

**Testimony of Vincent F. O'Donnell,
Affordable Housing Consultant**

Hearing:

Oversight of the HUD Inspection Process

**United States Senate
Committee on Banking, Housing and Urban Affairs
Subcommittee on Housing, Transportation, and Community Development Hearing**

September 22, 2016

Good morning, Chairman Scott, Ranking Member Menendez, and distinguished members of the Committee. Thank you for the opportunity to testify regarding the process of HUD oversight of federally-assisted multifamily housing.

I am Vincent O'Donnell, and am currently a private affordable housing consultant who has worked for over forty years with state and local government, nonprofit developers, Local Initiatives Support Corporation, the nation's largest nonprofit community development intermediary, and resident organizations. My primary mission has been, and is, to promote the creation and preservation of safe, affordable multifamily housing. In many of these capacities, I have worked closely with HUD at the local and Headquarters leadership level on issues specifically related to assisted multifamily housing that has become distressed.

Today, I speak for myself, but want to note that I am a co-author of an August 1, 2016 letter from the National Preservation Working Group to HUD regarding the recent challenges that the U.S. Department of Housing and Urban Development (HUD) has been confronting regarding HUD-assisted properties experiencing conditions of distress and unsuitable living conditions for residents. The PWG is a broad coalition of organizations that have advocated for the preservation of federally-assisted affordable rental housing. Its members include local and national nonprofit developers, policy organizations, tenant advocates, and state and local government. The PWG is convened by the National Housing Trust, a national nonprofit engaged in housing preservation through public policy advocacy, nonprofit real estate development and lending. This letter is attached to my testimony. In this testimony, I will summarize the PWG letter, while also attempting to put the current situation into a larger context. In my opinion, the overall system of providing project-based rental assistance is sound, and HUD has powerful asset management and quality control tools, but better coordination is needed to ensure that no property reaches the severe level of distress that has prompted the need for this hearing.

I think it is important to note that the overwhelming majority of project based rental assistance properties are in good physical condition. The portfolio of properties that have brought us here

today are unfortunate and unacceptable outliers, but were distressed when transferred to the current ownership.

Best practices for stabilizing and preserving distressed properties have been developed over several decades and are effective and vitally important in today's high-cost housing market. In the late 1970s, HUD was on its way to becoming the largest landlord in Boston, as a result of large scale foreclosure of properties with HUD- subsidized mortgages. One of those properties was Methunion Manor, in Boston's South End. This property's tenant association pointed out to then-Senator Edward Brooke that HUD's policies of ensuring a market return to the FHA Insurance Fund would result in their displacement from a neighborhood that was beginning to gentrify, in part because they and the federal investment has helped to stabilize a previously distressed neighborhood. With the Senator's leadership, Congress gave HUD both a mandate and a set of tools to enable them to remain in this neighborhood, based on mutually reinforcing principles:

- long-range repairs,
- community engagement; and
- preservation of project-based rental assistance.

The result was the restoration to physical and financial health of Methunion Manor [as a housing cooperative], and thousands of other units in Boston. Since then, there have been other challenges to the retention of this affordable housing stock: prepayment of subsidized mortgages and resulting deregulation, and expiration of project-based Section 8 contracts, but those core principles have continued to be observed.

Resident and community engagement ensures that the property's physical and social needs are identified; adequate project-based rental assistance ensures the availability of financing for capital repairs and also retains a stock of units restricted as affordable housing

Over the years, a toolkit has been developed for HUD portfolio oversight based on the preservation principles I mentioned. This toolkit also provides flexibility to tailor solutions to local needs. Some of what we've learned includes:

- Most assisted properties are good physical condition. The National Housing Trust has reported that, according to HUD, 96 percent of its 23,198 multifamily properties have passing scores of 60 or higher on REAC inspections. The average passing score is 86.7 percent. Only 0.1 percent of properties score below 30, 3.5 percent score between 31 and 59 percent. In other words, although we must double-down on problem properties and their causes, this inventory is mostly successful.
- Early identification of problems and intervention are essential. HUD has now restored its Management and Occupancy Review process, which will enable HUD to look more deeply into issues affecting the property's operations than a REAC score alone can do. REAC itself can be a blunt instrument, not always revealing serious problems. Further, it would be of great value to be able to mine the REAC and MOR data to detect multiple problems associated with common ownership or management.
- HUD has recently redesigned its entire multifamily portfolio oversight function to align better with private sector asset management techniques and create more accountability,

but it needs more careful allocation of resources for its oversight to reach its full potential.

- Mature properties undergo ownership transfers as a result of normal market processes. HUD's purchaser review process is an opportunity to ensure not only a strong owner committed to affordability, but a sound ownership and management plan that also reflects the property's true physical needs. The preservation community stands ready to support HUD in improving its existing tools for this essential process.
- HUD has many intervention strategies, but their implementation works best if there are clear thresholds for classifying properties as distressed, after consultation with local stakeholders. The experience of the Commonwealth of Massachusetts, the City of Boston and the local HUD office provide good examples of the positive outcomes of this approach.
- If a property has become distressed, remediation is urgent, both for resident health and safety, and also for long-term preservation. For this, resources are needed, and termination of assistance contracts should be a remedy of last resort: it displaces current residents from their homes and their social support systems, removes the long-term affordability from the property, and usually leaves a troubled asset to blight the community. Intermediate steps can be taken and, in the worst case where the current location is unsuitable, subsidies can be transferred to a new neighborhood with better opportunities.
- When a new owner takes over a distressed property, a combination of forbearance of enforcement and strong accountability is needed. Several years ago, in a different property in Jacksonville, where Eureka Gardens is located, a coalition of local stakeholders working with HUD and LISC was able to effect such a balance and that provided a window of time to make both immediate urgent repairs and to restore this major property to being a healthy community asset.
- Some of HUD's intervention tools require cooperation from other governmental agencies. For example, Congress has given HUD authority to seek a federal receiver when it lacks mortgage enforcement rights, but this depends on the U.S. Attorney's willingness to participate. In addition to greater interagency cooperation, the powers and duties of such a federal receiver should be clarified. For example, it is not clear whether such a receiver can require the sale of a property if that is found to be the only path to correction of problems.

Now we also have to recognize that best practices don't always work, since no system is perfect, which is why we're here today. Those of us in the affordable housing preservation community continue to work with HUD, residents and owners to ensure that these valuable federal investments in our communities aren't lost. Now, more than ever, as our cities undergo recovery, assisted housing is now located in places that are on their way back to being neighborhoods of opportunity, and only place-based subsidies enable them to stay there.

Many federal investments in affordable housing were sited based on economic considerations, with developers basically going where land prices fit budgetary constraints of the programs. Many of those neighborhoods are now rising markets in which current subsidized housing residents have for decades helped stabilize these neighborhoods. These same residents now

could not afford to live there, with or without a voucher, but place-based rental assistance enables them to remain in their community. On Monday, at a convening about neighborhood change, displacement and equitable development organized by the Federal Reserve Bank of New York, LISC and the New York University Furman Center, the constant refrain from around the country was that preservation of the existing affordable housing stock is integral to mitigating the negative effects on current residents of otherwise desirable rising neighborhood property values.

In conclusion, the portfolio of HUD-assisted affordable multifamily is an increasingly valuable asset that needs strong oversight as well as preservation. HUD has a powerful set of tools, and should be supported and held accountable in its robust application of these measures. Preservation of place-based subsidies is often the only way that low-income residents can afford to remain in vibrant urban communities or in rural communities where there is no other decent rental stock and one of few tools to ensure a stock of well-maintained affordable units. This point of view is complementary to recent efforts at promoting utilization of portable S.8 vouchers in neighborhoods of opportunity. These efforts are not mutually exclusive.

PRESERVATION WORKING GROUP

August 1, 2016

Priya Jayachandran
Deputy Assistant Secretary, Office of Multifamily Housing
U.S. Department of Housing and Urban Development
451 Seventh Street SW
Room 6106
Washington, DC 20410

Dear Priya:

The undersigned members of the national Preservation Working Group (PWG) are writing in regard to the recent challenges that the U.S. Department of Housing and Urban Development (HUD) has been confronting regarding HUD-assisted properties experiencing conditions of distress and creating unsuitable living conditions for residents. This is an important topic and one that our organizations have raised over many years with HUD. We believe that these issues are best addressed by broader utilization and more consistent application and coordination of existing property monitoring and enforcement tools. In fact, we believe that more effective oversight and management of HUD's assets may require more focused attention from a smaller number of offices and individuals within HUD, rather than creating new tools and supervisory roles that overlay the existing system, which is often redundant, uncoordinated, and lacking in clear authority.

We propose a four-part strategy to immediately strengthen HUD's tools to enforce requirements to keep properties with federal project-based rental assistance safe and in good repair for residents. We have long advocated for strategies to maintain the quality and sustainability of the assisted multifamily housing stock, as well as a long-term commitment to its affordability. These comments and recommendations are based on our decades-long dialogue with HUD about preventive strategies, early detection of problems, and effective remediation. Notwithstanding the fact that truly distressed situations are the exception, our position is that every property in this valuable stock must be owned and managed to a high standard of excellence.

Intervention Strategies

HUD's recent document titled Industry Standard Repairs (July 5, 2016) is an important clarification, but we believe the Department can do much more with existing tools and authority and we welcome an opportunity to engage in dialogue with HUD leadership about our shared goals.

HUD should define a clear threshold for classifying properties as troubled, after consultation with stakeholders. Potential problems should be referred to an action team convened by the HUD Secretary to review conditions and recommend action. This could include representatives from field and Headquarters Asset Management, the Real Estate Assessment Center, the Department Enforcement Center, and the Office of General Counsel. The team should consult with state and local government, housing finance agencies, and other appropriate local stakeholders, including the tenants and their representatives. This team should be authorized to recommend remedial actions, commit resources, and take other actions to address conditions that are causing distress at HUD-assisted properties.

If the Secretary determines that an owner is in default on the assistance contract and/or the use agreement, HUD should impose an immediate prohibition on the owner taking distributions from the property where it has the authority to do so. HUD also should use its authority to seek civil money penalties, if appropriate, from defaulting owners.

Unfortunately, some properties have proven to have problems that HUD cannot resolve through negotiations with existing owners, and past efforts to put properties with chronic problems into receivership have not received the necessary timely attention. We urge the Secretary to work with the U.S. Attorney General to prioritize Justice Department resources to bring prompt legal action where necessary to protect taxpayer investments and living conditions for residents.

Where HUD believes that current ownership is unable or unlikely to correct deficiencies at the property within an appropriate timeframe, HUD should seek to place the property in receivership, as authorized by the contract and Section 225 of the Fiscal Year (FY) 2016 Appropriations Act or its successors. Designated receivers of troubled properties must have strong and clear tools to turn properties around, including:

- The ability to abate and/or renegotiate contracts, including management contracts;
- The ability to entertain offers to purchase the property by new owners, subject to HUD screening criteria;
- The ability to require a minimum level of capital repairs required to correct deficiencies and stabilize the property for sustainable operation; and
- The ability to fund required repairs by incurring debt secured by the property, or by requiring a sale to a qualified owner able to carry out necessary repairs.

In addition, HUD should work with local governments when appropriate to file for or otherwise support receivership in state courts.

In any action to change ownership, HUD should work with preservation stakeholders to establish a purchaser review process that is thorough (including underwriting of both the purchaser and the transaction), timely, and practical, including an expedited process for urgent situations. HUD should consider pre-qualifying potential purchasers as part of an expediting process.

Where properties also have FHA-insured mortgages, HUD has additional tools to improve performance or replace nonperforming ownership and management, all of which should be fully explored and utilized.

Remediation

The goal of these actions should be to arrest further deterioration, preserve affordable housing, and ensure decent living conditions for residents. Termination of assistance contracts should be a remedy of last resort, since it displaces current residents from their homes and their social support systems, removes the long-term affordability from the property, and usually leaves a troubled asset to blight the community.

Properties that have suffered chronic under-investment and poor management, sometimes for several years, require time for high-capacity, experienced owners to improve conditions. While resident health and safety must always receive immediate attention, HUD must provide appropriate forbearance to new owners of distressed properties so that they are not punished for the acts and omissions of the previous owners while seeking new resources for redevelopment. HUD should hold new owners accountable for clear timelines and milestones for short- and long-term improvements at the property, but should avoid the application of standards that discourage new owners from taking on troubled assets. HUD's past use

of Compliance, Disposition and Enforcement Plans (CEDP) is an existing tool that has achieved good results when applied consistently.

While termination is a last resort, both HUD's Notice H 2015-02 and the underlying statutes specify that contract abatement of assistance, in whole or in part, is a potential remedy that HUD should consider exercising under certain conditions. The threat of withholding of assistance until issues are resolved is potentially a powerful preventive strategy that HUD should employ more often when appropriate, although care needs to be taken before depriving properties of needed resources for repairs. All remediation strategies should carefully consider the impact of temporary or permanent relocations on tenants, in active consultation with local stakeholders, and with the need for rapid remediation.

Enhanced Screening

In recent years there has been increased interest by investors in purchasing HUD-assisted properties. We urge the Department to strengthen and standardize review of the transfer of Section 8 properties to potential new owners. HUD should uniformly apply screening criteria so that assignments of Section 8 contracts are reviewed in a similar manner as Transfers of Physical Assets (TPA), and that potential purchasers are reviewed to verify their experience with assisted properties; their track record; their commitment to fulfilling all use restrictions at the property; and their financial resources to address known physical needs of the property at the time of transfer. We recommend that HUD review the TPA process and solicit comments from stakeholders, including the undersigned, on appropriate changes for screening of HAP contract transfers.

Early Identification of Problems

Residents of HUD-assisted properties and local governments are natural partners in identifying properties with chronic problems with property conditions. Local governments have a direct interest through enforcement of code violations, and can coordinate actions with HUD, including early warning regarding problems. HUD should review and consider recommendations from stakeholders, including but not limited to the National Alliance of HUD Tenants, as a potential resource for identifying properties with emerging problems. For example, HUD should provide residents with opportunities to engage in both REAC inspections and Management and Occupancy Reviews (MORs). HUD's revisions of Chapter 4350.1 of the Section 8 Renewal Guide should reflect these opportunities as well.

In addition, REAC standards in some cases are outdated and in need of revision. Specifically, REAC inspectors should be tasked with identifying conditions including lead paint, toxic mold, and bed bugs. REAC inspections should be designed to trigger testing for environmental concerns when necessary.

The Office of Asset Management and Portfolio Oversight (OAMPO) should have the lead role in early identification and intervention with properties in distress or showing early signs of possible problems. OAMPO cannot succeed in this effort unless it is provided with adequate resources and authority to fill vacant positions, provide adequate training and travel funding, and take appropriate management and enforcement actions. Other oversight and enforcement entities at HUD should coordinate with OAMPO to inform and support this function.

We are eager to assist HUD in strengthening efforts to identify and address problems early. We share HUD's goals of ensuring the long-term affordability and quality of assisted housing.

Sincerely,

California Housing Partnership
Coalition on Homelessness and Housing in Ohio
Florida Housing Coalition
Housing Partnership Network
LeadingAge
Local Initiatives Support Corporation
Minnesota Housing
National Alliance of HUD Tenants
National Housing Law Project
National Housing Trust
Preservation of Affordable Housing
Rental Housing Information Network in Ohio
Stewards of Affordable Housing for the Future
The Community Builders

cc: Edward L. Golding. Asst. Secretary for Housing and FHA Commissioner