | 1800 M Street NW Washington, D.C. 20036 | in principal areas of the world

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August 24, 1989

Mr. John M. Ols, Jr.
Director, Housing and
Community Development Issues
General Accounting Office
Room 4079
441 G Street, N.W.
Washington, D.C. 20548

Re: Public Housing: Planned Sale of Kenilworth-Parkside Project

Dear Mr. Ols:

This is in response to your letter dated August 16, 1989 addressed to Mr. Larry Doss.

Mr. Doss was on vacation at the time this was received but he asked me, by telephone, to forward this to Ms. Lisa Scheckel because she conducted our analytical review on this engagement. Attached is her response.

See comment 1.

Because of your tight deadline, Mr. Doss asked me to send Ms. Scheckel's response directly to you, without his reviewing it. He does not want you to do anything with this until he has had time to review it on his return from vacation on September 8.

If you have any questions, please call me on 822-4083.

Sincerely,

Gemma Leo

Gemma Leo

Encls.

COMMENTARY REGARDING GAO CRITIQUE OF KPRMC COST BENEFIT STUDY
(on an issue-by-issue basis)
August 25, 1989

o GAO Statement(s):

"The study . . . sought to assess the relative costs and benefits to the District of Kenilworth Parkside's first 4 years under resident management (1982 through 1985)." [See page 49 of GAO critique/excerpt, second paragraph].

"We found that the study was based on limited information about potential benefits and costs of resident management at the property." [See page 49 of GAO critique/excerpt, third paragraph].

Rebuttal:

See comment 2.

The first sentence is a mis-statement of the study objective. The second assertion implies that the study is incomplete. Both of these comments set the stage for GAO's assertion (inherent throughout the critique) that C&L's KPRMC analysis is incomplete and/or faulty.

See comment 3

All of the costs and benefits associated with KPRMC management could not be assessed (at the time the analysis was conducted, the District government did not see fit to provide C&L with the information required to conduct a comprehensive analysis). The lack of data for a complete assessment of the costs and benefits associated with KPRMC management is cited frequently throughout the C&L report. However, C&L felt that enough information was available to address the issue of cost-effectiveness. The true objective of the analysis (as stated in the Executive Summary, p. viii) was to "examine whether the benefits of resident management at Kenilworth Parkside exceed DHCD's [the District's Department of Housing and Community Development] cost to implement and support KPRMC."

C&L Rebuttal of GAO Critique RE: KPRMC Analysis (page 2)

o GAO Statement:

". . . the study compared rental revenues for the property under resident management with the average rental revenues for all District public housing properties. However, data were not available for a similar comparison of costs." [See page 50 of GAO critique/excerpt, top of page].

Rebuttal:

See comment 4.

These statements imply: 1) that C&L's approach for assessing rental revenue generation at the property was faulty and 2) that costs to maintain the site were not taken into consideration.

In fact, the following is true:

1) **Hard data obtained from District budgets and HUD proved conclusively Kenilworth Parkside's rent per-unit-per-month (PUM) was lower than District average PUM rents for the four years preceding resident management at the property. C&L concluded (conservatively) that, had private managers continued to operate the property, PUM rents at Kenilworth Parkside would have remained below or on par with District average PUM rents. Based on this assertion, the comparison of Kenilworth Parkside PUM rents with the District average PUM for the period in which the site was managed by KPRMC was a fair, if not overly conservative one.**

2) **Data regarding costs incurred by the District to operate the property under private vs. resident management were limited. However, the data available suggested that resident managers were at least as good if not better than private managers at controlling costs. Moreover, available data indicated that KPRMC managers were paid less in management fees. In order to compensate for the absence of hard data regarding costs, C&L utilized a significantly overblown estimate of the costs associated with implementing and maintaining resident management at the property, including estimated funds for site modernization which were not expended by the District (see discussion on page xx of Executive Summary).**

C&L Rebuttal of GAO Critique RE: KPRMC Analysis (page 3)

- GAO Statement:

  " . . . the study did not provide direct measures of these improvements [i.e. better care of the project and improved living conditions], possibly because of lack of data." [See page 50 of critique/excerpt, second paragraph].

See comment 5.

Rebuttal:

The "improvements" referred to included such items as reduced crime, a cleaner living environment, improved neighbor relations and social setting, in short: a generally higher standard of living. These items, with the exception of the reduced crime rate, are generally considered to be non-quantifiable (except under "esoteric" valuation assumptions). Crime statistics indicated a subtle improvement in the felony crime rate which was not considered statistically important. Petty crimes at the site all but disappeared under resident management but the improvement was considered non-quantifiable.

- GAO Statement(s):

  ". . . increased services were due to improvements in conditions at the property resulting from resident management. These savings make up the bulk of benefits attributed to resident management. However, the study does not contain sufficient information to rule out the possibility that such enterprises might have operated in the absence of resident management. In all fairness however, it would be quite difficult to rule out this possibility on the basis of the information provided in the study." [See page 50 of GAO critique/excerpt, end of second paragraph].

See comment 6.

Rebuttal:

This statement refers to job generation at the site. It correctly concludes that job generation was the single largest, quantifiable benefit of resident management.

C&L Rebuttal of GAO Critique RE: KPRMC Analysis (page 4)

The last statement in the GAO paraphrase is certainly true but is dwarfed by the comments which precede it. There were no jobs for residents at the property under private management and (with the exception of a few, single resident managers) on-site resident employment was non-existant District-wide at the time the study was conducted. There were jobs at the site under resident management for three primary reasons: 1) KPRMC created them, 2) KPRMC created day care facilities that were not available under resident management (nor were they available locally) which enabled mothers to work, and 3) KPRMC created a social environment in which retail entrepreneurial efforts could be profitable - a feat not accomplished under private management nor in other locations in the District. C&L felt strongly that it was safe to assume that jobs would not have been created at the property in the absence of resident management.

o GAO Statement:

"We also found that the principal analyst was unable to verify two statements that could have a bearing on the study's results. The study states that additional rental revenues "were used to fund additional staff positions and to subsidize KPRMC enterprises that provide service to Kenilworth Parkside residents." However, the principal analyst told us that this statement was an assumption. The study also states that unlike the private management firm that preceded it, [KPRMC] was responsible fro operating deficits exclusive of utility costs. However, the principal analyst told us that this was an assertion of a resident management corporation official. We found that, in fact, the District government normally pays for such deficits." [See entire last paragraph of GAO critique/excerpt].

Rebuttal:

C&L's response is two faceted, as follows:

1. **Although the two statements in question were not verifiable at the time the study was conducted, C&L did not feel that their veracity had a negative impact on the integrity of the study results. Moreover, in each instance, C&L's treatment of the issues resulted in a more conservative estimate of benefits than would otherwise have been obtained. To be specific:**

C&L Rebuttal of GAO Critique RE: KPRMC Analysis (page 5)

See comment 7.

a. In the first instance [use of additional rental income], C&L conservatively assumed that, in accordance with standard public housing practice, the additional rental income generated at the property under resident management was used by the District to improve the site. These additional revenues were therefore netted out of quantified benefits so they would not be double-counted. In view of the fact that the District could not verify that additional rental revenues were being used at the site, C&L's treatment of these funds results in a more conservative estimate of the benefits resulting from resident management.

See comment 8.

b. In the second instance [District payment of operating deficits], C&L concluded that an analysis of operating deficits under private vs. resident management at the property would prove that deficits had been lower in real terms under resident management. This assumption was based on available data, including: 1) higher PUM rents, 2) lower vacancy rates and, 3) [according to limited budgetary data] a history of high deficits under private managers and low or nonexistent deficits under resident management at the site and no real dollar increase in overall costs to run the property under resident management. The data available was unfortunately not of sufficient quality or duration to enable an analysis of operating deficits. The volume of benefits identified in the study are therefore slightly understated, because operating deficits and operating costs were inherently assumed to be equal under private and resident management. Recall also, that C&L utilized an exagerated proxy estimate of the costs incurred by the District to implement and maintain resident management at the property.

C&L Rebuttal of GAO Critique RE: KPRMC Analysis (page 6)

See comment 9.

2. **GAO's statement seems to imply that C&L does not do its homework. Every effort was made to verify the truth of the statements made in the study. In the absence of complete cooperation from the District government, alternative information sources were occasionally utilized. The statement regarding the District's use of rental income is accurate in light of existing housing policy. The statement regarding payment of operating deficits was obtained from the President of the KPRMC. Indeed, following issuance of the study, C&L was informed by DHCD (the District's Department of Housing and Community Development) that the District has always paid for operating deficits incurred at the site, even under resident management. Since this information had no bearing on the analytical results, C&L did not revise the study following its issuance. C&L would like to point out that the principal analyst on this project informed GAO of this descriptive error during GAO's initial review of our analysis earlier this year.**

* * * * *

See comment 10.

In conclusion, while GAO's critique does not contain any false statements, it does imply that the C&L study is at fault in a number of areas. C&L's position is that: 1) the shortcomings of the analysis are clearly spelled out in the study and that there are always data deficiencies in any analysis of the costs and benefits associated with public programs, 2) that C&L compensated for poor data quality through utilization of very conservative analytical assumptions, and 3) that for reasons cited in this rebuttal and in the study itself, the dollar volume of benefits that were identified in the C&L analysis are probably understated. Consequently, the study's conclusion (i.e that the benefits of resident management outweigh the cost to implement and maintain it at Kenilworth Parkside) is well-founded.

The following are GAO's comments on the letter from Coopers and Lybrand dated August 24, 1989. We were asked by the Senate Subcommittee on Housing and Urban Affairs to examine the assumptions made by Coopers and Lybrand in their cost-benefit analysis from a methodological standpoint. While Coopers and Lybrand made several observations regarding our critique, we did not find that any of them were compelling enough from a methodological viewpoint to change our conclusions.

GAO Comments

1. Ms. Leo subsequently told us that Mr. Doss had reviewed and approved Ms. Scheckel's response.

2. According to page 34 of the study, "The purpose of the Kenilworth-Parkside cost-benefit analysis is to quantify the costs and benefits associated with resident management at Kenilworth-Parkside in order to ascertain whether resident management at the project has been cost-effective." In discussing its scope, the study states that "only those benefits accruing to the District Government will be assessed."

3. The Coopers and Lybrand study states on page 37 that the information contained in available data sources, together with certain facts discussed elsewhere, were deemed sufficient to carry out a cost-benefit comparison between private and resident management at Kenilworth-Parkside. We have added additional clarification to the final report stating the principal analyst's position that the District Government did not provide enough information to conduct a comprehensive analysis.

4. We added wording to the final report to clarify that the principal analyst believes the comparison of rental revenues was a conservative one and that conservative cost estimates for implementing and maintaining resident management were used. While the use of such conservative assumptions is sometimes used as an approach to deal with uncertainty, it is difficult to know to what extent such an approach over or under compensates for lack of data in this analysis.

5. We revised the final report to more clearly acknowledge that these items are difficult to quantify.

6. We have added a statement to the final report stating that the principal analyst felt strongly that it was safe to assume that jobs would not have been created at the property in the absence of resident management. However, there was insufficient information in the report to

determine how safe this assumption is. It remains unclear from the study why only resident management could have led to the creation of all such jobs.

7. As stated in appendix III of our report, the assumption made in the study regarding additional rental revenue could have had a bearing on the study results. What remains unclear is to what extent some of the additional rental revenues resulted in some of the additional staff positions, and vice versa. With regard to "netting out" revenues, revenues were not counted as benefits in the study.

8. As stated in appendix III of our draft report, the statements referred to by Coopers and Lybrand "could have had a bearing on the study's results." A particular assumption, whether conservative or liberal, could nonetheless affect the analysis.

9. The Coopers and Lybrand study (p. iv) stated that the RMC was responsible for operating deficits exclusive of utility costs. The principal analyst told us that the statement was actually an assumption, but did not tell us that this was an error. Furthermore, this error affects the benefits and costs of resident management to the District. As stated in the principal analyst's comments, operating deficits and costs were assumed equal under resident and private management. If the District rather than KPRMC were paying KPRMC's deficit, costs to the District government would be higher.

10. We do not agree that all shortcomings of the study were clearly stated. As we pointed out, two assumptions of the study were presented as statements of fact. While data deficiencies are a problem in cost-benefit analyses, it is unclear to what extent the use of conservative assumptions compensates for inaccuracies due to poor data.

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